

Interview with Thomas Barnett, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice

Editor's Note: In this interview, Thomas O. Barnett discusses the priorities for civil enforcement at the Antitrust Division, including insights about cartel enforcement, the importance of domestic coordination with state attorneys general, and the increasing collaboration with international enforcement officials. As the Deputy Assistant Attorney General, Mr. Barnett is in charge of civil enforcement for the Division and oversees three of the Division's civil sections.

When R. Hewitt Pate, Assistant Attorney General for the Antitrust Division, announced Mr. Barnett's appointment on March 31, 2004, he noted: "Tom's mergers and acquisitions experience, as well as his litigation expertise, will make him a valuable addition to the Division. . . . The Department is extremely fortunate to have someone of his intellect and expertise on its antitrust enforcement team."

Prior to joining the Division, Mr. Barnett was a partner in the Washington, D.C. office of Covington & Burling, where he served as Vice Chair of the firm's Antitrust and Consumer Protection Practice Group.

The Antitrust Source conducted this interview on May 9, 2005.



Thomas O. Barnett

ANTITRUST SOURCE: Let's start with some basics. What falls under your bailiwick as Civil Deputy?

TOM BARNETT: I have responsibility for three of the Division's six civil litigating sections: Lit II, Lit III, and the Networks & Technology section. As you know, our sections are organized by industry, so my three sections cover, just as examples, the defense industry, the waste industry, media, newspapers, data networks, and computer software. My responsibilities cover both mergers and nonmerger issues that arise within those sections.

ANTITRUST SOURCE: You've been with the Antitrust Division for about a year. What are some of the highlights or your accomplishments in your first year?

BARNETT: I would say a few things, the first of which is hard to convey to an outsider. We have focused a lot of time and attention on the management of investigations, and we've made some progress in managing matters to a prompt resolution, whichever direction they go. I think it is important for all involved to try to reach an answer quickly, and then to move forward.

For example, there have been some consent decree violation matters in the waste industry that we resolved in a few months without extensive document productions, which is shorter and less burdensome than the average civil nonmerger investigation. In these cases, the prompt resolution also brought a quick stop to what we believed were ongoing violations.

There have also been some merger investigations in which the staff—implementing the merger review process initiative that Charles James rolled out a few years ago—was able to reach a quick decision. In those cases the staff was able to get information quickly, identify and evaluate

issues, and close the matter within the initial 30-day HSR waiting period, avoiding the need to issue second requests. Many of those matters were close calls that once upon a time would almost certainly have led to second request investigations, but the good work of the staff and the cooperation of the parties enabled us to shut down the investigations in a timely manner. In some instances, we issued second requests, but the staff focused on a few key issues and—again with the cooperation of the parties—we were able to close the investigation based on a production of only a small fraction of the information covered by the second request.

Another area that bears mention is our dealings with other antitrust enforcement officials and agencies. Within the United States, we have worked on a number of matters with the offices of various state attorneys general. For example, in the *Oracle/PeopleSoft* matter several states were co-plaintiffs, and we had a very productive relationship that included not only coordinating and cooperating on traditional things like fact-gathering, but also preparing the case and bringing it to trial, and consulting afterward in deciding whether to appeal.

There are other matters, most of which are pending right now, so unfortunately I can't discuss them publicly, where we have been working with State AG offices. In some matters the state officials are helping us work through our issues and in some they are taking the lead, with us providing support.

Finally, the antitrust world in this day and age is global, and for me a highlight of my first year has been the opportunity to meet and work with officials from various competition authorities around the world. Those experiences have ranged from working on merger and intellectual property issues with representatives at the OECD, to discussing China's draft antitrust law with representatives from their government.

I also was fortunate to have the opportunity to help lead a conference among competition officials from Southeastern European countries—a group that is trying to establish antitrust enforcement regimes in economies where the values of competition are not exactly deeply entrenched. I spent about a week with these officials in Budapest discussing antitrust enforcement issues, and we all learned something from each other during the conference.

ANTITRUST SOURCE: Do you have any observations about the difference between private practice and government service?

BARNETT: I'll start with an observation about something that's the same. In both areas I've had the good fortune to work with highly professional people who are very capable, very dedicated, and very interested in antitrust. And that's certainly been my experience at the Division. I feel very fortunate to work with these folks.

