

The Business of Sentencing: Facing the Facts After *Blakely*, *Booker*, and *Fanfan*

Tara L. Reinhart, Nathan J. Muyskens and Christopher E. Tierney

Looking back, 2004 was a year of significant and intriguing antitrust decisions. The Supreme Court showed a renewed interest in antitrust in both *Trinko*¹ and *Empagran*.² The Department of Justice's *Oracle*³ case and the Federal Trade Commission's *Arch Coal*⁴ case also brought new issues to the forefront at the trial court level. The most profound and unexpected changes, however, occurred in the context of criminal antitrust sentencing. First, on June 22, 2004, the President signed the Antitrust Criminal Penalty Enhancement and Reform Act of 2004,⁵ which raised Sherman Act penalties for corporations from \$10 million to \$100 million maximum fines, and penalties for individuals from \$350,000 to \$1 million fines and from three years to ten years imprisonment. Ordinarily, such legislation would be the year's highlight, but just two days later, the Supreme Court turned all federal sentencing on its head in *Blakely v. Washington*,⁶ a case involving Washington State's sentencing guidelines that left open the question whether the opinion, while applicable only to state law, would be extended to federal sentencing. On January 12, 2005, the Supreme Court answered with a resounding "yes."⁷ What remains to be seen is how criminal antitrust sentencing will be affected as a result.

Blakely, *Booker*, and *Fanfan*

In *Blakely*, the Court found Washington's sentencing guidelines unconstitutional to the extent they allow a judge to sentence a defendant beyond the Guidelines' base offense level or range without specified factual findings made by a jury beyond a reasonable doubt or admitted by the defendant in a plea agreement.⁸ The *Blakely* opinion extended the Court's holding in *Apprendi v. New Jersey*⁹ (another state sentencing case), and held that only those facts found by a jury or admitted by a defendant may give the court a basis to increase the defendant's sentence.

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¹ Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 298 (2004).

² F. Hoffman-LaRoche, Ltd. v. Empagran S.A., 124 S. Ct. 2359 (2004).

³ United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

⁴ FTC v. Arch Coal, Inc., No. 04-5291, No. 04-7120, 2004 WL 2066879 (D.C. Cir. Sept. 15, 2004).

⁵ Pub. L. No. 108-237, 118 Stat. 661 (2004). The legislative history accompanying the statute strongly encouraged the U.S. Sentencing Commission to raise the applicable U.S. Sentencing Guidelines (USSG) to bring antitrust offenses in line with other white collar offenses and ensure that antitrust offenders face real jail time.

⁶ 124 S. Ct. 2531 (2004).

⁷ See United States v. Booker, Nos. 04-104, 04-105, 2005 WL 50108 (U.S. Jan. 12, 2005).

⁸ The defendant in *Blakely* pleaded guilty to second degree kidnapping. The statutory maximum sentence was 10 years in prison. The state's sentencing guidelines allowed the court to depart upward from the standard range and impose a sentence up to the statutory maximum if it found substantial and compelling reasons warranting the departure. *Blakely*'s standard sentencing range was 49 to 53 months, but the court found that *Blakely* acted with deliberate cruelty and departed upward, sentencing him to 90 months in prison. The Supreme Court found the sentence improper to the extent the upward departure was based upon facts not admitted by the defendant in his plea agreement.

⁹ 530 U.S. 466 (2000).

Even though *Blakely* applied only to the State of Washington's sentencing guidelines, federal trial courts and the U.S. Department of Justice recognized the case's potential impact on the U.S. Sentencing Guidelines (USSG) because the USSG allow judges to increase sentences much like the Washington guidelines. Within days, federal judges were finding the USSG to be unconstitutional. The U.S. Department of Justice reacted almost overnight with instructions to prosecutors to secure "*Blakely* waivers" as part of every guilty plea,¹⁰ to request sentencing juries when possible, and to require lengthy plea agreements stating all facts needed for sentencing.¹¹ Dockets backed up as judges struggled to impose sentences consistent with the anticipated extension of the *Blakely* principles to the USSG.

Within weeks the Supreme Court granted expedited treatment to two cases, *United States v. Booker* and *United States v. Fanfan*, on the issue of whether *Blakely* applies to the USSG.¹² The Court has now handed down a pair of opinions in the consolidated *Booker/Fanfan* case that dramatically changes the sentencing landscape. In the first opinion, authored by Justice Stevens, and joined in by Justices Scalia, Souter, Thomas, and Ginsburg, the Court reaffirmed its holding in *Apprendi* and extended *Blakely* to the USSG. Specifically, the Court held that any fact, other than a defendant's prior conviction, used to increase one's sentence must be admitted by the defendant or found beyond a reasonable doubt by a jury. In the second opinion, authored by Justice Breyer, and joined in by Justices O'Connor, Kennedy, Ginsburg, and Chief Justice Rehnquist, the Court held that the USSG, while still functional despite certain provisions violating the Sixth Amendment right to a jury trial, can now be used only on an advisory rather than on a mandatory basis.

The effects of *Booker/Fanfan* will be felt immediately in criminal trials. In the antitrust context, the effect is clear, however, because defendants tend to negotiate plea agreements and are sentenced in uncontested hearings. In the past decade, the Antitrust Division has successfully negotiated huge fines from corporations without having to involve a jury. The question remaining for antitrust practitioners is: Will *Booker/Fanfan* disrupt the Antitrust Division's string of successes? Or will it be business as usual?

Sentencing Under the USSG Is Complex

To understand the significance of extending *Blakely* to federal antitrust sentencing, it is important to understand how federal sentencing has worked prior to *Booker/Fanfan*. All federal sentencing has been done pursuant to the USSG.¹³ The USSG calculates sentences by assigning a number to each offense then adding or subtracting from that number based on findings relating to the offender and offense conduct present in the case, including aggravating and mitigating factors,

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¹⁰ A "*Blakely* waiver" requires a defendant to agree not to challenge a sentence based on an argument that the sentence resulted from facts not included in his plea agreement. Available at <http://ussguide.com/members/BulletinBoard/Blakely/BlakelyWaiver.html>.

¹¹ See James Comey, Departmental Legal Positions and Policies in Light of *Blakely v. Washington* 4 (July 2, 2004), available at <http://www.ussguide.com/members/BulletinBoard/Blakely/DOJMemo.pdf>; see also Christopher A. Wray, Guidance Regarding the Application of *Blakely v. Washington* to Pending Cases, 2004 WL 1402697 (June 24, 2004).

¹² See *United States v. Booker*, 375 F.3d 508 (7th Cir. 2004), cert. granted, 125 S. Ct. 11 (2004), aff'd, Nos. 04-104, 04-105, 2005 WL 50108 (U.S. Jan. 12, 2005); *United States v. Fanfan*, 2004 WL 1723114 (D. Me. June 28, 2004), cert. granted before judgment, 125 S. Ct. 12 (2004), vacated sub nom. *United States v. Booker*, Nos. 04-104, 04-105, 2005 WL 50108 (U.S. Jan. 12, 2005).

¹³ In 1984, Congress passed the Sentencing Reform Act, ending most judicial discretion in sentencing. See 18 U.S.C. § 355 et seq. This was an attempt to create uniformity.

such as the defendant's criminal history and role in the offense. After a jury verdict or guilty plea, the sentencing court is required to review a series of these factors, including evidence that may or may not have been presented to the jury at trial or admitted by the defendant in the plea. The court compiles the numbers assigned to the factors and then calculates the defendant's offense level. After all of these calculations, the resulting offense level corresponds to a fine range or, for individuals, a range of months of jail time and/or a fine range set forth in a grid in the USSG. The sentencing court then selects a point within this range to set the final sentence. This calculus is complicated in most cases, but it is especially so in antitrust cases.

Antitrust Sentencing Involves the Added Complexity of the Volume of Commerce Affected

Typically, corporate antitrust defendants plead guilty. And, typically, plea negotiations result in "C" plea agreements under Fed. R. Crim. P. (c)(1)(C), which allows a defendant to withdraw a plea if the sentencing court refuses to enter a sentence consistent with the agreement's terms. The alternative is a "B" plea under Fed. R. Crim. P. 11 (c)(1)(B), in which the Antitrust Division recommends a sentence, but a defendant has no recourse if a court refuses to enter it. The use of "C" pleas is of paramount importance to the Antitrust Division's success in obtaining guilty pleas, and in furthering its policy objectives. Without the security of a "C" plea, defendants would be less likely to negotiate. Because of the importance of plea agreements to the Antitrust Division's mission, antitrust cases tend to result in plea agreements and rarely reach the point at which the issues raised in *Blakely* come into play.

Under the USSG, antitrust sentences are calculated like sentences for other crimes. But, unlike most other crimes, the most important sentencing factor is the volume of commerce affected by the crime. Significantly for *Booker/Fanfan* analysis, the volume of commerce is not a factor that is proved to a jury or admitted in a plea agreement. Instead, it is determined before the judge at the time of sentencing. Once the volume of affected commerce is defined, a judge uses one of two methods to determine the punishment faced by the defendant: either the USSG method or an alternative statutory method, the "twice-the-gain or twice-the-loss" provision of 18 U.S.C. Section 3571(d).¹⁴ After the base fine is determined, the judge makes a complex set of calculations involving factors such as the number of employees working at the company, the involvement of high-level employees in the crime, and lack of an effective compliance program, to arrive at the offense level and fine.

Under the USSG method, punishment is based on the affected volume of commerce attributable to the defendant being sentenced.¹⁵ Rather than require an actual determination of the effects attributable to the defendant, the USSG uses a proxy of 20 percent of the volume of commerce as a base fine. Comments to the USSG explain:

It is estimated that the average gain from price fixing is 10 percent of the selling price. The loss from price fixing exceeds the gain, because, among other things, injury is inflicted upon consumers who are unable or for other reasons do not buy the product at the higher prices. Because the loss from price fixing

¹⁴ 18 U.S.C. § 3571(d) states:

If any person derives pecuniary gain from the offense, or if the offense results in pecuniary loss to a person other than the defendant, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless imposition of a fine under this subsection would unduly complicate or prolong the sentencing process.

¹⁵ See U.S.S.G. § 2R1.1(b)(2).

exceeds the gain, subsection (d)(l) provides that 20 percent of the volume of affected commerce is to be used in lieu of the pecuniary loss under Section 8C2.4(a)(3). The purpose for specifying a percent of the volume of commerce is to avoid the time and expense that would be required for the Court to determine the actual gain or loss.¹⁶

Using the 20 percent proxy, the USSG method of calculating a fine is fairly simple. In a number of cases before the 2004 amendments to the Sherman Act, however, the calculation resulted in a USSG fine range that as a whole exceeded the Sherman Act maximum.¹⁷ When a USSG fine range exceeds the Sherman Act statutory maximum, the Antitrust Division must turn to the alternative statutory sentencing mechanism, the “twice-the-gain or twice-the-loss” provision, and calculate a maximum that justifies the fine amount in the plea agreement. The “twice-the-gain or twice-the-loss” provision requires calculating a different measure of volume of commerce than the one used to calculate the USSG fine range. Under Section 3571(d), the volume of commerce equals the total volume affected by the conspiracy, not the volume attributable solely to the defendant.¹⁸ The gain to defendants or loss to consumers is, in theory, calculated from the latter number, then doubled. In practice, for a corporate defendant the Antitrust Division offers little more than a stipulation, which the Probation Office adopts, that the volume of commerce totals “X” amount of dollars, together with a calculated assumption that consumers were harmed in an amount of at least 5 percent of that commerce. For example, in the graphite electrodes case, the Antitrust Division wrote in its sentencing memorandum supporting SGL Carbon AG’s \$135 million fine:

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The parties have not calculated the amount of the overcharge to the customers. However, the total volume of affected commerce for the charged conspiracy period from all conspirators is close to \$1.7 billion. Even a nominal overcharge to customers of as little as 5% would, when doubled, provide for a maximum fine under the alternative sentencing provision of approaching \$170 million.¹⁹

Courts typically accept the plea agreements. For practical purposes, their hands are tied, constrained by the reality of “C” pleas that can be nullified if the judge disagrees with the agreed-upon fine and the daunting task of delving into the volume of commerce numbers offered by the Antitrust Division. In some instances, agreed-upon fines are so steep that sending the parties home to renegotiate a fine within the USSG range could bankrupt a company. Indeed, more than once during the 1990s, courts accepted pleas below USSG ranges after finding that a defendant did not have the “ability to pay” anything higher. Moreover, requiring the Antitrust Division to do more than assume a percentage rate of harm and double it under Section 3571(d) would involve significant government resources and time and might not be possible.

Joel Klein, the former Assistant Attorney General, acknowledged during a Senate hearing in 1998 that calculating a fine under the alternative statutory mechanism of Section 3571(d) might be too burdensome to be practical.²⁰ Arguing for an increase in the statutory maximum, Klein stat-

¹⁶ U.S.S.G. § 2R1.1, comment (n.3).

¹⁷ Some of the calculated ranges, if calculated today, would exceed the recently enacted higher maximums.

¹⁸ See 18 U.S.C. § 3571(d).

¹⁹ United States v. SGL Carbon, Crim. No. 99-244, Government’s Sentencing Memorandum (E.D. Pa. filed June 11, 1999).

²⁰ See *Hearings Before the Senate Committee on the Judiciary, Subcommittee on Antitrust, Business Rights and Competition Concerning Antitrust Division Oversight*, reprinted at 1998 WL 8994049 (Feb. 26, 1998) (Testimony of Joel Klein, Assistant U.S. Attorney General), available at <http://www.usdoj.gov/atr/public/testimony/1581.htm>.

ed that, in an increasing number of cases involving high volumes of commerce, the USSG mechanism intended to deter the conduct was “thwarted” by the then-\$10 million cap:

In such cases [involving high volume commerce], the only alternative . . . is for the offending corporation to be sentenced under the “twice-the-gain or twice-the-loss” alternative sentencing provision. . . . Unfortunately, proving actual gain to the conspirators or loss to the victims from an antitrust offense is extremely difficult. On six occasions, we have had to settle for the \$10 million statutory maximum when the Sentencing Commission rationale may have justified a greater fine.²¹

To determine an actual “twice-the-gain or twice-the-loss” would require an analysis of copious amounts of data that the Antitrust Division routinely avoids collecting from defendants, the engagement of economists to separate the effects of market events from the effects of the illegal conduct, and a battle with defendants’ own expert economists who might see the analysis differently. By its terms, the alternative statutory mechanism may not be used if its application would unduly prolong or complicate the sentencing process.²²

Still, in at least one case a judge refused to accept an agreed-upon fine that fell far below the low end of the USSG range but above the then-\$10 million statutory maximum. That case arose out of the Antitrust Division’s investigation into graphite electrodes. Showa Denko Carbon Inc., one of the lead co-conspirators, agreed to plead guilty and pay a \$29 million fine. The court rejected this “C” plea agreement, finding that the agreed-upon USSG Section 5K1 downward departure for cooperation was too generous. The parties renegotiated the agreement to include a fine range of \$29 million to \$32.5 million and sought sentencing again. Assistant Attorney General Joel Klein participated in the sentencing colloquy to emphasize the importance of the plea agreement process to the Antitrust Division:

International cartel cases are probably as important as anything we do in the Antitrust Division and as complex. They are important because these are cases in which U.S. companies and U.S. consumers are being significantly harmed by international agreements and conspiracies involving compan[ies] that often more than not . . . don’t inhabit in the United States. . . The problem we face in these cases, your Honor, is that ninety percent of the putative defendants are not accessible to jurisdiction in the United States and so, we have to play a very different enforcement game. . . [I]f the defendant doesn’t have a certain level of confidence in the United States’ ability to actually secure the fine proposed, we’re afraid, your Honor, that they will not come forward and cooperate and subject themselves to jurisdiction in the United States. I think we have had, probably, nine to ten cases right now of significant fines, C-type fines in international cases and those fines were accepted by the court.²³

The court accepted the revised plea agreement and imposed a \$32.5 million fine on Showa Denko.²⁴

The Showa Denko experience is not the norm. Most judges employ a bare-bones colloquy confirming the maximum statutory sentence and do not require prosecutors to offer a factual basis for the volume of commerce or agreed-upon fine, beyond a detailed description of the defendant’s cooperation that warrants a downward departure from the USSG range.

²¹ *Id.*

²² 18 U.S.C. § 3571(d).

²³ *United States v. Showa Denko Carbon Inc.*, Crim. No. 98-CR-85-1, Transcript of Arraignment and Sentencing Hearing 74–75 (E.D. Pa. Sept. 8, 1998).

²⁴ *Id.* at 86.

The same can be said for individual pleas. Commentary to the USSG explains that “[t]he Commission believes that the most effective method to deter individuals from committing this crime is through the imposition of shorter sentences coupled with large fines.”²⁵ As a policy matter and to deter illegal conduct, the Antitrust Division excludes the most culpable executives from corporate plea agreements, leaving them vulnerable to prosecution.²⁶ Typically, these executives negotiate pleas of their own. Under the USSG, individuals face a fine in the amount of 1–5 percent of the affected volume of commerce. Also, as a policy matter, and absent extraordinary circumstances, the Antitrust Division requires individuals to agree to serve jail time.²⁷ Circumstances justifying a rare no-jail deal include, for example, unique cooperation potential from a non-U.S. citizen who otherwise refuses to travel to the United States and, therefore, remains beyond the reach of the Antitrust Division.

The USSG sets six to twelve months as a base incarceration range.²⁸ Jail time is increased by various factors, such as playing a leadership role in the offense, using a special skill, abusing a position of trust, or engaging in bid rigging. The volume of commerce attributable to the individual’s employer is factored in to determine a final offense level.

Why Not Try the Case?

A variety of circumstances and factors provide corporations with incentives to plead guilty rather than try a criminal antitrust case before a jury. Attorney’s fees can soar into the millions. Quite often, the Antitrust Division has a cooperating witness in the form of an amnesty candidate who provides damaging testimony and documents. The investigation frequently unearths explicit, detailed documentation of price fixing, often penned in an executive’s own hand. Protracted litigation disrupts business operations, inflicting significant hard and soft costs. Plaintiffs no longer wait for the resolution of the criminal investigations to file their treble damages complaints. Companies now often litigate and/or settle civil treble damages claims before a grand jury acts.

Moreover, the Antitrust Division offers explicit incentives for defendants to plead guilty.²⁹ Ironically, the few who have risked it all for a jury verdict have received comparatively moderate sentences, specifically because no one knows how to establish an appropriate fine under Section 3571(d).

For instance, while not involving corporate defendants, the *Lysine* case demonstrates how some of this sentencing calculus has worked at trial. In 1998, Archer Daniels Midland (ADM) executives Mick Andreas and Terry Wilson rolled the dice with a jury and were found guilty. They faced potential sentences of the then-statutory maximum three years in jail and fines of \$350,000, unless the government could establish “twice-the-gain or twice-the-loss.” The Antitrust Division recom-

²⁵ USSG § 2R1.1, comment. (n.7).

²⁶ See, e.g., U.S. Dep’t of Justice Press Release, Former Bayer AG Executive Agrees to Plead Guilty to International Rubber Chemicals Price Fixing Conspiracy (Nov. 23, 2004), available at http://www.usdoj.gov/atr/public/press_releases/2004/206481.htm.

²⁷ See generally Makan Delrahim, Deputy Assistant Att’y Gen., Antitrust Div., The Basics of a Successful Anti-Cartel Enforcement Program (Apr. 20, 2004), available at <http://www.usdoj.gov/atr/public/speeches/203626.htm>; see also Scott D. Hammond, Dir. of Criminal Enforcement, Antitrust Div., A Summary Overview of the Antitrust Division’s Criminal Enforcement Program (Jan. 23, 2003), available at http://www.usdoj.gov/atr/public/speeches/200686.htm#N_1_.

²⁸ U.S.S.G. § 2R1.1.

²⁹ For instance, it may agree to forgo prosecution of price fixing of other products or ancillary charges, such as obstruction of justice and fraud, to cover most or all executives under the agreement, and to assist implicated non-U.S. citizens in retaining their rights to travel freely to and from the United States.

mended a sentence of \$25 million for Andreas, and an unspecified fine over \$350,000 for the less-culpable Wilson. The trial judge initially rebuffed Andreas's challenge to the applicability of Section 3571(d), noting that the provision "is a procedural catch-all intended to increase fines where the current form of the relevant statute provides inadequate punitive fines compared to the magnitude of the crime."³⁰

The Antitrust Division offered an expert who calculated "twice-the-loss" to consumers by showing the price of lysine was higher than it would have been "but for" the conspiracy. After Andreas sought and failed to obtain discovery from foreign lysine producers to rebut the government's expert opinion, the court granted his renewed motion to prevent the application of Section 3571(d). Andreas was ultimately fined the statutory maximum \$350,000.

In the corporate setting, in 2000, Mitsubishi put the government to its burden of proof on charges of aiding and abetting the graphite electrode producers' price-fixing conspiracy, and was convicted. It faced a huge fine in an investigation that already had resulted in one of the Antitrust Division's record-breaking fines (\$110 million plea from UCAR International) and a \$135 million plea from SGL Carbon AG. (Although higher than UCAR's fine, the plea was no longer a record breaker at the time it was entered.) After conviction, Mitsubishi and the Antitrust Division negotiated and jointly recommended the court enter a fine of \$134 million. The court sentenced Mitsubishi accordingly.³¹

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So What's All the Fuss?

In many federal cases, courts find and apply facts that increase a defendant's sentence up to the applicable statutory maximum set by Congress.³² Post-*Blakely* and its progeny, to insure maximum sentences prosecutors must allege such facts in their indictments and plea agreements and must be prepared to prove them beyond a reasonable doubt to guarantee the possibility of enhanced sentences. The problem is not limited to cases that go to trial. For example, the *Blakely* case involved a "B" plea and a judge who believed the crime warranted more punishment than the agreed-upon jail sentence. Until *Booker/Fanfan*, courts had the obligation to apply sentencing factors to increase a sentence within a USSG range and, in rare cases, depart upward from that range to the statutory maximum. *Booker/Fanfan* nullify that obligation. Prosecutors now must consider in the first instance whether to allege sufficient facts and put on sufficient evidence to support the upward enhancements and departures to guarantee these factors are considered during sentencing.

With the new \$100 million corporate statutory maximum and \$1 million-10 years individual statutory maximum, in most criminal matters the Antitrust Division has greater leverage to negotiate fines more commensurate with the economic scope of the crime. Still, because they are based on the volume of commerce affected, fines sought by the Antitrust Division, especially in the context of hard-core, global cartel investigations, may exceed the Sherman Act statutory

³⁰ See *United States v. Andreas*, No. 96-CR-762, slip op. at 5 (N.D. Ill. Feb. 19, 1999).

³¹ See U.S. Dep't of Justice Press Release, *Mitsubishi Corporation Fined \$134 Million for Its Role in International Price-Fixing Cartel*, available at http://www.usdoj.gov/atr/public/press_releases/2001/8186.htm.

³² However, according to the U.S. Sentencing Commission, in testimony about *Blakely* before the U.S. Senate Judiciary Committee, "a majority of the cases sentenced under the federal guidelines do not receive sentencing enhancements that could potentially implicate *Blakely*." See *Blakely v. Washington and the Future of the Federal Sentencing Guidelines*, Senate Comm. on the Judiciary, 109th Cong. (July 13, 2004) (Joint Testimony of Commissioner John R. Steer and Judge William K. Sessions, III), available at http://judiciary.senate.gov/testimony.cfm?id=1260&wit_id=3665.

maximum. Before *Booker/Fanfan*, the sort of upward departure at issue in *Blakely* was unlikely because, in the complex but businesslike world of antitrust pleas, USSG calculations were rendered meaningless by agreed-upon fines. A deal was struck, and the Section 3571(d) alternative statutory maximum was sized to accommodate it. Defendants may be able to argue that *Booker/Fanfan* will burden prosecutors with pleading and proving the alternative statutory maximum beyond a reasonable doubt. This potential additional burden on prosecutors, however, may not be enough to encourage defendants to quit pleading and roll the dice.

Nothing about *Booker/Fanfan* alters the Antitrust Division's incentives to seek fines commensurate with the crime, as defined by the volume of commerce used to set the USSG fine. With the high stakes for corporate defendants, combined with the Division's commitment to prosecuting hard-core cartels, the Antitrust Division will continue to succeed in convincing companies to admit the types of facts that warrant large fines.

Nevertheless, the Antitrust Division's track record in providing "twice-the-loss" under Section 3571(d) may tempt some defendants to risk trial. The government may now be required to plead and prove beyond a reasonable doubt all of the sentencing factors, including "twice-the-gain or twice-the-loss," that it wants considered. Creating reasonable doubt regarding the econometrics and other damages calculations that prosecutors must rely on may prove easier for a defendant than challenging actual culpability. Defendants could try to take advantage of the prosecutors' burden. They may argue that it is now appropriate to offer defense evidence of lack of a conspiracy's effect on prices, a back-door means of arguing for acquittal. If the government's experts rely on evidence of defendants' conduct to establish an effect on prices for purposes of sentencing, judges must allow defendants to rebut that evidence.

The danger for defendants is that the government's expert could convince a jury that defendants' conduct caused a huge rate of loss to consumers. After all, the same economic experts retained by the government routinely perform these analyses in treble damages actions and help secure huge civil settlements. They can be very persuasive.

A Legislative Fix Could Cause Far More Change than *Blakely*

In Justice Breyer's opinion in *Booker/Fanfan*, the Court recommends the use of an advisory system under which judges utilize all of the facts that they believe to be relevant and reach a final sentence by using the actual USSG as a guide. The USSG would not be binding, but would help lower court judges reach consistent sentences for like behavior. The sentence would then be reviewable under a "reasonableness" standard instead of the current "de novo" standard. However, it is almost certain that this advisory system will be short lived.

In all likelihood, however, Congress will act quickly to preserve as much of the sentencing scheme intended by the USSG as possible. In fact, Justice Breyer invited Congress to act when he wrote: "The bill now lies in Congress' court. The National Legislature is equipped to devise and install, long-term, the sentencing system, compatible with the Constitution, that Congress judges best for the federal system of justice."³³ The Department of Justice, through a statement of Assistant Attorney General Christopher A. Wray, communicated its intention to work on "this critical issue" with Congress.³⁴

³³ United States v. Booker, Nos. 04-104, 04-105, 2005 WL 50108 (U.S. Jan. 12, 2005).

³⁴ Christopher A. Wray, Assistant Att'y Gen., Crim. Div., Prepared Remarks in Response to *Booker/Fanfan*, (Jan. 12, 2005), available at <http://www.usdoj.gov/criminal/pressRelease/WraySentencingGuidelinesfinalformatted.pdf>.

The Final Analysis

The ultimate effect of *Booker/Fanfan* on antitrust sentencing will not be felt until Congress reacts with legislation. In the meantime, the Antitrust Division's dogged determination to detect and prosecute hard-core price fixing continues to drive its willingness to accept guilty pleas. The uncertain outcome of an attempt to establish "twice-the-gain or twice-the-loss" before a jury beyond a reasonable doubt will ensure the Antitrust Division continues to agree to fines that advance its policy but are palatable to, and payable by, defendants. The "C" pleas will continue to flow. Defendants that plead guilty do so to minimize the disruption of business operations, attorneys fees, and the size of civil settlements. It is a business decision, and business between the Antitrust Division and offenders likely will continue as usual, until Congress accepts the Court's invitation to rewrite the USSG. ●

Indexing Comes to the HSR Act

Malcolm R. Pfunder¹

When Congress amended the Hart-Scott-Rodino Act in 2000,² it raised the minimum threshold for premerger notification filings to \$50 million. The intention was to make up for more than twenty years of inflation, which had eroded the initial \$15 million statutory threshold and over time effectively made the HSR Act applicable to smaller and smaller transactions. The 2000 amendments provide ongoing inflationary correction of this kind through annual indexing of several provisions that define the applicability of the Act to specific acquisitions of assets or voting securities. These indexing provisions will affect premerger notification obligations for the first time beginning sometime in February 2005. The statutory changes will require additional changes in the rules implementing the Act.³ It turns out that a relatively simple idea has relatively far-reaching results.

The Statutory Indexing Requirements

The 2000 amendments require indexing of four provisions in the HSR Act: the \$50 million size-of-transaction test,⁴ the \$200 million size-of-transaction test,⁵ and the \$10 million and \$100 million size-of-person tests.⁶ The indexing provision requires adjustment and publication “for each fiscal year beginning after September 30, 2004, in the same manner as provided in section 8(a)(5) to reflect the percentage change in the gross national product for each fiscal year compared to the gross national product for the year ending September 30, 2003.”⁷

The reference to “section 8(a)(5)” is to the Clayton Act provision for indexing the thresholds used to determine whether interlocking officers or directors are unlawful. That provision says:

¹ The author wishes to thank Michael Verne of the FTC’s Premerger Notification Office for an ongoing dialogue on many of these issues and for sharing the intentions of the FTC staff concerning the indexing proposals.

² The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) is Section 7A of the Clayton Act, 15 U.S.C. § 18a. The 2000 amendments in Pub. L. No. 106-553, 114 Stat. 2762, were effective February 1, 2001.

³ The rules implementing the HSR Act are codified at 16 C.F.R. Parts 801–803 and the Notification and Report Form, which is an Appendix to Part 803.

⁴ 15 U.S.C. § 18a(a)(2)(B)(i) requires premerger notification filings for transactions that result in the acquiring person’s holding assets or voting securities of the acquired person valued in excess of \$50 million (but not exceeding \$200 million), providing the statutory size-of-person tests are met.

⁵ 15 U.S.C. § 18a(a)(2)(A) requires premerger notification filings for transactions valued in excess of \$200 million, regardless of whether the statutory size-of-person tests are met.

⁶ 15 U.S.C. § 18a(a)(2)(B)(ii) requires premerger notification filings for transactions valued between \$50 million and \$200 million, providing the annual net sales or total assets of either the acquiring or the acquired person are at least \$100 million and the annual net sales or total assets of the other person are at least \$10 million. (The \$10 million test for an acquired person not engaged in manufacturing ignores that person’s annual net sales.)

The 2000 amendments also change the HSR Act filing fee thresholds, but not the amounts of the fees payable under those thresholds. The filing fee regime is found at 15 U.S.C. § 18a note.

⁷ 15 U.S.C. § 18a(a)(2)(A).

For each fiscal year commencing after September 30, 1990, the \$10,000,000 and \$1,000,000 thresholds in this subsection shall be increased (or decreased) as of October 1 each year by an amount equal to the percentage increase (or decrease) in the gross national product, as determined by the Department of Commerce or its successor, for the year then ended over the level so established for the year ending September 30, 1989. As soon as practicable, but not later than January 31 of each year, the Federal Trade Commission shall publish the adjusted amounts required by this paragraph.⁸

Traditionally, this information becomes available after the September 30 close of the federal fiscal year and is ready for implementation early in the ensuing calendar year.⁹ The first indexing applicable under the HSR Act will likely be announced in January 2005 and become effective thirty days after publication in the Federal Register.¹⁰

The relevant multiplier adopted by the Commission for the first round of indexing is an increase of 6.13 percent, rounded up to the nearest \$100,000. The result will look like this: Acquisitions of assets or voting securities valued in excess of \$212.3 million will be reportable without regard to size-of-person tests. Acquisitions valued between \$53.1 million and \$212.3 million will be reportable if either the acquiring or the acquired person has annual net sales or total assets of at least \$106.2 million and the other has annual net sales or total assets of at least \$10.7 million.

But it's not nearly that easy.

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Impact of Indexing on HSR Act Waiting Periods

The Commission will need to provide guidance for filing parties with transactions pending at the time the indexing becomes effective. The natural effect of the indexing will be to increase the statutory filing thresholds and thus to make nonreportable certain transactions that were reportable under the Act and rules applicable before the indexing.¹¹ There are three possible scenarios: (1) filings have been made, the waiting period has expired, but the transaction has not been closed; (2) filings have been made for a transaction, and the waiting period has not expired; (3) filings have been made, a second request has been issued, and the waiting period therefore has not expired. What happens in these three situations if, as a result of indexing, the previously reported transaction is rendered nonreportable?

The first case is straightforward. The parties have fully complied with the HSR Act, no further obligations arise as a result of the indexing, and the indexing has no impact on the transaction or the parties.

In the second case, as long as the waiting period has not expired, the parties' obligations under the HSR Act have not been fully satisfied. Thus, if indexing were to render a previously reported transaction nonreportable before the waiting period expires, the HSR Act does not apply to the transaction, and the parties would have the right to withdraw their filings and close the transac-

⁸ 15 U.S.C. § 19(a)(5). Note that the resulting adjustment is not really for inflation, as it is based on annual comparisons of gross national product, not consumer or other price-related index.

⁹ For example, on January 16, 2004, the FTC issued a press release containing the following statement:

The Commission has approved the publication of a Federal Register notice announcing changes in the two threshold figures that define when it is unlawful for an individual to serve as an officer or director of two or more competing corporations. Under the new thresholds, effective immediately, Section 8 of the Clayton Act is applicable to such arrangements (with certain exceptions) if each of two companies has capital, surplus, and undivided profits in excess of \$20,090,000, and the competitive sales of each corporation exceed \$2,009,000.

¹⁰ The FTC staff has recommended that the indexing be made effective for transactions closing on or after 30 days following publication of the changes in the *Federal Register*.

¹¹ Note that in the relatively unlikely event of a GNP decline, the jurisdictional reach of the HSR Act would *increase*, at least temporarily.

tion immediately. This would be true even in the third case, where the waiting period had not expired because it had been extended by issuance of a second request, and even where the parties had responded to a second request but the ensuing thirty-day extension of the waiting period had not run out.¹²

Impact of Indexing on HSR Act Filing Fees

The amounts of the filing fees applicable to reportable transactions as a result of the 2000 amendments will not be affected by indexing, but the thresholds that determine those fees will be indexed.

Currently, acquiring persons are required to pay filing fees of \$45,000 for reportable transactions valued above \$50 million up to \$100 million, \$125,000 for transactions valued from \$100 million up to \$500 million, and \$280,000 for transactions valued at \$500 million or more.

The effect of indexing will be that acquiring persons will pay filing fees of \$45,000 for transactions valued above \$53.1 million up to \$106.2 million, \$125,000 for transactions valued from \$106.2 million up to \$530.7 million, and \$280,000 for transactions valued at \$530.7 million or more.

Indexing will raise another set of issues relating to filing fees. As the discussion above indicates, indexing may render certain transactions nonreportable after notifications have already been filed. The Commission is likely to rely on existing Rule 803.9(e), which says that filing fees once paid are refunded only if it is determined that the transaction was not reportable *at the time the notification was originally filed*. If a transaction that is reportable at the time notification is filed subsequently becomes nonreportable (because, for example, newly issued financial statements reveal that the parties no longer satisfy the size-of-person test or the value of publicly traded stock being acquired declines), the parties may withdraw their filings, but the acquiring person cannot recover its filing fee.

Impact of Indexing on the HSR Rules

The statutory indexing requirement will necessitate or induce changes in a number of the HSR rules.

1. Notification Thresholds. Rule 801.1(h) defines five notification thresholds, which correspond roughly to the statutory reporting thresholds. Presently, where size-of-person tests are satisfied or are inapplicable, filings are required for transactions as a result of which the acquiring person will hold stock or assets of the acquired person (1) valued in excess of \$50 million, or (2) valued at \$100 million or more, or (3) valued at \$500 million or more, or (4) constituting at least 25 percent of the issuer's outstanding shares, and valued at more than \$1 billion, or (5) constituting 50 percent of the issuer's outstanding shares, valued at more than \$50 million. Notifications are required for each acquisition as a result of which the acquiring person's holdings meet or exceed the next higher (or indeed any higher) notification threshold.

The Commission will amend these notification thresholds to reflect the effect of the statutorily required indexing. Thus, the five notification thresholds will require filings for transactions (1) val-

¹² This is also true under present HSR rules. If the jurisdictional criteria in the HSR Act will not be met at the time a transaction is to be consummated, the Act does not apply, and the parties have no obligation to comply with either the filing or the waiting period requirements, even if they have already filed notification. The original notification is not automatically void, since the parties may choose to leave the notification on file, for example to provide insurance against the possibility that they will again satisfy the jurisdictional filing criteria prior to closing.

ued in excess of \$53.1 million, or (2) valued at \$106.2 million or more, or (3) valued at \$530.7 million or more, or (4) constituting at least 25 percent of the issuer's outstanding shares, and valued at more than \$1,061.3 million. The final threshold (5) would be 50 percent of the issuer's outstanding shares, valued at more than \$53.1 million.

2. Formations of Joint Venture Corporations and Unincorporated Entities. Rule 801.40 imposes special filing requirements where certain corporations are formed by two or more forming shareholders. Rule 801.40(c) creates a special three-way size-of-person test applicable to acquisitions by forming shareholders of the voting securities that are issued by the new corporation and valued at less than \$200 million. That three-way test looks to the annual net sales and total assets of any two of the forming shareholders and to the anticipated total assets of the new corporation.¹³ Either the new corporation or at least one of the forming shareholders must meet a \$100 million-size test, and the other two must meet a \$10 million test. Because these tests are analogous to the HSR Act's jurisdictional size-of-person tests that will be indexed, the \$100 million and \$10 million numbers in the three-way size-of-person test¹⁴ will be indexed.

Similarly, proposed rule 801.50,¹⁵ which will make formations of certain partnerships, limited liability companies, and other unincorporated entities reportable, has a special two-way size-of-person test, which is applicable where the value of a controlling interest in the new entity is less than \$200 million. Each forming person's acquisition of a controlling interest in the new entity will be subjected to a \$100 million/\$10 million test that is applied to the sales and assets of the acquiring person and to the total assets of the newly formed entity. The proposed special size-of-person test will be amended so that these dollar figures will also be indexed.

3. Rule 802.4 Exemption. Rule 802.4 exempts acquisitions of voting securities of issuers whose assets would be exempt if acquired directly. The exemption is available as long as the issuer does not hold more than \$50 million worth of "other non-exempt assets." At present the exemption is generally limited to issuers whose assets consist of exempt real estate. Proposed rules would expand the exemption to acquisitions of both voting securities of corporations and controlling interests in unincorporated entities, where the underlying assets of those entities could be directly acquired under any exemption available under the HSR Act or rules. Indexing will affect this exemption by increasing the current \$50 million limit on non-exempt assets to \$53.1 million.

4. Foreign Commerce Exemptions. Current rules exempt the acquisition of assets located outside the United States to which no more than \$50 million of sales in or into the United States are attributable,¹⁶ and certain acquisitions of voting securities of a foreign issuer that does not have assets located in the United States valued at more than \$50 million and did not make sales in or

¹³ Rule 801.40(d) is used to determine the assets of the new corporation. It requires inclusion of any assets that any of the forming shareholders have agreed to contribute at any time, and the amount of any credit or loans that any of the forming shareholders have agreed to extend to the new corporation or to or guarantee at any time.

¹⁴ The \$200 million number, above which size-of-person tests do not apply, will also be indexed. See discussion above.

¹⁵ In April 2004, the Commission issued for public comment a series of proposed amendments to the HSR rules. The proposed rules were published in the *Federal Register* at 69 Fed. Reg. 18,685 (Apr. 8, 2004). Among other things, these proposed rules would extend HSR Act reporting requirements to formations of certain unincorporated entities and to acquisitions of interests that confer control of certain unincorporated entities. The public comment period closed in June 2004, and it is expected that final rules will be promulgated sometime in early 2005 and become effective thereafter.

¹⁶ Rule 802.50(a).

into the United States of more than \$50 million in its most recent year.¹⁷ The \$50 million limitations in each of these rules will be indexed and the exemptions thereby expanded.¹⁸

5. Five-Year Exemption for Acquisitions Not Crossing a Higher Threshold. For five years following the acquiring person's notification of an acquisition of voting securities,¹⁹ Rule 802.21 exempts acquisitions of additional voting securities of the same issuer, so long as the acquiring person's resulting holdings do not cross a higher notification threshold. Thus, for example, a person that acquires and files for an acquisition of the stock of an issuer valued at \$60 million can thereafter acquire additional shares of the same issuer, so long as the shares held as a result of the subsequent acquisition(s) are valued at less than \$100 million (the next higher threshold). New filings are required if the resulting holding would exceed \$100 million in value, and the acquisition of any additional stock of the issuer more than five years after expiration of the original waiting period would also require notification.

Indexing of Rule 802.21(a) raises several issues. Suppose, for example, that a person files to acquire \$51 million worth of the stock of an issuer, and the waiting period expires. Thereafter, the minimum reporting threshold is raised to \$53.1 million as a result of indexing. Would the acquiring person be required to file again if it acquired a small amount of additional stock of the issuer, but the aggregate value of its holdings exceeded the "new" \$53.1 million threshold? The answer is no. The \$50 million threshold in this example is the same threshold, even though indexing has increased its value.

Indexing over multiple years may affect application of this exemption. Assume that a 6 percent annual increase in GNP is reflected in annual HSR Act indexing. Under the Rule 802.21(a) exemption, a person who files for an acquisition of more than \$50 million worth of an issuer's stock in Year 1 (prior to any indexing) could allow acquisition resulting in a holding valued up to (but not reaching) \$100 million later in Year 1, \$106 million in Year 2, \$112 million in Year 3, \$119 million in Year 4, \$126 million in Year 5, and \$134 million up to the fifth anniversary (sometime during Year 6) of the expiration of the original waiting period. Thereafter the exemption no longer applies, and any subsequent acquisitions of the stock of that issuer would require notification if the value of the stock held by the acquiror exceeded \$67 million.

6. Examples to the Rules. The FTC staff expects to review and, as needed, to revise all of the examples to any of the HSR Rules that would be affected by indexing, and specifically to revise any examples that may be rendered incorrect or misleading as a result of indexing.

¹⁷ Rule 802.51.

¹⁸ There are additional, very seldom used foreign commerce exemptions in Rules 802.50 and 802.51. Under the former, an acquisition of foreign assets generating more than \$50 million of sales in or into the United States is nevertheless exempt if the size of transaction is less than \$200 million, both acquiring and acquired persons are foreign, the aggregate sales of the acquiring and acquired persons into the United States in the most recent year were less than \$110 million, and the aggregate total assets of both persons located in the United States are less than \$110 million. Rule 802.51 has a similar exemption, with essentially identical conditions, for an acquisition of voting securities of an issuer that had more than \$50 million of U.S. sales or assets. The \$200 million and \$110 million limitations in these exemptions would also be indexed (to \$212.3 million and \$116.8 million respectively).

¹⁹ The five years runs from the expiration or termination of the waiting period that resulted from the earlier filing.

HSR Rules Not Affected by Indexing²⁰

There are a number of other places in the HSR rules where dollar amounts are mentioned, but the Commission's intention is not to amend those rules to apply annual indexing.

1. Mineral Reserves Exemptions. Rule 802.3(a) exempts acquisitions of reserves of oil, natural gas, shale or tar sands, and certain associated exploration or production assets, so long as the total value of the assets being acquired does not exceed \$500 million. Rule 802.3(b) provides a similar exemption for acquisitions of reserves of coal and certain associated exploration or production assets valued at no more than \$200 million. The \$500 million and \$200 million limits on these exemptions are not viewed as analogous to the HSR Act's jurisdictional filing requirements and therefore will not be indexed.