In terms of differences, unlike private practice, working in the Division is all antitrust, all of the time, which is a terrific thing for somebody who enjoys being an antitrust lawyer. There is an incredible array of cutting-edge policy issues that we deal with across the various matters within the Division. One faces many challenges in private practice, of course, but the sheer variety of the matters that cross our desks at the Division—individual cases, industries, economic, legal, and policy issues, and so on—is unique to government practice. Here, it is a smorgasbord of antitrust issues unmatched in the private sector.

ANTITRUST SOURCE: In a speech you gave last fall, [http://www.usdoj.gov/atr/public/speeches/speech_tbarnett.htm], in which you identified the Division's top three priorities, you said cartel enforcement was number one, merger review was second, and the promotion of objective stan-

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dards for evaluating monopolization and other single firm conduct was third. Let's talk about them individually, starting with mergers.

How would you describe the Division's merger enforcement priorities going forward?

BARNETT: Starting with merger review, our priority is to identify transactions that we think are likely to substantially lessen competition. We don't have a particular priority on a set of industries, or a particular kind of case. But we are focused, as the Division has been for a number of years, on improving the process, on trying to identify as quickly as possible the cases that really do require close scrutiny, ideally within that first 30-day period. I think I previously mentioned that we have had some success in that regard.

Where we've decided that there are serious issues, our second priority is to be transparent with the parties in terms of what we're doing, what our issues are, and then try to enable the parties to educate us about their responses to our concerns. Where we conclude that a merger is likely to be anticompetitive, our priority is to bring a challenge and fix the problem as efficiently and expeditiously as possible.

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ANTITRUST SOURCE: The *National Law Journal* recently chose *Oracle/PeopleSoft* as the top defense win in 2004. I believe you were quoted in the article as saying "you don't see any fundamental need to change the Division's approach." What lessons, nonetheless, should be taken from the *Oracle/PeopleSoft* case?

BARNETT: One lesson is that even when you have a sound case, the government doesn't always win. More generally, I do not see the decision in *Oracle/PeopleSoft* as indicating any fundamental flaw in our theory or the way that we presented the case.

We had a sound theory, we had solid evidence in terms of not just customer testimony, but also internal documents from the company, and expert economic testimony. The combination of all of this evidence was certainly an adequate basis for the judge to have concluded that the merger was likely to substantially lessen competition.

I respect the fact that the judge did not reach that decision. Although I don't agree with the decision, that's his role. However, the fact that the Division and a particular judge did not agree on how to interpret a particular body of evidence does not mean that we need to make any fundamental changes.

ANTITRUST SOURCE: Let's turn to customer testimony. The judge in *Oracle*, as well as the judge in the FTC's *Arch Coal* case, essentially dismissed or at least took much less seriously the customer testimony that the government presented. What, if anything, should the Division and the FTC do differently in the future with regard to customer testimony? Can customer testimony still carry the day, or is it now essentially just evidence that supports the economic evidence that is presented in court?

BARNETT: I believe that the right customer testimony can still carry the day. Customer testimony is most effective when it is concrete, based upon personal experience, and detailed enough to convey the richness of that experience to the court. I don't think that's a new lesson. That's something we've always known.

As for the *Oracle* case, as I said, we disagree with much of the judge's factual findings. That disagreement includes the conclusions that the judge reached with respect to the testimony we presented from enterprise software customers. We think there was very specific testimony—for

example about the relative cost and suitability of products that Oracle argued were in the market—to which the judge decided not to give weight or credence. That, of course, was his right.

But as a general matter, I come back to the point that customer testimony can be very effective in educating the court about the industry and the needs of customers in that industry. Concrete illustrations of customers' prior purchasing habits, as well as examples of where they have tried to reach out to other suppliers in the past, can be very effective in educating the judge about the factual background of the market and the industry and in providing a basis from which to infer the potential anticompetitive effects of the transaction.

ANTITRUST SOURCE: The EU antitrust regulators approved the Oracle/PeopleSoft deal. Did the Division have discussions with the EU regulators before filing the *Oracle* case?

BARNETT: I was not here at the time but I can say that as a general matter, the Division and the European Commission certainly consulted on the *Oracle* case throughout the process, as we do with many cases.

ANTITRUST SOURCE: Looking forward, do you see the Division having different priorities for coordinated versus unilateral effects cases, perhaps making one or the other a priority?

BARNETT: No. We take the cases as we see them. Our mandate or charge, if you will, is to look at the transactions that people in the marketplace put together or propose and to decide whether they are likely to substantially lessen competition. If the facts lead us to a unilateral effects analysis, that's what we'll do. If they lead us to a coordinated effects analysis, then that's what we'll use. And I should point out that those two theories, or labels for types of theories, are not mutually exclusive. There could well be cases in which we pursue both types of analysis.

ANTITRUST SOURCE: And the Division still intends to pursue both?

BARNETT: Absolutely.

ANTITRUST SOURCE: Is vertical merger enforcement likely to be a priority or a focus of the Division?

BARNETT: Again, we take our cases as they're presented. We certainly do look at vertical issues. I routinely see and discuss with staff potential concerns from vertical aspects of transactions. At the end of the day, all anticompetitive effects are horizontal, so horizontal mergers are, in my view, more likely to present serious competition issues, all else being equal. But that doesn't mean that we ignore vertical issues, or that we wouldn't bring a vertical case. We have done so in the past.

ANTITRUST SOURCE: Let's turn to monopolization. Again, in your November speech you identified promoting objective standards for evaluating monopolization and other forms of single firm conduct as a priority. You spoke about attempting to clarify the line between harmful exclusionary conduct and beneficial hard-nosed competition. What's the Division doing to pursue this goal or priority?

BARNETT: In our investigations we try to employ a standard that focuses as much as possible on objective criteria. In general we look to whether the conduct at issue makes any economic sense

for the firm under investigation but for the tendency of that conduct to reduce competition. In cases where there are legitimate reasons for engaging in a particular kind of activity, that justification is going to give us pause in deciding whether to challenge the activity as an antitrust violation.

This approach generally reflects the hierarchy of priorities I talked about last fall in my speech. As I discussed there, the issue with single firm conduct, or unilateral monopolization allegations, is that it can be difficult to distinguish conduct that is procompetitive from conduct that is not. We should not simply go after successful companies on the theory that the fact of their success somehow proves that they are acting anticompetitively. We want all firms—even those with large market shares—to compete aggressively.

Given that it can be difficult to distinguish between aggressive, procompetitive behavior and conduct that is exclusionary, we want to be particularly cautious in our enforcement decisions in this area. And so we are trying to live up to that standard by identifying those cases where we would be doing good for consumers by pursuing an antitrust enforcement action.

ANTITRUST SOURCE: In the amicus brief in *LePage's*, part of what the government essentially seemed to be saying was the Supreme Court shouldn't take the case up at this time because the law is not sufficiently developed in the application of Section 2 to bundled rebates or the like. Can we expect anything from the Division in this regard going forward? Is the Division trying to clarify the law in that area?

BARNETT: That's certainly something that, from my perspective, the Division ought to try to do. I personally think that the law on bundled rebates is quite muddled right now. If you try to parse through the Third Circuit's *LePage's* decision, it's difficult to discern exactly what the rule is, or what the proper analysis is. So some clarification in this area would be a very good thing.

ANTITRUST SOURCE: Do you scout for appropriate cases to bring? In the search for clarification do you take advantage of cases that come up, or has the Division given some thought to how it might clarify the standard on its own?

BARNETT: In the first instance the Division does look for appropriate cases that present the issues in a manner that will enable a court to provide some clarity—for example, cases that rest on clear and thorough factual records. Aside from that, we take advantage of our ability to further our policy agenda through speeches and articles. *LePage's* in particular raises issues that require some significant thought and study, so I wouldn't limit what we do in that regard. But good cases are always a prime vehicle for trying to move the law forward.

ANTITRUST SOURCE: Cartel enforcement, as you've mentioned, is the Division's top priority. Do you see the Division's stepping up of enforcement efforts in the past few years as having a deterrent effect on cartel behavior?

BARNETT: I do, personally, but I want to start by saying that I am, of course, a Deputy for civil enforcement. Scott Hammond is the Deputy for criminal enforcement, and as a general matter I refer people to Scott and defer to Scott when it comes to matters of criminal enforcement.