2. Acquisitions of Unproductive Land. Rule 802.2(c) exempts the acquisition of certain real property, including raw land, that has not generated total revenues of more than \$5 million during the 36 months preceding the acquisition. The \$5 million revenue limitation will not be indexed.

3. Expiration of Notification. Rule 803.7 causes a notification to expire one year after the end of the waiting period resulting from that notification, if the acquiring person during that time has not completed the acquisition that was the subject of the notification. Completion of the transaction in this context means that the acquiring person's holdings of the stock or assets of the acquired person must "meet or exceed the notification threshold with respect to which the notification was filed." If during that one-year period, indexing changes the dollar value that defines that notification threshold, the threshold itself remains unchanged for purposes of applying Rule 803.7. Thus, for example, a person who files to acquire \$50 million worth of an issuer's stock must acquire only \$50 million worth of that issuer's stock during the year following expiration of the waiting period, even if during that time indexing has raised the threshold to a higher value (e.g., \$53.1 million).²¹

4. Notification Form. Other than to implement the changes discussed above and to include references, where appropriate, to adjusted notification thresholds, it is not envisioned that any items in the Form or related Instructions will be changed as a result of indexing. For example, Item 6 allows entities with total assets of less than \$10 million to be omitted from listings of controlled entities, shareholders, and minority holdings. Item 5(c) allows nonmanufacturing revenues of less than \$1 million to be omitted. These provisions will not be indexed. Item 8 requires an acquiring person to identify previous acquisitions of entities that generated revenues in any overlapping NAICS codes identified in response to Item 7(a). That rule contains various \$1 million revenue limitations that will not be affected by indexing.

Conclusion

Indexing is a sensible way to offset the unintended enlargement of the HSR Act's reach resulting from inflation. It introduces an additional complication, particularly for practitioners or companies that do not make frequent acquisitions and filings. The question, "What are the filing requirements this year?" is likely to be asked frequently. And the answer requires a relatively detailed recitation

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²⁰ In addition, subsection (g)(1) of the HSR Act originally provided for civil penalties of up to \$10,000 per day for violations of the Act. This provision is already subject to indexing under the Debt Collections Improvement Act of 1996, which currently provides for civil penalties of up to \$11,000 per day.

²¹ However, a filing made with respect to an index-adjusted threshold will expire after one year if the acquiring person has not met or exceeded the adjusted threshold that was in effect at the time notification was filed.

of the jurisdictional criteria relating to size-of-person and size-of-transaction tests, as well as the notification thresholds and the filing fee thresholds. Application of indexing to some, but not all, of the dollar value criteria in the HSR rules further complicates the picture, but not impenetrably.

Indexing could introduce some interesting strategy considerations in the odd case where the reportability of a transaction might be affected by an anticipated future change in the index. For example, parties planning in December for a transaction that will close the following February might find themselves guessing whether yet-to-be-announced indexing will put their transaction below the revised filing thresholds. But this problem arises elsewhere under the HSR rules, apart from indexing.

In the end, indexing will likely become second nature, once we all get used to it. ●

Effects of HSR Indexing for 2005

STATUTORY OR RULES PROVISION	CITATION	INDEXED?	NEW RATE
■ \$50 M size-of-transaction test	7A(a)(2)(B)(i)	Yes	\$ 53.1 million
■ \$200 M size-of-transaction test	7A(a)(2)(A)	Yes	212.3 million
■ \$100 M size-of-person (SOP) test	7A(a)(2)(B)(ii)	Yes	106.2 million
■ \$10 M size-of-person (SOP) test	7A(a)(2)(B)(ii)	Yes	10.7 million
■ Filing fee thresholds currently \$50 million, \$100 million, \$500 million	15 U.S.C. 18a note	Yes	53.1 million 106.2 million 530.7 million
■ Filing fee dollar amounts currently \$45,000, \$125,000, \$280,000	15 U.S.C. 18a note	No	unchanged
■ Notification thresholds currently \$50 million, \$100 million, \$500 million 25% of stock worth \$1 billion, and 50% of stock	Rule 801.1(h)	Yes	53.1 million 106.2 million 530.7 million 1061.3 million
■ SOP tests for formation of joint venture corporation currently \$100 million/\$10 million sales or assets but not applicable if SOT exceeds \$200 million	Rule 801.40	Yes	106.2 million 10.7 million 212.3 million
■ SOP tests for formation of unincorporated entities currently \$100 million/\$10 million sales or assets but not applicable if SOT exceeds \$200 million	Proposed Rule 801.50	Yes	106.2 million 10.7 million 212.3 million
■ Acquisition of stock of entities holding exempt assets current limit is \$50 million	Rule 802.4	Yes	53.1 million
■ Foreign commerce exemptions (sales in or into U.S.)	Rules 802.50, 802.51	Yes	53.1 million
■ Exemption for subsequent stock acquisitions after filing Next higher threshold, currently \$100 million, \$500 million, 25% of stock worth over \$1 billion, and 50%	Rule 802.21	Yes	106.2 million 530.7 million 1061.3 million
■ Mineral reserves exemptions currently \$500 million oil and gas, \$200 million coal	Rule 802.3	No	unchanged
■ Exemption for acquisition of unproductive land limited to \$5 million revenue in previous 36 months	Rule 802.2(c)	No	unchanged
■ Expiration of notification	Rule 803.7	No	*
■ Notification Form (references to dollar amounts)	Various items	No	unchanged

*Acquiring person must within one year meet or exceed threshold in effect at the time of its filing.

A Simple Guide to the EC Merger Regulation of 2004

John J. Parisi

The Treaty of Rome of 1957, creating the European Economic Community and its institutions—the Council of Ministers, the European Parliament, the Court of Justice, and the European Commission (EC)—included articles condemning anticompetitive agreements among competitors and abuses of a dominant position. Merger control was not specifically mentioned in those articles. The need for merger control at the Community level was recognized in the early 1970s—coincidentally, at about the time that Germany amended its antitrust law to give the *Bundeskartellamt* merger control authority and shortly before the U.S. Congress enacted the Hart-Scott-Rodino Act requiring premerger notification—as the EC’s attempts to apply both Articles 81 and 82 to mergers illuminated its shortcomings.

The EC did not obtain merger control authority, however, until 1989, when—stamped with the “EC-92” label—its enactment was viewed as one of many measures necessary to facilitate the development of a single, integrated—or “common”—European market. EU merger control was intended to provide a “level playing field” in a “one-stop shop” for the examination of mergers with significant cross-border effects. Reflecting the reluctance of the Member States to cede such authority to the Commission and skepticism of the Commission’s ability to act in a timely manner, the Council of Ministers, in enacting the Merger Regulation, placed jurisdictional and procedural restrictions on the Commission’s authority. The former limits the scope of the EC’s merger control authority vis-à-vis the Member States and the latter subjects the Commission to certain, non-waivable decision deadlines. Amendments to the Merger Regulation, adopted in 2003, and effective since May 1, 2004, make evolutionary changes that preserve these distinctive elements of EU merger control. The Commission, coincidentally, also adopted consequential administrative and organizational changes. This article reflects the state of the Merger Regulation and implementing and interpretive instruments as of November 2004.

The EC Merger Regulation reflects legal structures and policy decisions that differ in important respects from those with which most American practitioners are familiar under U.S. law. Some of those differences—especially the division of jurisdiction between the Commission and the Member States and the procedural deadlines—have practical consequences that can be magnified when a merger is also subject to review by U.S. and other authorities. Differences in procedure under the EC Merger Regulation and the U.S. process under the Hart-Scott-Rodino Act (HSR) are noted at relevant points throughout this *Guide*.

This *Simple Guide* is intended to provide U.S. practitioners with an outline of the key facts and features of the EC Merger Regulation, as well as references to useful source material. The *Guide* summarizes the essential jurisdictional, procedural, and substantive elements of the EC Merger Regulation, highlighting changes made by the 2003 amendments as well as differences with U.S. law and practice. It is the author’s hope that the *Guide* will foster understanding of the EC Merger Regulation that will be useful to U.S. practitioners, especially when representing parties engaged in merger transactions subject to review by U.S. and European authorities. Throughout this *Guide*, elements that are new or revised in 2004 are indicated by this graphic device: ■.

■
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views of the FTC or any
Commissioner thereof.

The EC Merger Regulation and Related Legal Instruments

This section includes references and sources to the EC Merger Regulation of 2004, effective May 1, 2004, and the various regulations, notices, and guidelines under which it is implemented.

The EC Merger Regulation

■ Council Regulation (EC) No. 139/2004 of 20 January 2004 on the Control of Concentrations Between Undertakings, 2004 O.J. (L 24) 1 (Merger Regulation or ECMR), *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_024/l_02420040129en00010022.pdf.

The Implementing Regulation

■ Commission Regulation (EC) No. 802/2004 of 7 April 2004 Implementing Council Regulation No. 139/2004 on the Control of Concentrations Between Undertakings, 2004 O.J. (L 133) 1 (includes notifications, time limits, and hearings procedures), *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_133/l_13320040430en00010039.pdf.

Also available at this site (appended to the Implementing Regulation) are:

■ revised Form CO, Short (simplified) Form CO, and ■ Form RS.

Commission Interpretive Notices

Commission Notice on the Concept of Concentration, 1998 O.J. (C 66) 5.

Commission Notice on the Concept of Undertakings Concerned, 1998 O.J. (C 66) 14.

Commission Notice on Calculation of Turnover, 1998 O.J. (C 66) 25.

Commission Notice on the Concept of Full-Function Joint Ventures, 1998 O.J. (C 66) 1.

Available at <http://europa.eu.int/comm/competition/mergers/legislation/mergin98.html>.

■ Commission Notice on Restrictions Directly Related and Necessary to Concentrations (also described as ancillary restraints), *available at* http://europa.eu.int/comm/competition/mergers/legislation/consultation/restrictions_tru.pdf.

■ Commission Notice on Case Referrals in Respect of Concentrations (explains the case referral system under Arts. 4, 9, and 22 of the ECMR), *available at* http://europa.eu.int/comm/competition/mergers/legislation/consultation/case_allocation_tru.pdf.

Commission Procedural Notices

■ Access to the File—Commission Notice on the Internal Rules of Procedure for Processing Requests for Access to the File, 1997 O.J. (C 23) 3,¹ *available at* http://europa.eu.int/comm/competition/antitrust/accdosen_en.html.

■ Simplified Procedure—Commission Notice on a Simplified Treatment for Certain Concentrations, 2004, *available at* http://europa.eu.int/comm/competition/mergers/legislation/consultation/simplified_tru.pdf.

Commission Substantive Notices

Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law, 1997 O.J. (C 372) 5, *available at* http://europa.eu.int/comm/competition/antitrust/relevma_en.html.

¹ On October 21, 2004, the EC invited comments on a proposed revision of its Notice on Access to the File, *available at* http://europa.eu.int/comm/competition/general_info/access_to_documents.html. Comments were due by December 2, 2004.

- Guidelines on the Assessment of Horizontal Mergers, 2004 O.J. (C 31) 5, *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_031/c_03120040205en00050018.pdf.
- Commission Notice on Remedies Acceptable, 2001 O.J. (C 68) 3, *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c_068/c_06820010302en00030011.pdf.

Jurisdiction—What Transactions Are Covered and Who Examines Them?

This section provides an overview of the jurisdictional tests for transactions covered by the ECMR and discusses the agencies that are responsible for reviewing particular transactions.

Jurisdictional Triggers—the Scope of the Commission's Authority

A “concentration” of a “Community dimension” falls within the EC’s exclusive jurisdiction; EU Member States may not apply their merger regimes to such transactions, ECMR Art. 21.3, except where the Commission refers such a transaction to Member State authorities under ECMR Art. 9.²

WHAT IS A “CONCENTRATION” WITH A “COMMUNITY DIMENSION”?

- a. A “concentration” is deemed to arise where a change of control on a lasting basis results from:
 - (i) the merger of two or more previously independent undertakings, or
 - (ii) the acquisition of one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings.³

The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity, also shall constitute a concentration. (ECMR Art. 3)

- b. “Community dimension” is delineated in ECMR Art. 1 by worldwide and EU-wide turnover of the undertakings concerned. Concentrations are of Community dimension either where the merging parties’ (the “undertakings concerned”):
 - combined world-wide turnover is > €5 billion; each of (at least two of) the merging parties’ realized > €250 million turnover in the EU; unless each of the merging parties obtains more than 2/3 of its EU turnover in one and the same Member State,⁴ or
 - combined world-wide turnover is > €2.5 billion; in each of at least three Member States, the combined turnover of the merging parties is > €100 million; in each of those three Member States, the turnover of each of at least two of the merging parties is > €25 million; the Community-wide turnover of each of at least two of the merging parties is > €100 million; unless each of the merging parties obtains more than 2/3 of its EC turnover in one and the same Member State.⁵

² The thresholds delineating the EC’s jurisdiction and triggering the notification obligation are the same; by contrast, in the United States, the Clayton Act § 7, covers mergers that are not reportable under the Hart-Scott-Rodino Act (HSR), *available at* <http://www.ftc.gov/bc/hsr/hsr.htm>. The EC has exclusive jurisdiction over concentrations above the thresholds; by contrast, U.S. states have concurrent jurisdiction with the federal agencies.

³ The definition of “control” in ECMR Art 3.2 is not 50 percent, as under the U.S. HSR rules, but rather “the possibility of exercising decisive influence.”

⁴ The EU jurisdictional thresholds are based solely on the size and location of an undertaking’s turnover; unlike under HSR, there is no consideration of size or location of assets.

⁵ Relatively few cases have fallen within this second set of thresholds. *See, e.g.*, Case COMP/M.2867, UPM-Kymmene / Morgan Adhesives ¶ 8 (Oct. 16, 2002), *available at* http://europa.eu.int/comm/competition/mergers/cases/decisions/m2867_en.pdf.

WHEN MEMBER STATES MAY REVIEW CONCENTRATIONS OF A COMMUNITY DIMENSION

ECMR Art. 9 authorizes the Commission, at the request of a Member State, to refer a merger of a Community dimension to that Member State where the concentration either:

- threatens to affect significantly competition in a market within that Member State, which presents all the characteristics of a distinct market; or
- affects competition in a market within that Member State, which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.

Art. 9 is a subsidiarity “safety valve,” but a “partial” referral fragments review of the proposed concentration and potentially can result in conflicting decisions.⁶

What If the Transaction Is Not a “Concentration”?

Art. 81 of the EC Treaty may apply, but that does not preclude Member State merger review. See, for example, *Covisint*, a “B2B” venture of automakers that the EC reviewed under Art. 81 and Germany’s *Bundeskartellamt* reviewed as a merger under its competition law.⁷

What If the Transaction Is a Concentration, But Not of a Community Dimension?

- EU Member State merger control regimes may apply. Of the 25 EU Member States, only Luxembourg does not have a merger control regime; all of the ten new (since May 1, 2004) Member States have merger control regimes.
- The Member State(s) may refer to the Commission a concentration that is not of a Community dimension but that affects trade between Member States and threatens to significantly affect competition within the Member State(s) making the referral under ECMR Art. 22.⁸
- Where a concentration not of a Community dimension “is capable of being reviewed under the national competition laws of at least three Member States,” ECMR Art. 4.5 provides merging parties a process whereby the Commission may request referral of the merger. If no Member State objects to the request, the merger shall be deemed to be of a Community dimension and shall be notified to the Commission.

⁶ See, e.g., Case COMP/M.2621, SEB/Moulinex (Jan. 8, 2002). In response to the French Government’s request, the EC referred this matter, insofar as it affected markets in France, to the French competition authorities. The EC investigated the effects elsewhere in the EC and reached a settlement with the parties requiring remedies in nine Member States, but decided against the need for remedies in five other Member States. Third parties challenged, inter alia, the EC’s referral decision. The Court of First Instance upheld the EC’s referral but, in so doing, noted the potential for conflicting decisions in such “partial” referral cases. See Case T-119/02, *Philips v. Comm’n*, ¶¶ 311–358 (Apr. 3, 2003), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0119.

⁷ European Comm’n Press Release, Commission Clears the Creation of the Covisint Automotive Internet Marketplace (July 31, 2001), available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1155&format=HTML&aged=0&language=EN&guiLanguage=en>; Bundeskartellamt Press Release, *Bundeskartellamt* Allows Covisint Internet Platform to Go Ahead (Sept. 26, 2004), available at http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2000/2000_09_26.shtml. The *Bundeskartellamt* decision in the case is also available in German only, at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion00/B5_40_00.pdf.

⁸ See, e.g., Case COMP/M.2698, Promatech/Sulzer Textil (July 24, 2002), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m2698_en.pdf.

The Procedure of a European Commission Investigation

This section provides an overview of the timetable and procedure for merger investigations, highlighting ■ **Best Practices on the Conduct of EC Merger Control Proceedings**⁹ and the ■ **Implementing Regulation**;¹⁰ and an overview of the EC's investigative tools and penalties for noncompliance; and some key differences between EC and U.S. practice.

Timetable for Merger Review

Practice Note: All references to “days” in the Procedure mean “working days,” as defined in Art. 24 of the Implementing Regulation.

PRE-NOTIFICATION CONSULTATIONS

Informal, confidential consultations between the parties to a proposed concentration and DG COMP are recommended by the EC, and have been endorsed by the Court of First Instance.

Among the issues dealt with in such consultations are:

- Whether the Commission has jurisdiction over the proposed concentration;
- Whether the matter could be referred to Member State(s) under ECMR Art. 9 or from Member State(s) under ECMR Art. 22;
- What information the parties must submit in and with premerger Form CO;¹¹
- Identifying key issues and possible competition concerns;
- Raising possible efficiency claims;
- Potential interagency cooperation with foreign competition authorities;
- Ascertaining deadlines.

These consultations can take some time, but are useful, inter alia, to avoid a “bounced” notification and to properly focus the investigation once the deal is notified. Refer to **Best Practices**, § 3, concerning the purposes and timing of pre-notification consultations, as well as information to be provided in that process, and the possibility of contacting third parties prior to notification.

Phase I

The first stage of the procedure commences with Notification—for example, submission of Form CO¹²—and “starts the clock” on the 25-day period for the EC to issue its Phase I decision.

Practice Notes:

- Under ECMR Art. 4.2, parties merging or acquiring joint control file Form CO jointly; otherwise, only the acquiring party is required to file Form CO.

⁹ Available at http://europa.eu.int/comm/competition/mergers/legislation/regulation/best_practices.pdf.

¹⁰ Commission Regulation (EC) No. 802/2004 of 7 April 2004 Implementing Council Regulation No. 139/2004 on the Control of Concentrations Between Undertakings, 2004 O.J. (L 133) 1, available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_133/l_13320040430en00010039.pdf.

¹¹ There is no provision for a “second request” in the ECMR; thus, Form CO is far more demanding than the U.S. HSR premerger notification form. The EC considered the U.S. two-step approach, but rejected it. According to the EC's *20th Report on Competition Policy* 36 (1990):
a single notification form comprising from the outset all the information requested was preferred to a ‘two-stage approach’. The aim is to enable the Commission, from the first stage of the procedure, to assess whether a merger involves serious doubts as to its compatibility with the common market and thus to ensure that decisions to initiate proceedings are not taken merely in order to allow a more detailed examination, due to a lack of information. This would have run counter to the rapid procedures provided for in [the ECMR].

¹² Form CO is appended to the Implementing Regulation, *supra* note 10. There is no filing fee for filing Form CO.

- The Commission publishes the fact that notification has been received in the *Official Journal*,¹³ and distributes copies of Form CO to all of the Member State competition authorities.¹⁴
- Under ECMR Art. 4.1, notification may be based upon a letter of intent to merge or acquire (as allowed under U.S. rules) “where the undertakings concerned demonstrate to the Commission a good faith intention to conclude an agreement or, in the case of a public bid, where they have publicly announced an intention to make such a bid, . . .” The previous 7-day deadline for notification was repealed.
 - Within **three working days** after notification, the EC must transmit the copies of Form CO provided by the parties to the Member States’ competition authorities, ECMR, Art. 19(1), and it must publish the fact of notification in the Official Journal, per ECMR Art. 4.3.
 - Within **15 working days** after notification, the EC will offer a “**State of Play**” meeting where it appears that the concentration raises “serious doubts.” See **Best Practices § 5.1**, regarding aim and format of State of Play meetings.
 - Within **15 working days** after receipt of the notification from the EC, Member States must inform the EC if they wish to request **referral** of the case under ECMR Art. 9.2. Where referral is requested, the deadline for the Phase I decision is extended by 10 working days, to 35 days.
 - Within **20 working days** after notification, the parties must submit **proposed undertakings** if they hope to achieve a settlement in **first stage**; Implementing Reg., Art. 19.1. If so offered, the deadline for a Phase I decision is extended by 10 working days (to 35), after which the merger is either cleared, subject to the proposed undertakings, or, where the undertakings prove deficient, “second-stage” proceedings are initiated ECMR Art. 6.1(c).
 - Within **25 working days** after notification (ECMR Art. 10.1), DG COMP will:
 - determine whether the merger meets the jurisdictional thresholds;
 - confer with other interested Commission Directorates (for example, the Telecommunications Directorate in cases involving the telecoms industry) and the Legal Service;
 - make inquiries of, and consider submissions by, interested third parties;
 - decide whether the proposed concentration “raises serious doubts as to its compatibility with the common market” (for example, may be anticompetitive).
 - Unless undertakings are offered, **within 25 working days** after notification, the EC must issue its Phase I decision. (ECMR Art. 6.1) If the proposed concentration does not raise serious doubts, the EC must clear it.¹⁵ The EC issues a written decision in all but the most nonproblematic cases.¹⁶
 - If undertakings are offered, or a Member State seeks referral, the Phase I decision is issued within **35 working days** after notification.