Having said that, cartel enforcement is indeed the top priority of the Division, and with good reason. Cartels are nothing less than assaults on our free market system—the Supreme Court recently called them “the supreme evil” of antitrust. So the Division is pleased that, in addition to

the enforcement successes we've had in the U.S., we've had a fair amount of success in encouraging other jurisdictions around the globe to recognize that cartel enforcement is an important component of antitrust enforcement. We have worked to persuade other enforcers that it should be their top priority as well, and we have encouraged them to adopt tough penalties. We have also advocated the importance of effective leniency programs to help identify and root out often-clandestine cartel behavior.

In this regard, Commissioner Kroes in the European Commission has spoken about cartel enforcement as a top priority, and that's very gratifying to us. Australia, to cite just one other example, has announced that it's planning to adopt a criminal provision for its cartel enforcement program.

All of these things are extremely important in a global economy with global cartels. In such an environment it can be challenging for any one jurisdiction to play the role of solo enforcer. As more countries place a priority on cartel enforcement, and as penalties become suitably severe around the world, it will become more difficult for cartels to operate, and easier for the enforcers to detect and penalize them.

In this environment, it is hard for me to believe that there has not been increased deterrence of cartel activity. I can only point to anecdotal evidence, but my impression is that the culture in the business community around the globe is much more aware of and likely to respect the possibility of cartel enforcement than was the case, say, ten or fifteen years ago.

We have long believed that criminal penalties, and prison sentences for individuals in particular, are the most effective deterrent to cartel activity.

ANTITRUST SOURCE: To follow up, last year the President signed legislation that increased criminal penalties for both individuals and corporations. Do you think that the increase in criminal penalties has had an effect on cartel behavior? And, for example, the Division's amnesty program?

BARNETT: It's kind of early to draw conclusions, but I think it inevitably will have an increased deterrent effect. We have long believed that criminal penalties, and prison sentences for individuals in particular, are the most effective deterrent to cartel activity. As you know, the Division places a high priority on ensuring that the executives responsible for illegal cartels go to prison.

So increasing the maximum prison term for antitrust crimes from three to ten years, along with the recent adjustment by the Sentencing Commission of its guidelines to help implement that increase, should enhance the deterrent effect of our cartel enforcement program.

ANTITRUST SOURCE: Criminal enforcement often seems to be focused on, and public attention is drawn to, the international behavior of multinational cartels in high-profile industries. Is the less glitzy, smaller price-fixing and bid-rigging conduct also a criminal enforcement priority for the Division?

BARNETT: Yes, certainly. It may not get as much press nationally or around the world, but it's certainly a priority.

ANTITRUST SOURCE: Absent from the Division's top three priorities that you outlined is noncriminal multi-firm conduct. Are Division resources focused in this area, as well?

BARNETT: We do have Division resources addressing this area. For example, we recently brought an action against the Kentucky Real Estate Commission over regulations it has promulgated that prohibit real estate brokers from offering rebates and other inducements to attract customers. We have other real estate investigations going on around the country. We also have provided our

views regarding some of the legislative and regulatory activity that is underway in this area at the state level. Those efforts go a bit beyond your question, but most of this activity is driven by realtors—what we might call traditional, full-service realtors—who are trying through various mechanisms to respond to competition from new brokerage models.

I should also mention our enforcement efforts involving the collective—and potentially anti-competitive—conduct of health care providers and hospitals in communities across the country. Those efforts fall within the bailiwick of my colleague Bruce McDonald, the Deputy Assistant Attorney General who has responsibility for the Division's other three civil sections, so I am not in a position to discuss them in detail. But they are additional examples of the Division's enforcement activities in the area of "noncriminal, multi-firm" conduct.

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ANTITRUST SOURCE: Let's turn to international issues. You have already identified and discussed your involvement and the Division's involvement with international antitrust enforcement. Let me ask a couple of specific questions about that area.

Let's talk about convergence with the EC. Do you think that there has been and will continue to be substantive convergence between EC competition enforcement and antitrust enforcement here? And specifically in merger enforcement, but also in nonmerger enforcement?

BARNETT: We are now in the realm of another of my colleagues, Makan Delrahim, the DAAG responsible for international issues. From my own perspective, yes, I think there's been great progress in terms of substantive convergence between the United States and the European Commission.

Taking mergers first, as you know the EC recently revised its substantive test in a way that can be construed as consistent with the substantial lessening of competition test used in the United States, the United Kingdom, Australia, and elsewhere.

In our dealings with the EC, both on specific cases and in discussions about broader antitrust policy issues, we find ourselves saying basically the same thing. At a recent OECD meeting I was listening to Commissioner Kroes talk about enforcement priorities with special emphasis on criminal cartel enforcement, and I found myself thinking that Hew Pate could have given the same speech. It was gratifying to see convergence at this senior level, in addition to experiencing it on a more day-to-day level.

The revisions to the technology transfer block exemption are another example of where they have moved in a direction that's consistent with us, as is their movement towards having fewer per se rules. And, of course, the creation by the EC of a senior economist position within the Commission, along with their general recognition of the importance of economic analysis in effective antitrust enforcement, is something the Division has applauded.

I am not suggesting that we never reach different conclusions, but the terms of the discussion and the analytical framework are closer than they have ever been.

ANTITRUST SOURCE: When we talk about collaborative work between the U.S. and Europe, do you see that specifically at the staff level, or do you see that at your level, or both?

BARNETT: I have to say that on individual case matters I rarely see it at my level. It takes place principally at the staff level, and that is, I think, a reflection of the substantive convergence that we were just discussing. In the time that I've been here, the two sets of staff have almost always reached consistent results in their analyses, and where you have agreement like that there's simply no need for me or another deputy or for Hew Pate to get involved.

Are there specific cases where we are coming out differently? Clearly, yes—*Microsoft* is one example of that. Sometimes we come out the same way in terms of liability, but come out differently in terms of remedies. But we think we're making progress in general both in achieving greater convergence on what the scope of a remedy should be, as well as in avoiding conflicting remedies. And we've worked well with the European Commission, mainly at the staff level, in coordinating our remedies so that the parties don't find themselves in a bind—unable to satisfy one jurisdiction without violating obligations in the other.

ANTITRUST SOURCE: Switching back to the the U.S., to what extent is the Division involved in the Antitrust Modernization Commission's activities?

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BARNETT: In addition to contributing a Commissioner—my fellow deputy Makan Delrahim—Hew Pate provided a letter to the Commission in January setting forth suggested areas of focus, such as undertaking an empirical assessment of the benefits of antitrust enforcement, reconsidering immunities and exemptions, and evaluating the Robinson-Patman Act. Beyond that, in general we are open to discussions with the Commission and are ready to provide what help we can.

ANTITRUST SOURCE: Do you see any of the topics that were listed in Hew Pate's letter as being particularly significant or that you hope are addressed or focused on by the Commission?

BARNETT: I certainly agree that the Commission should study and hopefully recommend paring back some of the exemptions and immunities that are out there. As a general matter, I believe that competition is the best way to promote not only consumer welfare, but also many of the long-term goals that are often cited as excuses for setting the antitrust laws aside, such as increased employment and the fostering of an economy conducive to business growth. I think competition is the way to go.

Exemptions are rarely warranted in this day and age, and if the Modernization Commission can be instrumental in rolling some of them back, that would be helpful. One of the things that underscores this issue for me is when we talk with officials from other countries about preserving competition and not restricting competition, for example, to protect national champions. It is not helpful when they can say, "You all are not pure of heart. You have exemptions and immunities that you provide, as well."

The state action doctrine is another issue that I think is worthy of consideration by the Commission. There are some decisions out there that seem to read it too broadly. If states want to displace competition, they have the power to do so, but it should be done through a clear, express articulation of the state's policy, and the state must take upon itself the task of monitoring the market in which it has displaced competition. Short of that, the antitrust laws should apply.

ANTITRUST SOURCE: Do you currently see any need for new or revised policy guidelines in any area?

BARNETT: No, the merger guidelines are in good shape. And the remedies manual we put out last fall should provide some helpful guidance for practitioners and their clients. If there's a particular area you want to ask me about, that's fine, but as a general matter I don't see a specific policy area where we need to create a new set of guidelines.