¹³ By contrast, in the United States, even the mere fact of filing the HSR must be kept confidential.

¹⁴ By contrast, the U.S. federal agencies are not obliged to share HSR information with state authorities.

¹⁵ ECMR Art. 6.1(b). Under a *habilitation* adopted by the Commission (akin to what Americans call a delegation of authority), the Competition Commissioner may take this decision by himself.

¹⁶ In 2000, the EC issued notice—updated in 2004—of a “simplified procedure in unproblematic cases,” identifying three categories of cases that would qualify for a “short-form” decision. Commission Notice on a Simplified Treatment for Certain Concentrations, 2004, available at http://europa.eu.int/comm/competition/mergers/legislation/consultation/simplified_tru.pdf.

Phase II

Second-stage proceedings consist of the following steps that must be concluded **within 90 working days**. This timetable is subject to extension by the parties or Commission “stopping the clock” or the parties offering remedial commitments after the 54th day of the proceedings.¹⁷

- The EC initiates the **Proceedings (IP)** by issuing to the parties a formal, written decision, describing the Commission’s “serious doubts.”¹⁸ The decision is confidential, and the Commission does not prepare and issue a public version.
- Within **10 working days after IP**, the Commission will hold a “**State of Play**” meeting with the parties “to facilitate the notifying parties’ understanding of the Commission’s concerns at an early stage of the Phase II proceedings.” (Best Practices § 33(b)).
- “**Stop the Clock**” possibilities (ECMR Art. 10.3 ¶ 2):
 - Within **15 working days after IP**, the parties may request an extension of time; or
 - Any time after IP, the Commission may extend time with the parties’ agreement, but the total duration of such extensions cannot exceed 20 working days.
- “**Triangular**” meetings of parties, third parties, and Commission staff are suggested by the Best Practices § 5.3, to be held as early as possible in the investigation “in order to enable DG COMP to reach a more informed conclusion as to the relevant market characteristics and to clarify issues of substance before deciding on the issuing of a Statement of Objections.”
 - In approximately six weeks after IP, DG COMP concludes its investigation with the issuance of a **Statement of Objections (S/O)**, akin to an FTC administrative complaint) that describes all the competitive concerns the Commission has about the proposed concentration. Anything DG COMP wishes to rely on in its final decision must be included in the S/O. The S/O is accompanied by an invitation to the parties to reply in writing within a date set by the Commission, often within two weeks of its issuance. There is no deadline or best practice on timing of the S/O’s issuance. When issuance slips, it compresses the remaining process timetable.
 - S/O issuance triggers the parties’ right of “access to the file,” DG COMP’s investigative file, including third-party submissions redacted to eliminate “business secrets.”¹⁹
 - Approximately two weeks after issuance of the S/O, if the parties’ request it, DG COMP conducts a formal **hearing** at which unsworn testimony is taken from the parties and other interested persons including customers and competitors. It is not a trial in the American sense, as testimony is not sworn, nor is there the kind of cross-examination that is conducted in a U.S. judicial procedure. There is a hearing officer responsible for the fairness of the proceedings, but who has no decision-making authority.²⁰

¹⁷ The time limits for decisions in ECMR Art. 10 are strict and can be tolled only for a delimited period with the consent of the parties. By contrast, the final decision deadline in HSR may be tolled with the consent of the merging parties without limit. The EC must issue decisions in all cases. If it fails to issue a decision by the relevant ECMR deadline, the concentration—under ECMR Art. 10.6—is deemed cleared in the form originally notified.

¹⁸ ECMR Art. 6.1(c). The EC has opened Proceedings in 5 percent of the concentrations notified since the ECMR took effect in September 1990, through September 2004. Another 4 percent of the concentrations reviewed have been cleared subject to undertakings adopted in first phase. “Serious doubt” is interpreted to mean a “reasonable possibility of a negative decision” on the concentration. Under a *habilitation*, see *supra* note 15, the Competition Commissioner decides to open proceedings with the Commission President’s concurrence.

¹⁹ Commission Notice on Access to the File, available at http://europa.eu.int/comm/competition/antitrust/acdosen_en.html. Note that similar access is not afforded in the U.S. unless and until the agencies issue a complaint and the matter goes to litigation.

²⁰ Available at <http://europa.eu.int/comm/competition/hearings/officers/>.

- Following the parties' reply to the S/O and the Hearing, another "State of Play" meeting may take place, which "may also serve as an opportunity to discuss the scope and timing of possible remedy proposals. (Best Practices 33(d))
- Within **65 working days after IP** (for example, shortly after the hearing and about one month prior to the deadline for a final Commission decision), the parties must submit any proposed **undertakings** that they wish the Commission to consider to settle the case. (Implementing Regulation Art. 19.2)
 - If the parties submit proposed remedies between 55 and 65 working days after IP, the deadline for the Commission's final decision is extended by fifteen working days. (ECMR Art. 10.3)
- Another "State of Play" meeting may take place prior to the Advisory Committee meeting, primarily to discuss proposed remedies.
- An **Advisory Committee**, made up of representatives of the 15 EU Member State competition authorities, reviews DG COMP's proposed decision and issues an advisory opinion thereon. (ECMR Arts. 19.3–19.7)
- **Commission decision:** As a practical matter, the Commission aims to adopt its decision at its regular Wednesday meeting *two weeks prior to the statutory decision deadline*.

All decisions on concentrations following second stage proceedings must be taken by the full college of Commissioners. All decisions on concentrations—whether taken after first or second stage—are subject to review by the European Court of Justice.²¹

The EC's Investigative Tools

ECMR Arts. 11–13 describe the EC's investigative powers that include compulsory process to obtain answers to written questions and on-site inspection of books and records. The EC does not have the power, as do U.S. authorities, to compel oral testimony under oath (depositions), but it may take voluntary interviews. Its powers to inspect undertakings' premises include the ability to seal business premises and books and records.

Penalties for Infringements: Costs in Both Delay and Euros

1. SUSPENSION OF DEADLINES

ECMR Art. 10.4 allows the Commission to suspend the decision deadlines, if parties do not timely comply with information requests or on-site inspections. Art. 9 of the draft Implementing Regulation provides more detail as to application of this power. The EC resorted to stopping the clock in the investigation of the *Schneider/Legrand* case in 2002, an action that was upheld by the CFI in its review of that decision, and it has done so in more recent cases.²²

2. FINES

- ECMR Art. 14.1 provides for the imposition of fines of up to 1 percent of the aggregate turnover of the undertakings concerned where they, inter alia, intentionally or negligently: supply incorrect or misleading information on Form CO or other submissions; supply incorrect or misleading infor-

²¹ ECMR Arts. 21.1 and 16. See Judicial Review, *infra* at 15.

²² Case T-310/01, *Schneider Elec. SA v. Commission*, ¶¶ 74–113 (Oct. 22, 2002), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62001A0310.

mation in response to an Art. 11 request or decision or fail to respond within the time specified; or, refuse to submit to or fail to produce required records in an investigation. Under ECMR Art. 15.1, the EC may also impose periodic penalty payments of up to 5 percent of the average daily aggregate turnover of the undertaking(s) concerned per day for delays in providing complete and correct information in response to an Art. 11 request or for refusal to permit an on-site investigation.

■ ECMR Art. 14.2 provides for the imposition of fines of up to 10 percent of the aggregate turnover of the undertaking(s) concerned where they, inter alia, fail to notify a concentration prior to its implementation; fail to comply with conditions of a Commission decision clearing a merger; or, consummate a merger in the face of a prohibition decision.

Substantive Analysis by the European Commission and the Courts

The substantive analysis of an EC merger case begins with definition of “affected” markets, that is the relevant product and geographic markets. It proceeds to an assessment of the possible competitive effects in the affected markets as well as countervailing factors, and, with the cooperation of the parties, determines whether agreement can be reached within the decision deadlines on undertakings that would remedy anticompetitive effects.

The substantive test was revised by the Council in the new Merger Regulation of 2004. Consistent with that revision, the Commission issued horizontal merger guidelines describing its analysis. This section describes the analytical process, noting the sources of guidance used by the Commission.

Substantive Standard in the Merger Regulation

■ Arts. 2.2 and 3 of the Merger Regulation state the test of a merger’s “compatibility with the common market” to be whether it would significantly impede effective competition in the common market or in a substantial part of it in particular as a result of the creation or strengthening of a dominant position. . .²³

Recital 25, in the Regulation’s preamble,²⁴ clarifies the scope of the revised test, stating:

[T]he notion of “significant impediment to effective competition” in Arts. 2.2 and 3 should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.

■ STATUTORY FACTORS THAT THE COMMISSION MUST CONSIDER

Art. 2.1 of the Merger Regulation requires the Commission to take into account the following factors when appraising a merger:

(a) the need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or outside the Community;

²³ Under the previous standard, the Commission would first determine whether the merger created or strengthened a dominant position before determining whether the merger would significantly impede effective competition. The new standard preserves the creation or strengthening of dominance as a particular way in which effective competition may be impeded by a proposed merger and, thus, preserves prior case law on that issue.

²⁴ Recitals are expressions of legislative intent that the Council includes as a preamble to its Regulations.

(b) the market position of the undertakings concerned and their *economic and financial power*, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and *the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition*.

The factors in italics deserve some explanation. The first—*economic and financial power*—may appear to be a “deep pockets” factor that causes the Commission to take into account the financial wherewithal of the merged entity. This is not a factor that, by comparison, is given much weight by U.S. antitrust agencies. But, in *RJB Mining plc v. Commission*,²⁵ the CFI annulled the Commission's decision in the merger case in part for its failure to take this factor into account. The second—*technical and economic progress*—is language found in EC Treaty Art. 81.3 and is deemed the legal basis on which the Commission may consider efficiency claims.²⁶ The point to remember here is that these are *statutorily mandated* factors that the EC must consider in appraising concentrations.

Market Definition

The EC defines product and geographic markets pursuant to guidelines it issued in 1997.²⁷ They were immediately seen as a step toward analytical convergence with the U.S. agencies²⁸ as compared with the market definition provisions of their 1992 Horizontal Merger Guidelines.²⁹

Geographic market definition in some cases has reflected the fact that a “single” EU-wide market does not yet exist in some products. For example, in *Volvo/Scania*,³⁰ Sweden's stringent truck-rollover test contributed to a finding that Sweden was a separate geographic market for heavy trucks. The *Pirelli/BICC*³¹ case reflected the evolution of the market for electrical power transmission cables into an EU-wide market from the days of the early '90s when the EC found those markets to be national in scope in its decision in *AEG Kabel/Alcatel*.³²

²⁵ 2001 E.C.R. II-00337 (Ct. First Instance Jan. 31, 2001), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61998A0156.

²⁶ For a further description, see discussion of Efficiencies, *infra* at 13.

²⁷ Guidelines on the Assessment of Horizontal Mergers, 2004 O.J. (C 31) 5, available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_031/c_03120040205en00050018.pdf (EC Horizontal Merger Guidelines).

²⁸ See, e.g., Simon Baker & Lawrence Wu, *Applying the Market Definition Guidelines of the European Commission*, 19 EUR. COMPETITION L. REV. 273 (1998).

²⁹ U.S. Dep't of Justice and Federal Trade Comm'n, Horizontal Merger Guidelines (1992, revised 1997), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13, 104, available at <http://www.ftc.gov/bc/docs/horizmer.htm> (U.S. Merger Guidelines).

³⁰ Case COMP/M.1672, Volvo/Scania (Mar. 15, 2000), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1672_en.pdf.

³¹ Case COMP/M.1882, Pirelli/BICC (July 19, 2000), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1882_en.pdf.

³² Case IV/M.165, Alcatel/AEG Kabel (Dec. 18, 1991), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m165_en.pdf. Germany unsuccessfully sought an Art. 9 referral of the case to the *Bundeskartellamt*, believing that the markets were indeed national, that Alcatel's acquisition would affect a distinct market in Germany, and, that it would establish collective dominance in that market.

Safe Harbors?

■ The Merger Regulation, since its first enactment in 1989, has contained a recital (no. 32 in the 2004 Regulation) stating that “[c]oncentrations which, by reason of the limited market share of the undertakings concerned, are not liable to impede effective competition may be presumed to be compatible with the common market, . . . in particular, where the market share of the undertakings concerned does not exceed 25 percent either in the common market or in a substantial part of it.” The Commission points out in footnote 24 of its Horizontal Merger Guidelines that “such an indication does not apply to cases where the proposed merger creates or strengthens a collective dominant position involving the “undertakings concerned” and other third parties [citations omitted].”

■ The EC Horizontal Merger Guidelines §§ 19 and 20 provide Herfindahl-Hirschmann Index (HHI) measures that “may be used as an initial indicator of the absence of competition concerns. However, they do not give rise to a presumption of either the existence or the absence of such concerns.”³³

Theories of Competitive Harm

Once the markets have been defined, the Commission must determine whether the merger would significantly impede effective competition. Commission decisions have identified several theories of competitive harm, the first three of which are described in detail in the Commission’s Horizontal Merger Guidelines.

■ 1. NON-COORDINATED (A/K/A “UNILATERAL”) EFFECTS

The EC’s Horizontal Merger Guidelines §§ 24 and 25 describe two general circumstances in which a merger may lead to unilateral anticompetitive effects: where a merger creates or strengthens a dominant position of a single firm—one which, typically, would have an appreciably larger market share than the next competitor post-merger—or a merger in an oligopolistic market involving the elimination of important competitive constraints that the merging parties previously exerted upon each other with a reduction of competitive pressure on the remaining competitors. The Guidelines describe a number of factors which may influence whether significant non-coordinated effects are likely to result from a merger.

■ 2. COORDINATED EFFECTS

When a merger occurs in a market tending toward an oligopoly—that is, a market of few, roughly equal participants rather than a single, dominant player—judgments of the ECJ and CFI have confirmed that the Merger Regulation does cover such circumstances, so long as the Commission can show certain circumstances. These circumstances are similar to those specified in the U.S. Horizontal Merger Guidelines § 2.11, concerning the prospect that a merger would facilitate collusion in an oligopolistic market:

- First, there must be sufficient market transparency for each member of the dominant oligopoly to be aware of the others’ market conduct.
- Second, the “common policy” (tacit coordination) must be sustainable over time—meaning there must be adequate deterrents (for example, retaliation against cheating) to ensure that there is a long-term incentive to maintain the policy.

³³ EC Horizontal Merger Guidelines § 21.

- Third, it must be established that the foreseeable reaction of competitors and consumers would not jeopardize the results of the common policy.³⁴

■ 3. ELIMINATION OF A POTENTIAL COMPETITOR

A theory of harm not included in the U.S. Horizontal Merger Guidelines, the EC Guidelines describe specific conditions in § 60 which must be fulfilled for the Commission to conclude that a proposed merger would eliminate a potential competitor and therefore be prohibited.

■ 4. VERTICAL FORECLOSURE

As noted above, the statutory factors the Commission is required to consider include vertical relationships. The Commission explained its focus in this area as follows:

[V]ertical integration mergers can lead to dependency of competitors for their supplies on the vertically integrated firm with the risk that access to supplies is foreclosed or rendered more difficult or more expensive, thereby raising rivals' costs. This could lead to the weakening or exclusion of competitors and therefore to the creation of a dominant position in the downstream market [citing several cases in which this theory was examined].³⁵

The Commission found such effects in a series of mergers in the media industry in the mid- to late-1990s. For example, in *MSG Media Service*, the Commission found that this merger of programming rights, technology, and administrative services would establish the merged firm as a “gate-keeper” and foreclose competition.³⁶

■ 5. CONGLOMERATE EFFECTS

The CFI's decision in the *Tetra Laval/Sidel* case defines “conglomerate” mergers and declares that they may have anticompetitive effects in certain cases. The CFI said that a conglomerate merger is

a merger of undertakings which, essentially, do not have a pre-existing competitive relationship, either as direct competitors or as suppliers or customers. Mergers of this type do not give rise to true horizontal overlaps between the activities of the parties to the merger or to a vertical relationship between the parties in the strict sense of the term. Thus, it cannot be presumed as a general rule that such mergers produce anti-competitive effects. However, they may have anti-competitive effects in certain cases.³⁷

The anticompetitive effects found by the Commission include the creation of portfolio power,³⁸ (that is, the acquisition of a full-range of products that would lead to foreclosure of other suppli-

³⁴ EC Horizontal Merger Guidelines §§ 44–55. See Case T-342/99, *Airtours plc v. Commission* (June 6, 2002), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61999A0342.

³⁵ EUROPEAN COMM'N, 21ST REPORT ON COMPETITION POLICY 368–69 (1991).

³⁶ Case IV/M.469, *MSG Service* (Nov. 9, 1994), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&numdoc=31994D0922&lg=EN.

³⁷ Case T-5/02, *Tetra Laval BV v. Comm'n*, ¶ 142 (Oct. 25, 2002), available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0005.

³⁸ Case IV/M.938, *Guinness/GrandMetropolitan* (Oct. 15, 1997), available at http://europa.eu.int/eur-lex/pri/en/oj/dat/1998/l_288/l_28819981027en00240054.pdf. The CFI endorsed this theory in its decisions concerning third-party challenges to the Commission's decision in *SEB/Moulinex*, *supra* note 6. See Case No. T-114/02, *BaByliss v. Comm'n* (Apr. 3, 2003).

ers at the distribution level), bundling or tying,³⁹ and leveraging dominance existing in one market to another adjacent market.⁴⁰

Countervailing Factors

1. ENTRY

As noted above, entry is one of the statutorily mandated factors that the Commission is obliged to take into account in reviewing a merger. The EC Horizontal Merger Guidelines contain a chapter on entry that recites the same three critical factors that are considered by the U.S. antitrust agencies under their 1992 Horizontal Merger Guidelines—namely, whether entry will be likely, timely, and sufficient to prevent the potential anticompetitive effects of a merger.⁴¹

2. BUYER POWER

The ability of customers to counter the increase in market power that a proposed merger may create has been a determining factor in several EC merger decisions in the past. These cases are cited in support of the EC's description of the buyer power factor in its Horizontal Merger Guidelines.⁴²

3. FAILING FIRM

Similar to the “failing firm” defense as recognized by U.S. courts since the U.S. Supreme Court's decision in the *General Dynamics* case of 1974,⁴³ and in the DOJ/FTC Horizontal Merger Guidelines, the EC has been willing to clear “rescue mergers.” The EC's Horizontal Merger Guidelines recognize the failing firm defense and describe it in terms quite similar to those of the U.S. Guidelines.⁴⁴

4. EFFICIENCIES

■ Evolution of the EC's treatment of efficiencies echoes that of the U.S. antitrust agencies. The agencies and the courts rejected efficiencies as a positive factor in the examination of mergers until the 1997 revision to the DOJ-FTC Horizontal Merger Guidelines that was intended to “invite” parties to offer efficiency claims. The EC's 1991 *deHavilland* decision rejected efficiency claims offered by the parties and specifically left open the issue of “whether such considerations are relevant for the assessment under Article of the Merger Regulation.”⁴⁵

The EC's views on efficiencies evolved to the point where it proposed, and the Council adopted, a provision embodied in Recital 29 of the Merger Regulation, clarifying the Commission's authority to take efficiencies into account in merger cases. The EC's Horizontal Merger Guidelines

³⁹ Case COMP/M.2220, GE/Honeywell (July 3, 2001), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf.

⁴⁰ *Tetra Laval/Sidel*, *supra* note 37.

⁴¹ Compare EC Horizontal Merger Guidelines §§ 68–75 with U.S. Merger Guidelines § 3.

⁴² EC Horizontal Merger Guidelines §§ 64–67.

⁴³ *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

⁴⁴ Compare EC Horizontal Merger Guidelines §§ 89–91 with U.S. Merger Guidelines § 5.

⁴⁵ Case IV/M.53, ATR/DeHavilland, ¶ 65 (Oct. 2, 1991), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m53_en.pdf.

describe its approach to efficiency claims.⁴⁶ Suggested further reading on efficiencies includes:

- Mario Monti, The Commission Notice on Merger Remedies—One Year After (Jan. 18, 2002), available at http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/02/10I0IRAPID&lg=EN.
- Götz Drauz, An Efficiency Defence for Mergers: Putting an Intricate Puzzle Together, *Zeitschrift für Wettbewerbsrecht (Journal of Competition Law)* 254 (Sept. 2003).

Remedies

Authority and Procedure

Article 8.2 of the Merger Regulation authorizes the Commission to accept undertakings from the parties that modify their proposed concentration to make it compatible with the common market. Such remedies may be offered in First Phase within 20 working days after notification. This extends the First Phase decision deadline from 25 to 35 working days. If remedies are to be offered in Second Phase, they must be submitted no later than 65 working days after the initiation of Second Phase proceedings. If offered 55 working days after the initiation of Second Phase proceedings, the final decision deadline is extended from 90 to 105 working days.⁴⁷

Substance

The EC's Notice on Remedies was published in early 2001. It reflected not only the Commission's experience in working with merging parties to craft effective remedies up to that point, but also the findings of the U.S. Federal Trade Commission's (FTC) Divestiture Study, issued in 1999,⁴⁸ as acknowledged by EC Competition Commissioner Mario Monti.⁴⁹

The Notice begins with General Principles, one of which—stated in § 9—is the preference for structural, rather than conduct, remedies. The CFI gave support for that preference in its decision in the *Gencor* case.⁵⁰ The Commission does not rule out conduct remedies, but they must amount to something more than a promise to behave in a certain way—specifically, for example, not to abuse a dominant position.⁵¹

⁴⁶ EC Horizontal Merger Guidelines §§ 76–88.

⁴⁷ Merger Regulation, Art. 10.1 (¶ 2); Implementing Regulation, Art. 19.

⁴⁸ FEDERAL TRADE COMM'N, A STUDY OF THE COMMISSION'S DIVESTITURE PROCESS (1999), available at <http://www.ftc.gov/os/1999/08/divestiture.pdf>.

⁴⁹ Mario Monti, The Commission Notice on Merger Remedies—One Year After (Jan. 18, 2002), available at http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/02/10I0IRAPID&lg=EN.

⁵⁰ Case T-102/96, *Gencor v. Comm'n*, 1999 E.C.R. II-00753, available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61996A0102.

⁵¹ The upcoming ECJ decision in the Commission's appeal of the CFI judgment in the *Tetra Laval/Sidel* case may give further guidance on this point. In its press release announcing the appeal, the EC said,

The CFI required the Commission to consider, as possible solutions to the competitive problems created by a merger, commitments by the merging parties not to engage in certain commercial practices. However, such commitments do not solve the structural problems created through certain mergers and are very difficult, if not impossible, to monitor. The Merger Regulation governs structural changes in competitive conditions brought about by mergers and is intended to avoid the need for complex ongoing monitoring of undertakings' behaviour.

EC Comm'n Press Release, Commission Appeals CFI Ruling on *Tetra Laval/Sidel* to the European Court of Justice (Dec. 20, 2002), available at http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.getfile=gf&doc=IP/02/1952I0IRAPID&lg=EN&type=PDF.

On May 2, 2003, the Commission provided further guidance to merging parties in the form of Best Practice Guidelines for Settlement Commitments,⁵² consisting of a standard model for divestiture commitments and a standard model for trustee mandates, as well as explanatory notes.

Judicial Review

Commission decisions are subject to judicial review by the European Court of Justice (ECJ), including its Court of First Instance (CFI). The courts have issued several decisions interpreting the scope of the Merger Regulation and the appropriateness of the Commission's enforcement. For example, the courts upheld the Commission's interpretation of the Merger Regulation to cover cases of collective dominance in the *Kali und Salz*⁵³ and *Gencor* cases.⁵⁴ The courts have also annulled Commission decisions, as it did in the *Airtours*, *Schneider*, and *Tetra Laval/Sidel* cases decided in 2002, finding that the Commission had made "manifest errors of assessment"—in other words, the Commission did not produce sufficient supporting evidence for its decisions. The *Airtours* decision also unleashed a debate over whether there is a "gap" in the coverage of the Merger Regulation. The Council's adoption of a new substantive standard is aimed, in part, at filling the gap. Meanwhile, the Commission has appealed the CFI's *Tetra* judgment to the ECJ, concerning the standard of review applied by the court.

The following sections contain some features that distinguish EU judicial review.

Standing

Commission decisions may be challenged by appeal to the European Court of Justice's Court of First Instance (CFI) under Art. 230 (formerly Art. 173) of the EC Treaty, by

[a]ny natural or legal person. . . against a decision addressed to that person or against a decision which, although in the form of a regulation or decision addressed to another person, is of direct and individual concern to the former.

The merging parties, employees of the merging firms, competitors, and Member State governments are among those recognized as having standing to challenge a Commission merger decision. For example, in *RJB Mining plc v. Commission*,⁵⁵ the CFI, citing a string of precedents, ruled that the plaintiff (a competitor) had standing, stating (in ¶ 59),

an undertaking is concerned by a Commission decision [and therefore may institute judicial proceedings for its annulment] that allows benefits to be granted to one or more undertakings which are in competition with it.

Standing to challenge an EC merger decision is, thus, broader than in the United States where "[a] competitor in the merging industry ordinarily lacks antitrust standing."⁵⁶

⁵² The Best Practices, consisting of Model Forms and explanatory notes, available at http://europa.eu.int/comm/competition/mergers/legislation/divestiture_commitments/.

⁵³ C-68/94 and C-30/95, *France v. Comm'n*, 1998 E.C.R. I-1375, ¶¶ 165–78.

⁵⁴ *Gencor v. Commission*, *supra* note 50.

⁵⁵ *Supra* note 25.

⁵⁶ *See AlliedSignal, Inc. v. B.F. Goodrich Co.*, 183 F.2d 568, 575–76 (7th Cir. 1999).

Confidentiality

In at least one other aspect, judicial review in Europe is notably different from that in the United States: In Europe, pleadings (briefs, etc.) are kept confidential. Thus, unless parties to the appeal issue statements, nothing will be known until the court issues a decision. The confidentiality rules were articulated by the Court of First Instance as follows:⁵⁷

135. Under the rules which govern procedure in cases before the Court of First Instance, parties are entitled to protection against the misuse of pleadings and evidence. Thus, in accordance with the third subparagraph of Article 5(3) of the Instructions to the Registrar of 3 March 1994 (OJ 1994 L 78, p. 32), no third party, private or public, may have access to the case-file or to the procedural documents without the express authorisation of the President, after the parties have been heard. Moreover, in accordance with Article 116(2) of the Rules of Procedure, the President may exclude secret or confidential documents from those furnished to an intervener in a case. 136. These provisions reflect a general principle in the due administration of justice according to which parties have the right to defend their interests free from all external influences and particularly from influences on the part of members of the public.

Standard of Review

The Court's standard of review accords the Commission some deference in appraising issues that involve economic assessments. This standard is often referred to as the "manifest error" rule. The Courts have stated the standard in merger cases as follows:

[T]he basic provisions of [the Merger] Regulation. . . , in particular Article 2 thereof, confer on the Commission a certain discretion, especially with respect to assessments of an economic nature, and, consequently, when the exercise of that discretion, which is essential for defining the rules on concentrations, is under review, the Community judicature must take account of the discretionary margin implicit in the provisions of an economic nature which form part of the rules on concentrations (*Kali & Salz*, paragraphs 223 and 224, and *Gencor v Commission*, paragraphs 164 and 165). Therefore, it is in the light of the foregoing considerations that it is necessary to examine the merits of the grounds relied on by the applicant to show that the Commission made an error of assessment in finding that the conditions for, or characteristics of, collective dominance would exist were the transaction to be approved.⁵⁸

The CFI restated this language in its judgment, annulling the Commission's decision to prohibit the *Tetra Laval/Sidel* merger.⁵⁹ The Commission has appealed this CFI judgment, arguing that "the CFI has imposed a disproportionate standard of proof for merger prohibition decisions."⁶⁰

Efficacy

Despite complaints over the length of time consumed by judicial review,⁶¹ that has not deterred parties and third parties from challenging Commission decisions. For example, half of the Commission's 18 prohibition decisions have been appealed. Furthermore, appeal of Commission decisions has been made more attractive by the Court's adoption of expedited (colloquially known

⁵⁷ Case T-174/95, *Svenska Journalistförbundet v. Council of the European Union*, 1998 E.C.R. II-2289, available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61995A0174.

⁵⁸ *Airtours plc v. Commission*, *supra* note 34.

⁵⁹ *Tetra Laval BV v. Commission*, *supra* note 37.

⁶⁰ See European Comm'n Press Release (Dec. 20, 2002), *supra* note 51.

⁶¹ See, e.g., John Ratliff, Sven Volcker & Antonio Capobianco, *EC Merger Control 2001/2002: From Controversy to Change*, in GLOBAL COMPETITION REVIEW SPECIAL REPORT, THE EUROPEAN ANTITRUST REVIEW 33, 34–35 (2003).

as “fast-track”) procedures.⁶² Whereas the CFI took three years to decide the *Airtours* case, both the *Schneider* and *Tetra Laval/Sidel* cases were decided by the CFI under the expedited procedures within eight months. A useful explanation of the expedited procedure may be found in the EC’s Competition Policy Newsletter of October 2002.⁶³ ●

⁶² RULES OF PROCEDURE OF THE COURT OF FIRST INSTANCE OF THE EUROPEAN COMMUNITIES OF 2 MAY 1991, as amended on December 6, 2000, 2000 O.J. (L 322) 4 ch. 3a, art. 769, available at <http://curia.eu.int/en/instit/txtdocfr/txtsenvigueur/txt7.pdf>. See also Notes for the Guidance of Counsel in Written and Oral Proceedings Before the Court of Justice of the European Communities § 12, available at <http://curia.eu.int/en/instit/txtdocfr/autrestxts/txt9.pdf>.

⁶³ Kyriakos Fountoukakos, *Judicial Review and Merger Control: The CFI’s Expedited Procedure*, EC COMPETITION POLICY NEWSLETTER (Oct. 7, 2002), available at http://europa.eu.int/comm/competition/publications/cpn/cpn2002_3.pdf.

Appendix V—Bibliography

Author's Note: *Many trees have fallen to produce the paper on which words have been published about the EC's Merger Control Regulation. At the risk of possibly constraining inquiry and offending knowledgeable authors on this subject, I recommend the following references for those seeking more background concerning the role of merger control in the EU, especially that practiced by the European Commission. These references also provide solid background as to the EU's nonmerger antitrust enforcement.*

—JOHN J. PARISI

Valentine Korah, *An Introductory Guide to EC Competition Law and Practice* (7th ed. 2000). This little yellow book is much more than a nutshell without the bulk of a treatise.

Jonathan Faull & Ali Nikpay, *The EC Law of Competition* (1999), a textbook by insiders that provides a broad depiction of EU competition law.

Valentine Korah (Gen. Ed.), *Competition Law of the European Community* (2d ed. 2002). This is the treatise, containing, in chapter 5, Nicholas Levy's comprehensive review of the enforcement of the EC Merger Control Regulation that has now also been published separately.

European Commission, *Competition Policy Newsletter*, published three times a year, contains useful articles highlighting significant developments in EC competition law, available at <http://europa.eu.int/comm/competition/publications/cpn/>.

Readers are invited to recommend additional references. Send them to The Antitrust Source, antitrust@att.net.

Transparency in Antitrust Merger Review: A Modest Proposal for More

David I. Gelfand and Jeremy Calsyn

Public disclosure of the federal agencies' analysis in merger cases serves many purposes. It enables companies to understand better the possible risks associated with proposed transactions. It allows all practitioners—not just those with inside knowledge about recent deals—to predict with greater certainty how the agencies will analyze particular markets. It provides an incentive for the agencies to ensure that their decisions are based on accurate facts and sound economic principles. The public also benefits from a better understanding of this important area of government regulation.

Although there is almost universal agreement that transparency in merger review is a commendable goal, there is disagreement about how much burden should be placed on the agencies to explain their decisions.¹ Transparency requires resources to prepare and publish decisions, and the agencies do not have unlimited resources. A requirement of public disclosure might also discourage the agencies from clearing transactions that arguably raise competitive issues because they may fear that such precedents will be difficult to distinguish in future cases. Perhaps for these reasons, the historical practice in the United States has been to publish statements about the competitive impact of mergers only when the agencies challenge a merger and when the parties enter into a consent decree to remedy the competitive problems. This is in contrast to the European Commission, which publishes a decision in every case reviewed under the Merger Regulation, even those in which the transaction is cleared without remedies.

This article describes the U.S. agencies' approach to publicizing merger decisions, including a recent trend toward greater transparency, and proposes a modest step toward even greater transparency in U.S. merger review. The proposal would require a public competitive analysis in every merger for which the agency has issued a Second Request. This would result in public disclosure of the agencies' analysis in transactions that raise significant competitive issues but would not unduly burden the agencies with a significant amount of additional work. Thus, from a practical perspective, we believe the proposal should be workable.

■
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¹ A symposium devoted to transparency in antitrust enforcement appeared in the Fall 2003 issue of the *Buffalo Law Review*. The lead article by Warren S. Grimes examined the issue in depth. Warren S. Grimes, *Transparency in Federal Antitrust Enforcement*, 51 BUFFALO L. REV. 937 (2003). Critical comments and replies were authored by Robert Pitofsky of the Georgetown University Law Center and former Chairman of the Federal Trade Commission, John M. Nannes, formerly of the Department of Justice, and Peter C. Carstensen of the University of Wisconsin Law School. Robert Pitofsky, *Comments on Warren Grimes: Transparency in Federal Antitrust Enforcement*, 51 BUFFALO L. REV. 995 (2003); John M. Nannes, *Transparency in Federal Antitrust Enforcement Decisions: A Reaction to Professor Grimes*, 51 BUFFALO L. REV. 1017 (2003); Peter C. Carstensen, *Transparency in Antitrust—Do What We Say and Not What We Do: Some Reflections on Professor Grimes's Quest*, 51 BUFFALO L. REV. 1001 (2003).

The U.S. Agencies' Current Practice of Limited Publication Provides Limited Guidance for Future Transactions

Section 7 of the Clayton Act prohibits transactions that may substantially lessen competition in a relevant market. Determining what constitutes a relevant market and what combinations may substantially lessen competition is often difficult. Is the industry susceptible to coordinated interaction? Are the merger parties each other's closest rivals? How easy and likely is it for other suppliers either to enter or expand output in the relevant market? Will buyers turn to substitute goods in response to a small but significant nontransitory increase in prices? These are complicated questions that are highly dependent on both the circumstances in the industry involved and the economic theory used to assess those circumstances.

Recent case law analyzing mergers under Section 7 is relatively scarce, and the agencies' guidelines, while helpful, are general and in some respects obsolete.² Moreover, the occasional speeches delivered by agency officials, which often start with the caveat that they reflect only the views of the individuals involved, also tend to be general. Information about how the agencies analyze specific transactions—which is potentially the best source of information for merger parties in future transactions, especially in industries that have recently been analyzed in depth by the agencies—is available in only a small percentage of cases.

Under current law, the Department of Justice and the Federal Trade Commission are not required to publish their reasoning in merger cases that are cleared without remedies. The typical practice in such cases is for the reviewing agency to allow the waiting period under the Hart-Scott-Rodino Act to expire without any public explanation. Indeed, unless the parties have received early termination of a transaction—in which case a brief mention of the transaction appears on the FTC's Web site—there is usually not even a public acknowledgement by the agency that a transaction has been reviewed and cleared by the government.

At the other extreme, in cases in which an agency seeks to block a transaction, its reasoning is set forth in detail in the complaint and other court filings. Absent a settlement, a detailed opinion, either blocking the transaction or finding that it is not likely to lessen competition substantially, is typically published by the court that hears the government's challenge. Even in these cases, however, neither the agency nor the court addresses the product areas and markets the agency has decided not to challenge.

In between these two extremes are cases involving negotiated settlements. In these cases, the agencies are required to publish their competitive analysis.³ These statements can provide helpful insight into how the agencies view the relevant markets and why they believe a particular transaction might violate the antitrust laws but for the proposed remedy. However, they generally focus only on the areas of competitive concern and the reasons for the proposed remedy; they do not explain the agency's analysis of product areas for which the agency decided that no remedy was necessary.

The European Commission's practice stands in contrast to that of the U.S. agencies. For cases in which the EC clears transactions without any conditions, it issues statements identifying the par-

Information about how

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of cases.

² For example, numerous transactions have been cleared in recent years even though they result in concentration levels that significantly exceed the thresholds in the DOJ/FTC Horizontal Merger Guidelines (1992, revised 1997), available at <http://www.ftc.gov/bc/docs/horizmer.htm>.

³ The DOJ must issue a public Competitive Impact Statement as required by the Antitrust Procedures and Penalty Act (Tunney Act), 15 U.S.C. 16(b). Similarly, the FTC's rules require an explanation of the consent order to be placed on the public record. 16 C.F.R. §§ 2.31–2.34 (2004).

ties and the nature of the transaction as well as discussing the relevant product and geographic markets, the degree of overlap of the participating firms, and other pertinent facts. In 2003, the EC published 203 such clearance decisions.⁴ Although these statements are often limited in detail, they typically provide at least some basic information about the EC's view of the companies and markets involved in the transaction.

In cases that are resolved after in-depth investigations, the EC issues detailed public decisions whether it blocks the merger, allows the merger with conditions, or allows it to proceed without conditions. The result of this practice is that, even though the European Union has had a merger regulation for only fifteen years, it has a richer body of authority in merger cases than the United States, revealing how the agency views the relevant markets and dynamics of competition in a broad range of industries.

The U.S. Agencies Are Moving Toward More Transparency in Merger Cases

Federal Trade Commission Takes the Lead. In recent years, the FTC has attempted to adopt a more transparent approach in mergers that raise competitive issues but are cleared without challenge or settlement. Although not required by rule or statute, the FTC has issued official public statements in connection with several decisions, sometimes with dissenting statements.⁵ These statements vary in length and detail—from 2–3 page overviews in the Amerisource/Bergen Brunswig, Sunoco/Coastal Eagle Point Oil, and Caremark Rx/Advance PCS cases, to a 25-page majority analysis, 14-page dissent, and 5-page statement (from a Commissioner who did not participate in the voting) in connection with the Genzyme/Novazyme case. Typically, the FTC has published written decisions in cases for which there is disagreement among the Commissioners or when a case has received a great deal of media attention. However, the FTC appears broadly committed to greater public disclosure, noting in a recent statement that it has a “continuing effort to provide transparency to its decision-making process, and to provide guidance about the application of the antitrust laws to mergers in [the affected] market.”⁶

One of the more important recent examples of a published FTC decision was in connection with the proposed cruise line mergers. In October 2002, after a ten-month investigation, the FTC issued a statement announcing its 3–2 decision not to challenge the competing bids of Carnival Cruise Lines and Royal Caribbean Cruise Line for P&O Princess Cruises. The majority statement

⁴ Statistics for the European Commission are available at <http://europa.eu.int/comm/competition/mergers/cases/stats.html>.

⁵ See, e.g., Statement of the FTC, Amerisource Health Corporation/Bergen Brunswig Corporation (Aug. 24, 2001), available at <http://www.ftc.gov/os/2001/08/amerisourcstatement.pdf>, and Concurring Statement of Commissioner Mozelle W. Thompson, available at <http://www.ftc.gov/os/2001/08/amerisourcethompsonstatement.pdf>; Statement of the FTC, Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc (Oct. 4, 2002), available at http://www.ftc.gov/os/2002/10/cruise_statement.htm, and Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, available at <http://www.ftc.gov/os/2002/10/cruisedissent.htm>; Statement of the FTC, Sunoco Inc./Coastal Eagle Point Oil Co. (Dec. 29, 2003), available at <http://www.ftc.gov/os/caselist/0310139/0131229stmt0310139.pdf>; Statement of Chairman Timothy J. Muris, Genzyme Corporation/Novazyme Pharmaceuticals, Inc. (Jan. 13, 2004), available at <http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf>, Dissenting Statement of Mozelle W. Thompson, available at <http://www.ftc.gov/os/2004/01/thompsongenzymestmt.pdf>, and Statement of Commissioner Pamela Jones Harbour, available at <http://www.ftc.gov/os/2004/01/harbourgenzymestmt.pdf>; Statement of the FTC, Caremark Rx, Inc./AdvancePCS (Feb. 11, 2004), available at <http://www.ftc.gov/os/caselist/0310239/040211ftcstatement0310239.pdf>; Statement of the FTC, RJ Reynolds Tobacco Holdings, Inc./British American Tobacco plc (June 22, 2004), available at <http://www.ftc.gov/os/2004/06/040622batrjrstmt.pdf>, and Concurring Statement of Commissioner Mozelle W. Thompson, available at <http://www.ftc.gov/os/2004/06/040622thompson.htm>.

⁶ Statement of the FTC, RJ Reynolds Tobacco Holdings Inc./British American Tobacco plc, *supra* note 5, at 1.

Had the FTC chosen simply to close the investigation without an explanation of its reasoning, practitioners and the public would not have known the answers to these questions, nor would they have known how the characteristics of the cruise industry affected the FTC's analysis.

said that “it [was] appropriate to provide an unusually detailed explanation for [its] decision” because the matters presented “important, albeit firmly settled, issues of merger policy,” the “issues were complex and the ultimate decision depended on a close analysis of industry-specific facts,” and “the transactions [had] been the subject of unusually extensive media coverage—some of it misinformed.”⁷ A dissenting statement by Commissioners’ Anthony and Thompson was also issued.⁸ Although the FTC’s statement was brief in comparison to the EC’s lengthy analysis in the same transaction, it explained the Commissioners’ final reasoning and analysis in far greater detail than usual. The dissenting statement was also informative as it advocated blocking the transaction in light of the Horizontal Merger Guidelines’ presumptions of anticompetitive effects.

The cruise lines mergers raised several important substantive issues. Was the relevant antitrust market cruises marketed in North America or did the market include other forms of leisure and vacation activities and in other geographical regions? Were cruise offerings differentiated products or were they substantially similar? Would the merger enable the remaining cruise companies to identify a group of less price-elastic customers (similar to business travelers on airlines) to whom they could raise prices? Would the merger increase the ability of the cruise companies to coordinate their capacity expansion decisions?

Had the FTC chosen simply to close the investigation without an explanation of its reasoning, practitioners and the public would not have known the answers to these questions, nor would they have known how the characteristics of the cruise industry affected the FTC’s analysis. With the public statements, the Commissioners’ analytical approach was clearly revealed. They unanimously agreed that the likely relevant market was cruising and not a broader vacation market. The majority explained that they believed that unilateral effects were unlikely because, among other reasons, the merging parties were not uniquely close competitors. They also explained that the economic evidence did not prove that the merger would increase the ability of the remaining firms to coordinate pricing decisions given the complexity of the industry’s pricing behavior, and they found that the characteristics of the cruise industry did not lend themselves to coordination in capacity decisions.