ANTITRUST SOURCE: Let me just follow up on the merger guidelines. Is the Division working with the FTC on the merger guidelines commentary that's going to come out?

BARNETT: Yes.

ANTITRUST SOURCE: Do you see the commentary leading to or identifying areas for improvements in the merger guidelines in any specific areas? For example, entry is one area that people often talk about as maybe needing to be more industry-specific.

BARNETT: No. Let me just put it this way—the commentary is not intended to revise the guidelines, either expressly or implicitly. Our goal is to illustrate how we apply the guidelines and the principles behind them in the work that we do. And while the format has certainly not been completely worked through at this point, I envision some case studies, based where possible on actual cases that the agencies have handled. For example, you mentioned entry. We might describe a case in which, notwithstanding high market shares, we determined entry was likely to be sufficient to discipline potential anticompetitive behavior. In discussing the case, we might describe the key factors that we considered. Something along those lines, we hope, will provide more insight for people outside the Division and the FTC regarding how we apply these principles on a day-to-day basis.

ANTITRUST SOURCE: The Division, as you know, has a new policy for increased transparency in the decisions not to challenge mergers. Can you tell us a little bit about the Division's efforts here? How is it going? Can you think of any beneficial examples?

BARNETT: I do think it is a good policy and one that we intend to continue, and if possible expand upon. We obviously don't issue statements in every case that we decide not to bring. We try to identify cases that are of some interest. In some ways this is very similar to what I was just talking about with the merger commentary. If we have a particular case where entry was a key issue that enabled us to decide to shut down an investigation, a closing statement would give us an opportunity to explain how we reached that conclusion.

There are limits to what we can do in that regard. As you know, frequently much of the information we collect is confidential. Unlike cases that reach litigation in which information necessarily gets into the public record, if we never bring a challenge, the information we collect has to stay confidential, so there are limits to what we can say. We also need to be cautious about saying things in closing down an investigation that might be taken out of context or misconstrued in future cases, regardless of how many disclaimers we include.

But with that in mind, I think the more transparency that we can have the better off we all are. It enables counselors in the private sector to guide their clients to the right answer, and it makes our enforcement job easier.

ANTITRUST SOURCE: Improvement of the second request process is an area that FTC Chairman Majoras has some interest in. Is the Division focused on the improvement of the second request process? Are you working with the Commission on this?

BARNETT: We are focused on it, as well, and are discussing with the FTC what might be done to improve the process.

Of course, there are some tensions among the different positions taken by those who would seek to change the process fundamentally.

To the extent that people want to construe decisions like *Oracle* and *Arch Coal* as requiring plaintiffs to present fact-intensive, extensive, empirical analyses, and detailed testimony, et cetera, et cetera, that is likely to increase the burden upon the Division to put in a more detailed, fact-intensive case. Depending on how much time we have between filing the complaint, and when we go to trial—which may not be very long—that requirement will in turn make it more difficult for us to pare back what we ask for during the second request process.

So, while we very much would like to find ways to reduce the burden on the parties and on the Division for the vast majority of cases that never lead to a challenge—and for that matter for those that never see the inside of a courtroom for anything other than a consent decree—we also need to bear in mind the Division's responsibility to be in a position to present an effective case if and when that is necessary.

ANTITRUST SOURCE: There seems to be a decline in the number of business review letters that are issued yearly. In 2000, for example, there were 15 letters issued, I believe. And in 2004 there was one letter issued. Why is the number decreasing? Is it because they are less helpful? Is it because they're becoming harder to issue, or are people just asking for them less?

BARNETT: I suppose I could try to claim that we're being so successful in our transparency efforts that they aren't necessary, but I'm not sure I could prove that.

I would say—and this is impressionistic, I don't have a firm basis for drawing a conclusion—that there are a couple of factors driving that trend. I don't think they've become less useful or less easy to get. I think to some extent economic conditions affect the volume of requests for business review letters.

You mentioned 2000. As you know, that year was at the peak of the late '90s boom, when there was a lot of business activity going on. I think you're more likely during boom times to see an increase in joint ventures, strategic alliances, and other behavior that is likely to prompt someone to request a business review letter. So it's not surprising to me that we saw a decline in those requests when the markets slowed down.