These statements sparked a vigorous dialogue both about public disclosure of agency decisions and about the economic theories at issue in the cruise lines decision. For example, one article applauded the FTC’s decision to publish its reasoning but criticized the FTC’s analysis by questioning the Commission’s dedication to the Merger Guidelines presumptions and by arguing that the evidence did not support the Commission’s conclusion.⁹ In September 2004, two former

⁷ Statement of the FTC, Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc, *supra* note 5, at 1.

⁸ See Dissenting Statement of Commissioners Anthony and Thompson, Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc, *supra* note 5.

⁹ See Warren S. Grimes & John E. Kwoka, *A Study in Merger Enforcement Transparency: The FTC’s Ocean Cruise Decision and the Presumption Governing High Concentration Mergers*, ANTITRUST SOURCE, May 2003, available at <http://www.abanet.org/antitrust/source/05-03/metstudy.pdf>.

FTC officials involved in the cruise lines investigation responded to this criticism and defended the Commission's analysis of both unilateral and coordinated effects.¹⁰

Although there has not been another merger in the cruise area since the FTC's decision, those in that industry and in other industries with similar features have the benefit of knowing the FTC's analysis and the reasons for its decision to close the investigation. They are better able to weigh the risks of future transactions and better able to prepare their advocacy before the FTC.

Another important example is the Genzyme/Novazyme decision.¹¹ The merger of the two companies had already been consummated when the FTC opened its investigation of how the merger would affect innovation in pharmaceutical products for treating Pompe disease, a life-threatening medical condition affecting infants and young children. At the time of the merger, Genzyme and Novazyme had the only two research programs for enzyme replacement therapy for Pompe disease. Thus, the merger resulted in a merger to monopoly for pending research in this area. The FTC opened the investigation to analyze whether the merger reduced the innovation incentives of the merged companies, specifically whether absent the merger Genzyme and Novazyme would have engaged in a "race to market" a Pompe disease therapy.

In closing the Genzyme investigation without seeking a remedy, Chairman Muris explained in a detailed analysis of innovation markets that such a "race to market" was unlikely and that the merger had not substantially altered the companies' incentives in this area. He also found that the efficiencies in R&D resulting from the combination of the two companies were proven and significant. In an important development for pharmaceutical and other high-tech companies, Chairman Muris rejected the notion that there should be a presumption of anticompetitive effects in innovation markets, even in cases involving merger to monopoly. His statement also made clear that the FTC can consider the merged companies' post-merger behavior in investigations that arise after closing.

In his dissent, Commissioner Thompson explained that under a Merger Guidelines analysis, the merger should be challenged because it resulted in the merger of the only two companies operating in this innovation market, with new entry unlikely. Thompson argued that absent the merger the companies would have been driven to innovate against each other to be the first to market with an enzyme replacement therapy for Pompe disease. As a result of the merger, he believed that competitive incentive would be lost.

Without these statements, only those practitioners involved in the case would have had the benefit of the FTC's analysis in this important decision. By making its reasoning public, the FTC provided valuable guidance about its evolving approach to innovation markets.

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¹⁰ See Mary Coleman & Joseph J. Simons, *Response to Grimes and Kwoka*, ANTITRUST SOURCE, Sept. 2004, available at <http://www.abanet.org/antitrust/source/09-04/Sep04SimonsColeman.pdf>; Warren S. Grimes, *Reply to Coleman and Simons*, ANTITRUST SOURCE, Sept. 2004, available at <http://www.abanet.org/antitrust/source/09-04/Sep04GrimesReply.pdf>. See also Mary Coleman, David Meyer & David Scheffman, *Empirical Analyses of Potential Competitive Effects of a Horizontal Merger: The FTC's Cruise Ships Mergers Investigation*, 23 REV. INDUS. ORG. 121 (Sept. 2003); Joseph Simons & David Scheffman, *The FTC Cruise Line Merger Investigation*, ABA Section of Antitrust Law "Brown Bag" Program, Address before the ABA Section of Antitrust Law (Nov. 2003), revised version available at <http://www.abanet.org/antitrust/source/01-03/lerner.pdf>, and presentation available at <http://www.ftc.gov/be/hilites/ftcbeabrownbag.pdf>. For a summary of the Grimes/Kwoka exchanges with Coleman/Simons on the rebuttability of the Merger Guidelines presumptions and the competitive effects of yield management systems, see *Cruise Line Mergers: Post-Game Analysis*, FTC: WATCH, Oct. 25, 2004, at 4.

¹¹ See *supra* note 5.

Department of Justice Catching Up. The DOJ has been less active in publicizing its merger decisions. In a November 2004 speech, however, Deputy Assistant Attorney General of the Antitrust Division Thomas O. Barnett explained that the DOJ would be moving toward more disclosure in such decisions.

[R]egarding the goal of increased transparency, the European Commission and others have been ahead of the U.S. when it comes to explaining the reasons behind decisions not to bring challenges. During the past year we announced a policy of issuing public statements beyond the usual press release upon the closing of certain investigations, for example in cases where public dissemination of the rationale behind our decision not to bring an action might benefit businesses attempting to comply with complex antitrust standards."¹²

Mr. Barnett cited the DOJ's statement explaining the Arch/Metrocall merger (involving electronic pagers) as an example of the DOJ's increased dedication to transparency.¹³

Although it included some background on the industry and a short explanation of the DOJ's reasoning, the Arch/Metrocall statement was fewer than two pages long and was less detailed than a Competitive Impact Statement. It merely described the market and the recent competitive situation as demand for paging has declined. It then listed the reasons for the DOJ's conclusions that the merger would not lead to a substantial lessening of competition on a unilateral or coordinated effects theory. This type of summary statement is a helpful step toward transparency but still lacks much of the detailed analysis needed to fully understand the DOJ's competitive assessment of the industry.

A Modest Proposal Toward Greater Transparency in Merger Decisions

Despite the movement toward more public statements by both U.S. agencies, it remains unclear which mergers will be covered by this policy. The current practice involves selective announcements of the agencies' analysis in closing merger investigations where the agency involved believes that the decision deserves a public explanation. Although a good start, the statements are issued only in selected cases, and practitioners are without the benefit of the agencies' analysis for a number of other cases that raise significant competitive issues. Moreover, because agency statements do not provide detailed information for all of the potential overlaps, the agencies' reasoning is often not complete.

The public would benefit from a more consistent policy of public disclosure. But when should public statements be required? Recognizing that there are significant costs involved in publicizing the agencies' analysis, it would be imprudent and enormously burdensome to require that the agencies publish statements explaining their reasoning in every transaction notified under the HSR Act. Such a requirement would have resulted in over 1,000 decisions in 2003 (nearly five times more decisions than the EC issued) with the vast majority of decisions involving no competitive issue whatsoever. Insisting on this level of publication would be tremendously burdensome, and would result in hundreds of cursory opinions that provide little guidance to the public.

¹² Thomas O. Barnett, Deputy Ass't Atty Gen., Antitrust Div., U.S. Dep't of Justice, Antitrust Enforcement Priorities: A Year in Review, Address Before the Fall Forum of the ABA Section of Antitrust Law 5 (Nov. 19, 2004), available at <http://www.usdoj.gov/atr/public/speeches/206455.htm>.

¹³ *Id.* See Statement of the Department of Justice, Background to Closing of Investigation of Proposed Acquisition by Arch Wireless of Metrocall Holdings (Nov. 16, 2004), available at http://www.usdoj.gov/atr/public/press_releases/2004/206339.htm.

However, requiring a statement of analysis in all merger cases in which Second Requests have been issued, even where the agency decides to close the investigation without a challenge or settlement, would be a meaningful further step toward transparency and consistency. Moreover, the burden of such a requirement would be relatively limited.¹⁴ The agencies through the Second Request process have access to significant amounts of information, data, and internal company documents; have access to staff recommendations which outline the relevant markets, the competitive issues, and possible remedies; have often conducted extensive economic analyses; and have talked to industry participants, such as customers and competitors. Public statements could easily be prepared based on this information. Furthermore, this proposal would not require an unmanageable number of additional statements. Only 35 Second Requests were issued in 2003 (with 49 the year before), and many of these resulted in settlements requiring public statements in any event.

While the burden would be limited, the benefits from such a requirement would be considerable. It would increase the amount of information available to practitioners and companies considering future transactions. It would eliminate the discretion agencies currently have to keep their competitive analysis confidential. And it would lead over the years to a more complete body of precedent in a range of industries.

Conclusion

The FTC and the DOJ have taken initial steps toward greater transparency in merger cases. Further improvements are needed, however, to ensure consistency and provide the public with information about the agencies' analysis of all cases involving significant competitive issues. A requirement of public disclosure in cases involving Second Requests would go a long way toward achieving this goal without imposing undue burdens on the agencies. ●

¹⁴ Although the confidentiality of company information is a valid concern, it is an issue with which the agencies (and the European Commission) effectively deal when issuing statements, filing court briefs, and giving speeches. There should be little doubt that the agencies could protect company confidential information under this proposal, while still describing their competitive analyses. In order to ensure this information is protected, any public statement should be reviewed with the merging parties' counsel.

Editor's Note: Franchise and Dealership Termination

Several months ago, the Antitrust Law Section of the American Bar Association published The Franchise and Dealership Termination Handbook (2004). The Handbook identifies relevant legal issues and provides helpful strategies for protecting interests when dealing with franchise or dealership termination. In this way, the Handbook provides useful and timely information to antitrust practitioners, as well as to general commercial practitioners.

On June 3, 2004, two of the contributing authors to the Handbook, Matthew E. Moloshok and Deborah S. Coldwell, participated in a TeleSeminar sponsored by the Antitrust Section, entitled "Terminating Franchises and Dealerships Within the Bounds of the Law." Both authors have revised papers prepared for the TeleSeminar for publication in this issue of the Source.

—AMY A. STATHOS

Constraints Against Termination of Dealers and Franchisees

Matthew Moloshok

Relations between dealers and franchisees and suppliers and franchisors have long been a matter of interest to antitrust law.¹ How dealers get appointed, located, or terminated can have profound effects on the prices of goods and services as well as overall efficiency. When those effects result from or are enforced by horizontal arrangements, we are near the core of antitrust concerns,² even if the restraint is purely within a single brand.³ Short of resale price maintenance agreements, however,⁴ unilateral terminations by a supplier or franchisor⁵ have usually withstood antitrust scrutiny, on the basis that parties should be free to choose with whom they will deal.⁶ Standing and “antitrust injury” requirements also serve to impede antitrust challenges to terminations.⁷ For the most part, therefore, termination disputes, whatever their potential effects on prices and efficiency, get resolved under bodies of law other than antitrust law, and those bodies of law often restrict the suppliers or franchisors’ ability to terminate its dealer or franchisee.⁸

The Franchise and Dealership Termination Handbook released by the ABA Section of Antitrust Law in 2004⁹ provides a roadmap through the process of terminating distribution relationships. It addresses at length the many issues that can arise in connection with termination, including legal constraints against termination of franchise and dealerships. Those constraints derive from a variety of sources—contractual limitations, implied contractual obligations, equitable principles, and state and federal relationship statutes.

¹ See, e.g., *United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290, 323 (1897) (antitrust law exists to protect “small dealers and worthy men”); see also *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) (although antitrust law protects competition not competitors, “we cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned business”); *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 213 (1959) (the law will not tolerate a group boycott disadvantaging a discounter, “merely because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy.”)

² *Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 930 (7th Cir. 2000).

³ E.g., *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

⁴ *Business Elecs. Corp. v. Sharp Elecs., Inc.*, 485 U.S. 717 (1988); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

⁵ See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986) (citing *Monsanto v. Spray-Rite Service Corp.*, 465 U.S. 752, 764 (1984)).

⁶ *United States v. Colgate & Co.*, 250 U.S. 300 (1919). This principle is sometimes called the *Colgate* doctrine.

⁷ Joseph P. Bauer, *The Stealth Assault on Antitrust Enforcement: Raising the Barriers for Antitrust Injury and Standing*, 62 U. PITT. L. REV. 437 (2001).

⁸ *Bronx Auto Mall, Inc. v. Am. Honda Motor Co., Inc.*, 934 F. Supp. 596, 608 (S.D.N.Y. 1996), *aff’d per curiam*, 113 F.3d 329 (2d Cir. 1997).

⁹ ABA SECTION OF ANTITRUST LAW, *FRANCHISE AND DEALERSHIP TERMINATION HANDBOOK* (2004) [HANDBOOK].

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The wisdom of imposing noncontractual restraints must be left to others.¹⁰ Awareness of constraints on termination of distribution relationships is, however, critical to avoiding significant costs and liability. “More often than one might expect,”¹¹ parties ignore those constraints and suffer harsh consequences as a result.

Reasons the Parties Might Want to Part Ways

Before turning to the constraints, it should be recalled that franchise and dealership arrangements are commercial arrangements and, thus, largely creatures of contract. Parties choose with whom they will deal and the terms on which they will deal. As in any relationship, however, some arrangements work out better or are more durable than others. Not all parties meet their contractual obligations, perform as expected or desired, or meet even the most minimum reasonable standards of performance. A franchisor or supplier will be fed up with a lazy, incompetent, undercapitalized, or otherwise poorly performing franchisee or dealer; the same can be said of a franchisee or dealer having to deal with a lazy, incompetent, undercapitalized, or otherwise poorly performing supplier or franchisor.

The lore of franchise and dealership protection seems to turn on a model of a small, family business that is about to be shunted aside for arbitrary, inconsequential reasons.

Even if each side is meeting its contractual duties, there are many reasons why parties would be better off ending a relationship. What is mutually desirable and profitable today may not be workable a year from now (to say nothing of five, ten, or twenty years from now). It may often be efficient or desirable for a supplier and its dealers (individually or collectively) or a franchisor and its franchisees (individually or collectively) to part ways. Each side might naturally and reasonably seek as much flexibility as it can to adapt to changes in technology (such as the advent of the World Wide Web) or to be able to end the existing relationship and take up with a more efficient or better financed business partner even if the existing partner has fully met its contractual obligations. The *Colgate* doctrine certainly suggests a “hands off” approach so as not to second-guess these kinds of business decisions, which could also impede business adaptability. It is precisely because it is so difficult to predict the kinds of circumstances in which change might be desired that suppliers and franchisors might prefer to provide that they could terminate for any reason or no reason.

Nevertheless, it would be naïve to think that all terminations are high-minded, efficient, or appropriate. There are the anecdotal reports that Dealer A gets replaced by Dealer B because Dealer B paid a kickback to the supplier’s agent or Dealer B is a relative of the supplier. There are the occasions when the supplier, having ridden the back of the dealer, now wants to “eliminate the middleman” and appropriate the dealer’s good will. (Going the other way, there are the franchisees who want to misappropriate trade secret information or are simply opportunistic.) There are equitable considerations when one side sinks large amounts into performance only to have the other side destroy that investment by unexpectedly ending the relationship.

Overall, then, Congress, state legislatures, and courts have chosen to fashion protections against termination for certain groups of franchisees and dealers. Where and how, however, should lines be drawn? The lore of franchise and dealership protection seems to turn on a model

¹⁰ See FRANCHISE PROTECTION: LAWS AGAINST TERMINATION AND ESTABLISHMENT OF ADDITIONAL FRANCHISES, ABA SECTION OF ANTITRUST LAW MONOGRAPH No. 17 (1990); Thomas J. Collin, *State Franchise Laws and the Small Business Franchise Act of 1999: Barriers to Efficient Distribution*, 55 BUS. LAW. 1699 (2000).

¹¹ HANDBOOK, *supra* note 9, at 35, 58–59; REPORT [TO CONGRESS] OF THE AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW ON PROPOSED SMALL BUSINESS FRANCHISE ACT, (1999), available at <http://www.abanet.org/antitrust/comments/1999/final.doc>.

of a small, family business that is about to be shunted aside for arbitrary, inconsequential reasons. Whether that model works when some distributors (think, as examples, of Wal-Mart, or even Toys “R” Us) are bigger or more powerful than their suppliers seems questionable. Yet many small, family-owned enterprises that invest their life-savings into their businesses still remain and, rationally, want protection against arbitrary or bad faith terminations. Even when a termination is “efficient,” it does not mean that it should take place without fair recompense for whatever loss, cost, or disruption it may cause to a franchisor or dealer who had invested relationship-specific costs in reliance on a long-term relationship.

Terminations and Inadvertent Terminations

If one party (say the supplier) decides to part ways, you might expect it will make a forthright statement to its dealer, “I’m ending the relationship effective today,” or after a period of notice. Not all terminations, however, are that straightforward. The supplier might engage in a creeping, silent withdrawal from or undermining of the relationship.¹² The supplier might inadvertently make profitability too difficult for the dealer by appointing what the dealer asserts is an encroaching dealer and thereby constructively terminate the relationship.¹³ Withdrawals of one line of products among several the supplier was furnishing could be deemed a constructive termination as well.¹⁴

Non-renewal of relationships is even more complex. State and federal statutes protecting franchises or certain dealerships, discussed below, equate termination and the failure to renew a relationship at the end of its contractual term. Franchisors’ and suppliers’ actions can potentially be considered a failure to renew if renewal is conditioned upon impermissible changes in terms of the relationship.¹⁵ (What constitutes “termination” does not involve antitrust issues specifically. Antitrust policy may be concerned, however, if parties are forced to remain in inefficient arrangements. And if we assume, in the long run, parties’ contracts will produce the optimum efficiency, antitrust policy would view “surprise” restrictions skeptically.)

What Limits Terminations and Non-Renewals?

The common law of contracts and the *Colgate* doctrine of antitrust law teach that parties are free to determine with whom they will do business. Included is the ability to walk away from an existing business relationship without cause, and even without prior notice, unless the contract says otherwise. Whatever the *laissez-faire* appeal of these principles, however, they have limited application.

Contractual Limits. As a practical matter, distribution relationships often require large investments by dealers and franchisees—sometimes large in absolute terms, and almost certainly very large as a percentage of the dealer’s or franchisee’s net worth. To encourage those investments, the parties usually reach an express agreement that requires, at a minimum, some period of notice

¹² See, e.g., *Sons of Thunder v. Borden*, 148 N.J. 396, 690 A.2d 575 (1997); *R.J. Gaydos Ins. Agency v. Nat’l Consumer Ins. Co.*, 168 N.J. 255, 773 A.2d 1132 (2001).

¹³ See, e.g., *Petereit v. S.B. Thomas, Inc.*, 63 F.2d 1169 (2d Cir. 1995).

¹⁴ *Compare Central GMC, Inc. v. General Motors Corp.*, 946 F.2d 327 (4th Cir. 1991) (product line withdrawal authorized by contract did not terminate a “franchise” under statute), with *Arthur Glick Truck Sales, Inc. v. General Motors Corp.*, 865 F.2d 494 (2d Cir. 1989) (“heavy duty truck” line could be separate “franchise” for purposes of statute even though only one of several truck lines provided under dealer’s contract).

¹⁵ HANDBOOK, *supra* note 9, at 12–14.

prior to termination. Where huge absolute investments, such as those found with automobile dealerships, exist or where the contract requires development of a new territory, the contracts may be of many years' duration. Some contracts may even require mediation or arbitration before a termination can take effect, requiring the parties to work together while the arbitration process is underway in order to avoid injury to the investment.¹⁶

Often, a contract will require that the supplier have specified "cause" to end the relationship before its stated term expires. Frequent "cause" grounds for termination include any failure to make payments that are due, failures to meet operating standards, and other uncured breaches of the contract, violations of law, or various types of fraud or misleading business practices.¹⁷ The definition of "cause" itself may require a period of notice and opportunity to cure before "cause" even comes into existence. As a result, some courts even hold that dealers who mislabel products be afforded notice and opportunity to cure because the contract provision was intended to give the dealer the chance to clean up his act.¹⁸ Similarly, a dealer who starts to cure will sometimes receive protection against termination until the cure can be completed.¹⁹

An "implied covenant of good faith and fair dealing," applicable to contracts, prevents termination that denies the other side the reasonably anticipated fruits of the distribution agreement.

Equitable Principles and Implied Obligations. Even if a contract allows termination, implied obligations and equitable principles may impose further restraints. It has occasionally been held that, as a matter of equity, dealers cannot be subject to termination (absent cause) until they have had a reasonable and adequate opportunity to recoup their investment or if the supplier had so much power in the transaction as to make the exercise of termination "unconscionable."²⁰ An "implied covenant of good faith and fair dealing," applicable to contracts, prevents termination that denies the other side the reasonably anticipated fruits of the distribution agreement. Courts divide over whether the implied duty "trumps" express provisions of the contract.²¹

Statutes. Another set of constraints is statutory: forty-eight states have statutes barring termination of or failure to renew a motor vehicle dealer absent "good cause" criteria established by the statute.²² Usually, a showing of "good cause" requires proof that the dealer materially breached a reasonable term of the contract and the breach remains uncured after an adequate period of notice and chance to cure, or that the dealer is guilty of a crime or a fraud. Some states specifically authorize terminations incident to a complete, nondiscriminatory market withdrawal or for other approved business reasons. Also, states sometimes have statutes similar to the motor vehicle dealer laws to protect dealers in specific industries—commonly beer and wine wholesalers, and farm or heavy equipment dealers.²³

¹⁶ Long duration contracts may be traps for unwary franchisees, especially in the hotel industry. Franchisees developing hotels may have 15 year contracts—yet will face liquidated damages if there is a premature termination.

¹⁷ Sometimes courts have refused to accept contractual definitions of default: a court refused to enforce a dealership agreement that made it an event of default for dealers to have "below average" sales; applied literally, at all times, half of the distribution network would be in default and subject to termination and the standard gave no consideration to individual competitive circumstances. *Marquis v. Chrysler Corp.*, 577 F.2d 624 (9th Cir. 1978).

¹⁸ *See, e.g., Lippo v. Mobil Oil Corp.*, 776 F.2d 706 (7th Cir. 1985) (majority holds notice and opportunity to cure misbranding required; Posner, J., in dissent, asserts that misbranding is an incurable breach).

¹⁹ *H.C. Blackwell Co., Inc. v. Kenworth Truck Co.*, 620 F.2d 104 (5th Cir. 1980).

²⁰ HANDBOOK, *supra* note 9, at 39–41.

²¹ *See* cases cited *id.* at 15 n.15 and accompanying text.

²² *Id.* App. C.

²³ *Id.* App. B.

On top of these, two federal statutes are noteworthy. The Petroleum Marketing Practices Act prohibits terminations or non-renewals of petroleum distributors unless (1) it is mutual and voluntary, (2) the franchisee violated a “reasonable provision of the franchise agreement” that is “material” or does not “exert good faith efforts,” or (3) an event “makes termination reasonable.”²⁴ (Those events are dealer dishonesty or events outside the control of either party.) The Automobile Dealers Day in Court Act²⁵ requires a manufacturer to act in “good faith” when performing, terminating, or renewing a motor vehicle franchise. In practice, this bars “intimidation” or “coercion” by the manufacturer and, thus, has proven of limited help when manufacturers terminate or decide not to renew.²⁶

Last, but certainly not least, roughly twenty states have “franchise protection” or “relationship” laws that provide “good cause” or similar protections to all “franchises” or business relationships that have certain statutorily defined characteristics.²⁷ This requires that the parties ascertain early in the process whether the termination could involve a protected “franchise” or “relationship” under the statutory definition. Even if the parties disclaim that the relationship is a “franchise,” it could nonetheless be considered a “franchise” under the statute.²⁸

In the interests of simplicity, statutory definitions of protected “franchises” usually follow one of two models. “Marketing plan” statutes, found in California, Connecticut, Illinois, Indiana, Iowa, Virginia, and Washington define a protected franchise as involving, in essence, three elements: (1) the franchisee pays a franchise fee, either directly or indirectly through its purchase obligations; (2) the franchisee operates under the franchisor’s trademark or service mark; and (3) the franchisee is required to follow a marketing plan prescribed by the franchisor.²⁹ The other major type, found in Missouri, Nebraska, New Jersey, and Wisconsin, is a “community of interest” statute. These usually involve two main elements: (1) the dealer has to actually derive, or be intended to derive, a substantial portion of its sales under the trademark of the supplier or franchisor and (2) the dealer and the supplier will have a “community of interest.”³⁰ A “community of interest” usually arises when the franchisee makes franchise-specific investments or is otherwise highly dependent on the franchisor.³¹ Thus, “marketing plan” definitions cover what everyone usually thinks of as a franchise, while “community of interest” definitions capture a range of relationships and can create, in effect, “inadvertent” franchise relationships.³² Much of the litigation under the relationship statutes turns on fact-and-circumstances inquiries as to whether the statutory criteria have been met.³³

²⁴ 15 U.S.C. §§ 2801–2806.

²⁵ 15 U.S.C. §§ 1221–1226.

²⁶ HANDBOOK, *supra* note 9, at 47–48.

²⁷ *Id.* at 49ff and App. A.

²⁸ *See, e.g.*, *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 177 (D. Conn. 2002).

²⁹ HANDBOOK, *supra* note 9, at 49.

³⁰ *Id.*

³¹ *See, e.g.*, *Cooper Distrib. Co. v. Amana Refrigeration, Inc.*, 63 F.3d 262 (3d Cir. 1995); *Instructional Sys. Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 328, 614 A.2d 124 (1992).

³² *See, e.g.*, as a cautionary tale, *Gentis v. Safeguard Business Systems, Inc.*, 60 Cal. App.4th 1294, 71 Cal. Rptr. 2d 122 (1998).

³³ *See* HANDBOOK, *supra* note 9, at 51–52.

Adjunct Claims

Collateral or adjunct claims, including claims of various types of antitrust violations, often are critical to how the parties resolve their relationship. Such claims may provide grounds to defend against termination or create a risk of large damages unless the parties can settle.³⁴ In addition, it is often true that these claims would have lain dormant but for the provocation of, or the need to respond to, a termination.

Some adjunct claims one might expect to encounter include:

- Allegations that the dealer was terminated because it would not go along with a price-fixing or resale price maintenance scheme in violation of Section 1 of the Sherman Act;³⁵
- Allegations that the dealer was terminated as the result of a group boycott;³⁶
- Allegations that the dealer was terminated as the result of the effects of price discrimination or as the result of complaining about discriminatory pricing in violation of the Robinson-Patman Act;³⁷
- Allegations that the dealer was terminated because it would not pay kickbacks to the supplier or allegations that the termination came about at the behest of its competitor who paid such kickbacks;³⁸
- Allegations that a franchisee was misled into investing in the first place by the franchisor's misrepresentations;³⁹
- Allegations that a franchisor failed to support the franchise system, or even undermined it for its own benefit;⁴⁰
- Allegations that a supplier priced the products it required its dealers to purchase at levels it knew would preclude the dealers' profitable operations;⁴¹
- Allegations that the supplier impermissibly tied the opportunity to purchase certain desired products to a requirement to purchase unwanted products (again in violation of antitrust law).⁴²

Consequences of Termination in Violation of the Constraints

A supplier's attempt to end franchises or protected relationships without establishing requisite "good cause" and satisfying whatever notice and cure requirements are found in the statutes can

³⁴ Thus, the fact that a party could have terminated or exercised a right consistently with the contract will not protect it from antitrust liability if it exercised the right in furtherance of an anticompetitive purpose. *See Poller v. CBS*, 368 U.S. 464 (1962); *Lee-Moore Oil Co. v. Union Oil Co.*, 599 F.2d 1299 (4th Cir. 1979).

³⁵ *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 765 (1984); *McCabe's Furniture v. La-Z-Boy Chair Co.*, 798 F.2d 323 (1986); HANDBOOK, *supra* note 9, at 156–62.

³⁶ *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Rossi v. Standard Roofing, Inc.*, 156 F.3d 452 (3d Cir. 1998); HANDBOOK, *supra* note 9, at 166–70.

³⁷ *George Haug Co. v. Rolls-Royce Motor Cars Inc.*, 148 F.3d 136 (2d Cir. 1998); *Stelwagon Mfg. Inc. v. Tarmac Roofing Sys., Inc.*, 63 F.3d 1267 (3d Cir. 1995).

³⁸ *Cf. United States v. Joselyn*, 206 F.3d 1444 (1st Cir. 2000) (widespread kickback scheme as condition of allocations of vehicles).

³⁹ HANDBOOK, *supra* note 9, at 132–37.

⁴⁰ *E.g., Sherman v. Master Protection Corp.*, 2002 WL 318-54905 (Cal. Ct. App. Dec. 18, 2002).

⁴¹ *Wilson v. Amerada Hess Corp.*, 168 N.J. 236, 773 A.2d 1121 (2001).

⁴² *Eastman Kodak Co. v. Image Technical Servs. Inc.*, 504 U.S. 451 (1992). *Compare Queen City Pizza Inc. v. Domino's Pizza Inc.*, 124 F.3d 430 (3d Cir. 1997) (required purchases did not create an impermissible tie-in), *with Collins v. Int'l Dairy Queen*, 939 F. Supp. 875 (M.D. Ga. 1996) (required purchases were an impermissible tie-in). *See generally* HANDBOOK, *supra* note 9, at 170–75.

Even if a contract is terminable at will, failure to give notice may preclude termination altogether or, worse, constitute a material breach of the agreement by the terminating party.

buy big trouble for franchisors and suppliers. To start, even if a contract is terminable at will, failure to give notice may preclude termination altogether or, worse, constitute a material breach of the agreement by the terminating party. Then, too, there can be steep costs associated with litigation—including extensive discovery, expert witnesses, motion practice, and possible trial—or arbitration.⁴³ Moreover, statutes often provide fee-shifting to the franchisor or supplier, vastly increasing the costs. Some statutes provide liberalized availability for preliminary injunctions, provide multiple damages or civil penalties, or impose requirements that the franchisor repurchase inventory, supplies, or special equipment. There are even five states whose statutes make willful violation of the relationship laws a crime.

Terminations in furtherance of antitrust violations will incur treble damages and/or injunctive relief⁴⁴ and conceivably could result in criminal liability.

Negotiating the Termination Process

Termination is a process, which, in some unfortunate circumstances, lasts longer than the parties' actual business relationship. It is a process in which negotiation and the leverage each side brings to bear (whether at the bargaining table or in the courtroom) may be more important than the niceties of whether there was sufficient notice or sufficient cause.

Parties considering whether to terminate or how to respond to a threat of termination need to think of many issues, including:

- Who are the parties? Would termination destroy a family business? Has the dealer made large, recent investments?
- What is the parties' relationship? Is it a franchise or something else?
- What governs the relationship? Is it just the contract or will a statute or implied obligation have to be considered?
- What is the basis to end the relationship—and will it be deemed adequate under the contract, the implied obligations, and any applicable statute?
- What notice and opportunity for cure was required and has it been given?
- What can (or should) be done to preserve the relationship?
- What adjunct claims or counterattacks are likely to be mounted?
- Watch out—is there a release, waiver, statute of limitations, or estoppel defense that will have an effect on either the ability to terminate or the ability to pursue adjunct claims?

Conclusion

Do the many constraints on termination level the distribution playing field or tilt the field in favor of the dealers and franchisees in their relations with suppliers and franchisors? From an antitrust perspective, these constraints in the aggregate could be viewed as a desirable encouragement to investment by the dealers and franchisees who are the flesh and blood of real competition in real markets or as an undesirable barrier that entrenches incumbents and invites inefficiency.

Congress, as much as state legislatures and common-law courts, have chosen to protect automobile dealers (through the Automobile Dealers Day in Court Act), petroleum dealers (through the

⁴³ Many agreements require arbitration instead, but arbitration is not necessarily less expensive. Also, automobile dealers are beneficiaries of a relatively new federal amendment to the Dealers Day in Court Act that allows many, perhaps most, automobile dealers to opt out of arbitration. 15 U.S.C. § 1226.

⁴⁴ See, e.g., *Monsanto*, 452 U.S. 752 (1984); *Toys "R" Us*, 221 F.3d 928 (7th Cir. 2000).

Petroleum Marketing Practices Act), and small dealers (generally, through the Robinson-Patman Act) from impositions by automakers, oil companies, and chain stores, respectively. This may indicate a belief that such protections are consistent with (or at least deserve to be reconciled with and balanced against) the efficiency concerns of antitrust law. Under all circumstances, do not forget the many constraints against termination and failure to renew franchise and dealership arrangements and the significant adverse consequences that can flow from ignoring those constraints. ●

Issues to Consider in Bringing or Defending Franchise and Dealer Termination Litigation

Deborah S. Coldwell

Why should the antitrust lawyer be concerned with franchise and dealer termination issues at all? There are at least two reasons: one, historical, and the other, practical.

Historically, as one New York district court stated, “At one time, the battle between franchisors and franchisees was waged primarily in the antitrust arena.”¹ In the late 1960s, before the existence of relationship or disclosure laws, franchisees used the courts to seek shelter from those franchise practices they believed to be harmful. In addition to common law remedies, franchisees and dealers often sought protection by using antitrust laws.² Aggrieved dealers or franchisees sometimes claimed that a combination of manufacturers, distributors, and others conspired to sell to dealers at discriminatory prices, driving the aggrieved dealers out of the open competitive market.³ Arguments were later made that certain franchisor/franchisee or dealer/supplier relationships were anticompetitive because the right to use the franchisor’s or dealer’s trade name and service marks was tied to purchasing sanctioned supplies from suggested vendors.⁴

With the evolution of legislation and statutes designed both to protect franchisees and dealers from “unholy” actions by franchisors and suppliers and franchise systems from renegade franchisees and dealers, however, the battlefield and rules of combat changed. Nonetheless, it was from this historical wellspring that the attempt to reconcile competing policies (protection of franchisees’ rights v. the franchisor’s freedom to contract) appears to have evolved.⁵

Practically, it is still crucial for the franchise or dealer litigator to have an antitrust lawyer “in the wings” to help figure out those thorny cases that primarily involve antitrust claims or that at least involve some type of antitrust analysis on discrete claims. For example, in the past few years, we have seen cases in which dealers have brought a class action alleging misuse of market power to control the product allocation process, allegedly to coerce dealers into purchasing unwanted products, requiring a tying analysis.⁶ We have also seen an alleged price-fixing case involving claims by cigarette wholesalers against several manufacturers, alleging that the manufacturers conspired to fix cigarette prices at unnaturally high levels in violation of the Sherman Act and the Clayton Act.⁷ And the Robinson-Patman Act remains alive and well in dealership and franchise

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¹ Bronx Auto Mall, Inc. v. Am. Honda Motor Co., 934 F. Supp. 596, 608 (S.D.N.Y. 1996), *aff’d per curiam*, 113 F.3d 329 (2d Cir. 1997) (citing Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) and United States v. General Motors Corp., 384 U.S. 127 (1966)); ABA SECTION OF ANTITRUST LAW, THE FRANCHISE AND DEALERSHIP TERMINATION HANDBOOK 2–3 (2004) [HANDBOOK].

² *Id.*

³ See, e.g., Klor’s Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); HANDBOOK, *supra* note 1, at 2–3.

⁴ *Id.*

⁵ *Id.*

⁶ George Lussier Enter., Inc., v. Subaru of New England, Inc., 286 F. Supp. 2d (D.N.H. 2003).

⁷ Williamson Oil Co. v. Philip Morris USA, 346 F.3d 1287 (11th Cir. 2003).

litigation.⁸ Thus, while it is important for the franchise litigator to understand when antitrust issues arise, it is equally important for the antitrust litigator to have an understanding of franchise and dealer issues in order to assist when the need arises, as the antitrust claims never seem to appear in a vacuum.

This article briefly addresses some of the main practical issues to consider in prosecuting or defending against franchise and dealer litigation, including: making sure the termination is proper; the benefits of choice-of-forum clauses and choice-of-law provisions; the reach of anti-waiver statutes; and the remedies available.

Make Sure Termination Is Proper

Has the franchisee or dealer been properly terminated? An initial consideration in most franchise and dealer disputes, from both the plaintiff and defendant perspective, is whether the termination of the franchisor-franchisee or supplier-dealer relationship was proper. While termination is typically governed by the franchise or dealership agreement, it is important to remember that many states have general franchise and relationship laws, and many of those contain specific requirements for termination. A chart highlighting states that have franchise relationship laws and where termination may be governed by statute and not the franchise agreement is attached as Appendix A. Key provisions of general franchise laws, and the requirements for termination under these laws and under various dealership statutes, are included in *The Franchise and Dealership Termination Handbook*.⁹ It is imperative for the litigant and attorney to review these basics at the outset of any franchise or dealer termination litigation.

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Enforceability of Forum-Selection Clauses

Can the franchisor enforce its forum-selection clause? Can the franchisee get around it? While the Supreme Court has clearly embraced forum-selection clauses, it is difficult today to predict whether a court will enforce a particular forum-selection clause. In *M/S Bremen v. Zapata Off-Shore Co.*,¹⁰ the Supreme Court stated that forum-selection clauses are valid and enforceable absent any fraud, undue influence, or uneven bargaining power.¹¹ After *Bremen* was decided, the Supreme Court appeared to take a small step back from the enforcement of forum-selection clauses in *Stewart Organization Inc. v. Ricoh Corp.*¹² In *Stewart*, the Supreme Court stated that a forum-selection clause is only one factor to consider in deciding whether to grant a 28 U.S.C. § 1404(a) transfer, which allows a district court to transfer any civil action to another district or division where it might have been brought, based on the convenience of parties and witnesses, and in the interest of justice.¹³ The Court stated that district courts must also consider the bargaining power of the parties, forum convenience, and fairness of transfer.¹⁴

⁸ *Cleveland v. Viacom, Inc.*, No. 02-50811, 2003 WL 22014776 (5th Cir. Aug. 25, 2003); *Mikeron, Inc. v. Exxon Co., U.S.A.*, 264 F. Supp. 2d 268 (D. Md. 2003); *Maddaloni Jewelers, Inc. v. Rolex Watch U.S.A., Inc.*, No. 02 Civ. 6438 SAS, 2003 WL 21507529 (S.D.N.Y. June 30, 2003).

⁹ HANDBOOK, *supra* note 1, at Appendix F.

¹⁰ 407 U.S. 1 (1972).

¹¹ *Id.* at 13–14.

¹² 487 U.S. 22 (1988).

¹³ *Id.* at 23.

¹⁴ *Id.*

In *Schwartz v. Colorall Technologies, Inc.*, a California court held that a forum-selection clause was invalid for lack of mutual assent.¹⁵ The court reasoned that the clause was clearly invalid under the California Franchise Relations Act and, therefore, the franchisee had no reasonable expectation that it had agreed to a forum other than California. The court added that just because the forum-selection clause was invalid did not mean that the arbitration and mediation clauses were likewise unenforceable. Thus, arbitration and mediation clauses might be a means for franchisors to designate a forum.

Although there are a number of states that have not enacted anti-waiver provisions, it is still uncertain in those states as to whether a court will enforce a contractual forum-selection clause. A prime example is the New Jersey Supreme Court's decision in *Kubis N. Perszyk Associates, Inc. v. Sun Micro Systems, Inc.*¹⁶ The contract contained both a choice of forum and choice-of-law provision as follows: "Any action related to this agreement will be governed by California law, excluding choice-of-law rules, and will be brought exclusively in the United States District Court for Northern California or the California Superior Court of the County of Santa Clara." In *Kubis*, the New Jersey Supreme Court refused to enforce the forum-selection clause even in the absence of a state anti-waiver statute because the court reasoned that the forum-selection clause was contrary to public policy.

A state supreme court in *In re GNC Franchising* refused to enforce a forum-selection clause in a franchise agreement by denying a franchisor's petition for writ of mandamus.¹⁷ The court rejected the franchisor's argument that forum-selection clauses were beneficial to both franchisor and franchisee because it allowed them to make more intelligent and informed litigation decisions. Recently, however, in an insurance coverage dispute, the same state supreme court held that subjecting a party to trial in a forum other than that agreed upon in the forum-selection clause in the contract between the parties "is clear harassment."¹⁸

In sum, enforcement of forum-selection clauses remains a largely unpredictable area of the law. As such, other alternatives, such as arbitration clauses, should be considered.

Choice of Law—The Franchisor's Home State

Who gains from a choice-of-law provision? Franchisors typically prefer choice-of-law provisions because franchisors normally deal with franchisees located throughout the country. It sometimes works to a franchisee's benefit, however, to use the law chosen by the franchisor because it may be more beneficial than the law of the jurisdiction in which the franchisee resides. Further, many states have attempted to level the playing field between franchisors and franchisees through legislation. Consequently, courts may be faced with a dilemma when deciding whether to enforce the terms of the agreement to which the franchisee purportedly agreed or whether to grant the protection that legislators intended to extend to franchisees.

In resolving the dilemma of which state's laws should govern, courts have relied heavily upon the *Restatement (Second) of Conflict of Laws* § 187 (2003) for guidance. Pursuant to Section 187(1), a choice-of-law provision will be enforced "if the particular issue is one which the parties could have resolved by the explicit provision in their agreement directed to that issue." Cases typ-

¹⁵ Bus. Franchise Guide (CCH) ¶ 12,609 (D.C. Cal. Feb. 22, 2000).

¹⁶ 680 A.2d 618 (N.J. 1996).

¹⁷ 22 S.W.3d 929 (Tex. 2000).

¹⁸ *In re Allstate Ins. Co.*, 148 S.W.3d 109 (Tex. 2004).

ically are not resolved on these grounds, however, because the parties lack the contractual capacity to avoid the applicability of the protective provisions of the franchisee's state law.

When the issue is not one the parties could have resolved by the explicit provisions in their agreement,¹⁹ the choice-of-law provision will nonetheless be enforced under Section 187(2) unless, (1) "the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice," or (2) "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state" or that state has the most significant relationship.²⁰ In other words, Section 187(2) provides that choice-of-law provisions should be enforced when the chosen state has a substantial relationship to the parties; there is an absence of misrepresentation, duress, undue influence, or mistake; and the chosen state's law is not contrary to the fundamental policy of the franchisee's state.

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Section 187(2) attempts to give parties wide discretion in shaping the terms of their contracts.²¹ For example, under Virginia law, using a test that is fairly typical in most states, choice-of-law provisions of an agreement are enforced where (1) the choice-of-law provision was not obtained by unfair means; (2) the state law selected has a reasonable relation to the contract or the parties have a reasonable basis for choosing a particular state's law; and (3) the law of the state chosen is not contrary to the public policy of the state whose law would otherwise govern.²²

In *Brenco Enterprises, Inc. v. Takeout Taxi Franchising Systems, Inc.*,²³ the choice-of-law provision in the franchise agreement assisted the franchisor in convincing the court to dismiss many of the franchisees' claims. The particular dispute involved claims by several franchisees against the franchisor brought in Virginia state court. The franchise agreements had a Virginia choice-of-law clause. The franchisees asserted that the franchisor had violated the North Carolina, Tennessee, and California deceptive trade practices acts and the California franchise statutes, among other claims.

While the franchisees asserted that the choice of Virginia law applied only to the construction and interpretation of the franchise agreements, the court disagreed. The court found that the function of a choice-of-law provision was to provide the parties with a degree of certainty as to the respective rights and duties that they were creating by the agreement. The existence and scope of these rights and obligations, however, were matters determined through the "interpretation and construction" of the contents of the agreement. The agreements at issue provided that they were the entire agreement between the parties, indicating an exclusion of other rights and obligations beyond the four corners of the agreement. Further, they also referenced the laws of Virginia and the United States Trademark Act, while pointedly omitting any reference to the laws of any other jurisdiction as establishing other obligations or rights. For these reasons, and others, the court found the agreements specifically excluded any action based exclusively upon breaches or torts under laws in foreign jurisdictions, and the court sustained the demurrers as to those claims asserted under the laws of states other than Virginia.

¹⁹ "Examples of such questions are those involving capacity, formalities and substantial validity." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. d (2003).

²⁰ See *LaGuardia Assocs. v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119, 128 (E.D.N.Y. 2000); *America's Favorite Chicken Co. v. Cajun Enters., Inc.*, 130 F.3d 180, 182 (5th Cir. 1997).

²¹ See RESTATEMENT, *supra* note 19, at § 187, cmt. e.

²² No. 177164, 2003 WL 21659422 (Va. Cir. Ct. May 23, 2003) (the author was one of the counsel of record in this case.)

²³ *Id.*

While most states have adopted provisions similar to the *Restatement's* significant relationship test, application of the test has proven to be less than predictable. Some courts have found that, even in the presence of an anti-waiver provision, parties may still contract around that state's substantive law via a choice-of-law provision in the contract.²⁴ Other courts have held that choice-of-law provisions are unenforceable because they are contrary to fundamental public policy when they attempt to opt out of a state's law when that state has specifically enacted anti-waiver provisions.²⁵

Franchisees sometimes attempt to avoid the choice-of-law provision by alleging a misrepresentation, mistake, or fraud in the execution of the franchise agreement. If fraud or misrepresentation is found by a court, then the choice-of-law provision is unenforceable.²⁶

While difficult to accomplish, the ability to designate which state's law will apply in the event of a dispute can be very significant.

Anti-Waiver Provisions for Forum-Selection Clauses and Choice-of-law Clauses

A discussion of forum-selection clauses and choice-of-law clauses must necessarily include a look at anti-waiver provisions.

Forum-Selection Clauses. A line of lower court opinions and state legislation has upended the enforceability of many forum-selection clauses. In particular, a number of states have enacted legislation prohibiting the enforcement of forum-selection clauses.²⁷ California's anti-waiver statute is extremely broad. It not only allows franchisees to file suit in California for all claims under California franchise law, but it allows them to file suit in California even when the claims complained of are not covered by California law.²⁸ Thus, claims under state franchise law can be brought in California, as can any claims brought by a California franchisee.²⁹

The Ninth Circuit invalidated a forum-selection clause in a franchise agreement. In *Jones v. GNC Franchising, Inc.*,³⁰ the choice of forum provision selected Pennsylvania; the franchisee, however, filed suit in California. The franchisor filed a motion to dismiss or transfer venue. The

²⁴ *Tele-Save Merch. Co. v. Consumers Distrib. Co.*, 814 F.2d 1120, 1123 (6th Cir. 1987) (it was not enough that the state's statute had a policy to protect franchisee; central inquiry is whether the choice of law "caused a substantial erosion of the quality of protection" the statute would have otherwise provided); *Modern Computer Sys.*, 871 F.2d 734, 735 (8th Cir. 1989) (overruled by statute for all agreements entered into after 1989). *See also* *Cottman Transmission Sys., Inc. v. Melody*, 869 F. Supp. 1180, 1186 (E.D. Pa. 1994) (enforcement of choice-of-law provision would result in no erosion of the quality of protection offered under the state law of the franchisee's state).

²⁵ *See, e.g.*, *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 129 (7th Cir. 1990) (only connection to provisions of law was that it was franchisor's state of incorporation). Some jurisdictions have seemingly taken contradictory positions. Note that both the Sixth and Eighth Circuits have waffled on decisions regarding choice of law. The Sixth Circuit has stated that the state's franchise law at issue did represent a fundamental policy, but it still enforced the choice-of-law provision under the rationale that the application of the provision did not substantially erode the protections under that state's law. *Banek Inc. v. Yogurt Ventures U.S.A., Inc.*, 6 F.3d 357 (6th Cir. 1993).

²⁶ RESTATEMENT, *supra* note 19, § 187.

²⁷ *See* CAL. BUS. & PROF. CODE § 20040.5 (West 2004) ("A provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state."); IND. CODE ANN. § 24-5-8-8 (West 2004) ("Any waiver by an investor of the provisions of this chapter [business opportunity transactions] is deemed contrary to public policy and is void and unenforceable."); IOWA CODE § 523H.3(1) (West 2003) (suit may be brought wherever jurisdiction of the parties in the subject matter exists despite a provision in the agreement limiting the forum).

²⁸ *See* CAL. BUS. & PROF. CODE § 20040.5 (West 2004).

²⁹ *See id.*

³⁰ 211 F.3d 495 (9th Cir. 2000).

court held that the forum-selection clause was contrary to California's fundamental policy illustrated in the California statute, which voids all choice of forum provisions selecting a forum other than California.³¹

Michigan has enacted a provision that invalidates a forum-selection clause in any franchise agreement which requires litigation or arbitration in any other state.³² Similarly, under the Wisconsin Fair Dealership law, a franchisee may bring a cause of action for violation of the statute in any competent jurisdiction.³³ Such provisions are also per se invalid in North Carolina under a general statute that invalidates all contractual provisions, whether in franchise agreements or otherwise, which require that disputes be litigated or arbitrated outside North Carolina.³⁴ While the Illinois Franchise Disclosure Act invalidates any provision that requires litigation outside Illinois, contractual provisions that require arbitration outside of Illinois are valid and enforceable.³⁵

Choice of Law. Many states have enacted anti-waiver provisions that prevent franchisors from escaping the applicability of the franchise laws of the franchisee's home state.³⁶ Many of these states take a paternalistic approach, in that the statutes void all contractual choice-of-law provisions even where there is no overreaching. Most of these states justify the anti-waiver provisions by emphasizing that negotiations for business opportunities are often marked by unequal bargaining power between the franchisor and franchisee.

Remedies

What remedies are available in franchise and dealer litigation? Remedies available for common franchise-related and dealer-related claims are typical—breach of contract remedies, fraud and misrepresentation remedies, statutory remedies, and certain equitable remedies.³⁷ Contract remedies include expectation damages, reliance damages, and restitution.³⁸ Fraud and misrepresentation damages include benefit of the bargain ("lost profits") type damages, rescission remedies, and damages that intend to restore the status quo ("out-of-pocket damages").³⁹ The most unique remedies sought in franchise disputes, however, are Lanham Act damages for trademark infringement claims and liquidated damages for breach of contract claims, particularly in hotel litigation.

³¹ See CAL. BUS. & PROF. CODE § 20040.5 (West 2004).

³² MICH. COMP. LAWS § 445.1527(f) (West 2004).

³³ WIS. STAT. ANN. § 135.06 (West 2003).

³⁴ N.C. GEN. STAT. § 22B-3 (2003).

³⁵ 815 ILL. COMP. STAT. 705/4 (West 2004); see also IND. CODE ANN. § 23-2-2.7-1(5) (2000).

³⁶ See, e.g., ARK. CODE ANN. § 4-72-206(1) (Michie 2003); CAL. BUS. & PROF. CODE § 20040.5 (West 2004); 815 ILL. COMP. STAT. § 705/4 (West 2000); IND. CODE ANN. § 23-2-2.7-1(5) (West 2004); IOWA CODE § 523H.3 (West 2003); MICH. STAT. ANN. § 19.854(27)(b) (1999); MINN. STAT. § 80C.21 (West 2004); NEB. REV. STAT. § 87-406(1) (Michie 2003); N.H. REV. STAT. ANN. § 358-E:1-6 (2003); S.D. CODIFIED LAWS § 37-25A-54 (Michie 2003).

³⁷ Troy S. Bader, Deborah S. Coldwell & Patrick J. Carter, *Remedies: Damages, Injunctive Relief and Rescission*, ABA 22nd Annual Forum on Franchising (Oct. 13–16, 1999); Ellen Lokker & Joseph Schumacher, *The Ultimate Issue: Judicial Remedies*, ABA 20th Annual Forum on Franchising (Oct. 22–24, 1997).

³⁸ *Id.*

³⁹ *Id.*

Damages Under the Lanham Act

Under the Lanham Act, a plaintiff who prevails on a claim of trademark infringement is entitled, subject to the principles of equity, to recover, (1) defendant's profits; (2) any damages sustained by the plaintiff; and (3) the costs of the action.⁴⁰ These remedies are nonexclusive, and a plaintiff may recover all three simultaneously. A plaintiff cannot recover punitive damages, however. Instead, the court may enter judgment for any sum above the amount found as actual damages, not exceeding three times such amount.⁴¹ Additionally, if the court finds that the amount of recovery based on profits is either inadequate or excessive, the court may enter judgment for a sum the court deems just.⁴² Also, in exceptional cases, the court may award reasonable attorney's fees to the prevailing party.⁴³ These additional sums constitute compensation and not a penalty.⁴⁴ Because the Lanham Act does not provide for additional damages to penalize for trademark infringement, if a plaintiff intends to recover punitive damages, the recovery must be based on his common law claims.

Liquidated damages provisions . . . are useful in franchise agreements, where it is often difficult to ascertain . . . the actual damages a party would sustain . . .

Liquidated Damages Provisions. Liquidated damages provisions are damages specified in a contract as a remedy in the event the contract is breached. When utilized properly, these provisions are useful in franchise agreements, where it is often difficult to ascertain in the event of a breach the actual damages a party would sustain, and are often used in hotel litigation. These provisions allow the parties to enter the agreement with a better understanding of their obligations in the event of a breach, rather than allowing these obligations to be fixed in less predictable judicial or arbitration proceeding.

While liquidated damages provisions have many benefits, courts will not enforce these provisions if the amount designated for damages is tantamount to imposing a penalty on the breaching party. A term fixing unreasonably large liquidated damages as a penalty is unenforceable on the grounds of public policy.⁴⁵ The general rule is that "[l]iquidated damages must compensate for loss rather than punish for breach."⁴⁶ To make this determination, courts typically consider two factors: (1) the damages must be reasonable in light of the anticipated or actual loss caused by the breach; and (2) the difficulties of proving the actual loss.⁴⁷ Typically, the party seeking to avoid the liquidated damages clause bears the burden of proving the clause does not meet these factors.⁴⁸

For example, in *Ramada Franchise Systems v. Jacobcart*,⁴⁹ a Texas district court, applying New Jersey law, upheld a liquidated damages provision in a hotel license agreement that required the licensee to pay the licensor \$200,000 if the licensee breached or prematurely terminated the agreement. Under applicable New Jersey law, liquidated damages provisions are upheld when

⁴⁰ 15 U.S.C. § 1117(a).

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ See RESTATEMENT (SECOND) OF CONTRACTS § 356 (2003).

⁴⁶ See *Space Master Int'l, Inc. v. City of Worcester*, 940 F.2d 16, 18 (1st Cir. 1991).

⁴⁷ See RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 45, § 356.

⁴⁸ *Zidell, Inc. v. Pacific N. Marine Corp.*, 744 F. Supp. 982, 987 (D. Or. 1990).

⁴⁹ BUS. FRANCHISE GUIDE (CCH) ¶ 12,609 (N.D. Tex. Feb. 21, 2003). (The author was counsel of record for the franchisor in this case.)

the set amount of damages was a reasonable forecast of just compensation for the harm caused by the breach and when that harm was very difficult to measure. The court held that the provision was reasonable and enforceable for several reasons. First, damages from breach for early termination of a hotel license agreement were difficult to estimate when the agreement was drafted, due to fluctuations in the travel industry. Second, the agreement covered a fifteen-year period, and it was difficult to predict the franchisee's income that far into the future. Third, New Jersey law assumed that the liquidated damages provision was enforceable, and the franchisee did not meet its burden of showing that the provision was unreasonable and should not be enforced.

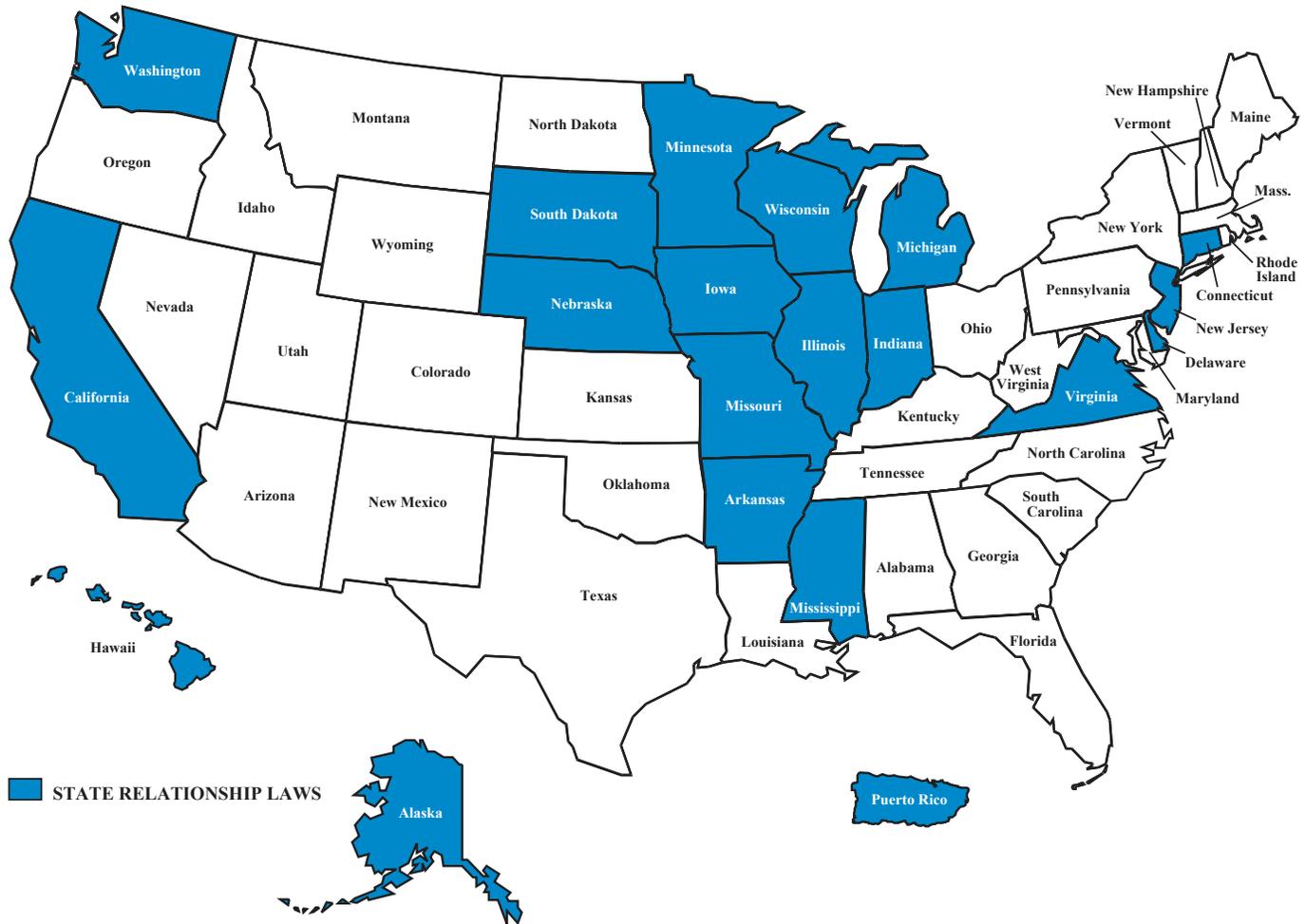
Conclusion

Most franchise or supplier litigation involves termination issues: either the franchisee or dealer wants to exit or stay in the system, while the franchisor or supplier wants the opposite. Thus, proper termination is important and, in fact, may be required to enforce other rights under the parties' agreement. Understanding the nuts and bolts of some practical aspects of litigation involving franchises and dealerships is essential before undertaking prosecution or defense of a franchise or dealer termination action. ●

Appendix A

State Relationship Laws

States where the criteria for termination is dictated by statute and not the franchise agreement



Paper Trail: Working Papers and Recent Scholarship

Editor's Note: In this issue we note a recent paper by Patrick Greenlee, David Reitman, and David S. Sibley that argues that bundled loyalty discounts may either increase or reduce consumer welfare and should be viewed as tying arrangements rather than predatory pricing.

Send comments and suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Recent Papers

Patrick Greenlee, David Reitman, and David S. Sibley, An Antitrust Analysis of Bundled Loyalty Discounts, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=600799

In the last issue, we noted Barry Nalebuff's paper, *Bundling as a Way to Leverage Monopoly*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=586648. That paper showed that a monopolist can increase profits by offering consumers a bundle of (1) a monopolized product, priced *below* the standalone, profit-maximizing level, and (2) a second, competitively supplied product, priced *above* marginal cost. Nalebuff's argument depends on the envelope theorem, which holds that, if a monopolist is charging the full monopoly price for a product, a small reduction in price will cause only a trivial reduction in monopoly profits but a much larger increase in consumers' surplus and in allocative efficiency. Nalebuff shows that this disparity between the loss to the monopolist and the gain to consumers gives the monopolist an opportunity for profit: the monopolist's reduction in the price of the monopolized good has less effect on its profits than the increase in price of the competitively supplied good. In Nalebuff's model, bundling increases both consumer surplus and social welfare, although Nalebuff suggests that the practice may be anticompetitive in the long run because rival producers of the competitively supplied good are foreclosed.

David Mills of the University of Virginia's Economics Department called our attention to the current paper, a still more recent one, by economists in the Antitrust Division's Economic Analysis Study Group. Greenlee, Reitman, and Sibley (GRS), on assumptions similar to Nalebuff's, offer a model of bundling that suggests that in some circumstances bundling can reduce consumer welfare, while in others it can increase welfare. GRS confirm that in the case discussed by Nalebuff, in which the monopolist (while continuing to offer the monopolized good separately at the preexisting monopoly price) reduces the price of the monopolized good and slightly increases the price of the competitively supplied good, the producer's profit and consumer surplus increase, for essentially the reasons we discussed in the November issue, <http://www.abanet.org/antitrust/source/11-04/Nov04-PaperTrail1129.pdf>. In addition, equally efficient producers of the competitively supplied good are foreclosed. GRS emphasize that these kinds of bundles are not like predatory pricing because there is no sacrifice of short-term profits; instead, they more closely resemble tying arrangements.

GRS go on to show that, in some circumstances, depending upon the relative demand conditions in the market for the monopolized good and the market for the competitively supplied good, a bundle could reduce consumer welfare through monopoly leveraging. In essence, the increase in consumer welfare (and the reduction in profit) attributable to discounting in the price of the monopolized good may be offset by the loss in welfare (and increase in profit) from increasing the price of the competitively supplied good, if demand for the latter good is large relative to demand for the former. For this result to occur, the firm must, when it introduces the bundle, set the standalone price of the monopolized good high enough to deter the consumer from buying it separately and buying the competitively supplied good from a rival. Apparently, this strategy is the same as not offering the monopolized good separately at all—GRS even state that the firm may set the standalone price “arbitrarily high” (while increasing the bundled discount), and that as the price of the monopolized good increases, “the incentive compatibility constraint converges to that of a straight requirements tying problem.”

GRS add that, in their model, “the [Chicago School’s] one monopoly rent theorem does not hold,” presumably because the goods are not used in fixed proportions. Whinston and others have already shown that, when this condition is not present, tying can increase profits and reduce consumer welfare through leverage.¹ GRS distinguish their argument from Whinston’s by noting that their model assumes that demand is downward-sloping, with a positive consumer surplus, and there are constant returns to scale.

GRS also point out that, in their model, consumers are never marginal; only units of demand are marginal. Apparently this condition is an implication of the assumption that there is consumer surplus in the market for the monopolized good at the initial price. GRS suggest that in this case, “a small increase in [the price of the competitively supplied good] does not reduce profits from [the monopolized good] at all” and, because the consumer is not marginal, the net reduction in consumer welfare does not cause the consumer to switch to a rival supplier of the competitively supplied good. If there were no consumer surplus in the market for the monopolized good (for example, because of price discrimination), the one monopoly profit theorem would hold.

The authors observe that their analysis suggests that loyalty discounts on bundles should be treated as tying rather than predation. They criticize the *Ortho* standard,² for example, which condemns bundles only if the revenue from the sale of the competitively supplied good, less the reduction in revenue attributable to the discount on the monopolized good, fails to cover the seller’s cost of producing the competitively supplied good. This standard, which analogizes the bundle to predatory pricing, fails to account for the envelope theorem and consequently would condemn bundles that increase consumer welfare. The authors propose instead that the legality of bundles be determined by comparing the “effective price of the monopoly good in the bundle” after the bundle is introduced, to its price when both goods were priced independently. If the prices are the same, consumer surplus must decline. If the price of the monopoly good in the bundle is lower than its pre-existing monopoly price, compare the standalone price to the pre-existing monopoly price. If the standalone price is the same as the pre-existing monopoly price, the bundle must increase consumer welfare; if it is higher, the bundle must reduce consumer welfare.

¹ See, e.g., Frederick R. Warren-Boulton, *Vertical Control of Markets* 101–05 (1978); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837 (1990).

² *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996).

GRS argue that the court in *SmithKline*³ reached the correct result under their proposed test, but erred in justifying its result by the *Ortho* test. Unfortunately, the record in *LePage's*⁴ does not reveal the prices necessary to apply the authors' test.⁵ ●

—WHP

³ *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978).

⁴ *LePage's Inc. v. 3M Co.*, 324 F.3d 141, 156 (3d Cir. 2003).

⁵ We thank John Lopatka for helpful observations in an exchange of e-mails about this paper.