There has always been an issue with these requests, of course. We do what we can to expedite the process and to get an answer out there as quickly as we can, but the way the program is set up—and it's set up in a sensible way—those who request a business review letter cannot start the activity in question until the business review letter process is completed. Some people just can't wait for the process to play itself out.

Finally, I think people might be more comfortable making decisions on their own about where the line is as standards have become better understood. So they may be requesting fewer business review letters. At least that's my impression.

ANTITRUST SOURCE: What is your view of the current balance between federal and state enforcement?

BARNETT: I believe that there's a role for both to play here, one that in recent years has worked reasonably well. I mentioned the Oracle/PeopleSoft investigation and trial as a good illustration of cooperation between the Division and the offices of the various state attorneys general.

I do think it is important that we coordinate with the states when they are involved in the same matters as the Division because it does not make sense for parties to have to deal with 2, 3, 4, or 12 different processes. That's unnecessarily burdensome and confusing for everyone involved. A certain degree of inefficiency is perhaps an unavoidable reality when it comes to multinational transactions, but I would hope we could keep things relatively efficient within the U.S., especially for matters that don't raise uniquely local issues.

ANTITRUST SOURCE: In reviewing the DOJ Web site, there seems to be quite a lot of "advisory outreach activity"—amicus briefs, letters, testimony, and the like—often in state fora. Does that fall within your bailiwick?

BARNETT: Some of it does. For example, the real estate matters I mentioned—the Division's recent letters to the Oklahoma legislature and the Texas Real Estate Commission—fall within my sphere of responsibility. Another example that arises frequently is the unlicensed practice of law. You probably won't be shocked to hear that there have been efforts to enact or promulgate definitions of the "practice of law" that unduly restrict competition. Our Networks and Technology section leads our advocacy in this regard. We work closely with the Federal Trade Commission on these issues.

More generally with respect to "competition advocacy," the Division has a long history of communicating with other federal agencies, and state governments. We seek to promote or defend competition by educating federal, state, and local officials about the competitive consequences of their actions so that they can make informed judgments in their efforts to serve the public interest.

ANTITRUST SOURCE: I think people are often just fascinated by how the agency works. Several times you alluded to the division of responsibility between the criminal deputy and the civil deputies, for example. Do you coordinate your activities? Does Hew Pate bring you together in policy meetings where you see if there are any issues that might straddle various sections? Or do you set-up a task force? In general, how do you and the other deputies and Hew Pate organize your work and keep in touch with each other?

BARNETT: We communicate and coordinate on a regular basis. We have periodic meetings, certainly. Every week we have a senior staff meeting in which Front Office personnel talk about the current issues that they have on their plate for the week. And through that mechanism we are generally aware of what everyone is doing. We also have an internal weekly report that summarizes major developments in the Division's more significant matters, upcoming decisions, and so on. Perhaps most importantly, David Higbee does a superb job as Deputy and Chief of Staff in coordinating all of the matters within the Division.

As to specific matters that might come up, fortunately the Front Office isn't a big place, and we all sit next door, across the hall, or around the corner from each other. So we don't have to schedule a formal meeting to consult with one another. It's like a practice group at a law firm. We're all right there, and the staff for the most part isn't far away. So I can easily consult with Scott Hammond on whether a particular multi-party Section 1 investigation that one of my sections is conducting should be pursued criminally. Bruce McDonald and I talk on a regular basis about the various civil merger and nonmerger enforcement issues that we face. And all of the deputies meet periodically with Hew to talk about policy issues, internal management issues, or whatever needs

to be addressed at that particular point in time. So, there is a lot of communication, and from my perspective it works fairly well.

ANTITRUST SOURCE: Because a lot of the Division's activities rely to a great extent on economic theory, do the lawyers share responsibility with the economists in deciding whether an activity would or wouldn't lead to an increase or decrease in competition? Who has input into that process?

BARNETT: With respect to the Division's lawyers and economists, economic analysis is such a fundamental part of what we do that it's hard for me to think of a matter in which I have been involved where I have not actively consulted with the economics group.

ANTITRUST SOURCE: Looking ahead, what do you think is the number one challenge for the Division over the next six months to a year?

BARNETT: Well, you ask about the Division, so I will answer that as best I can, with the caveat that I'm only responsible for a portion of the Division under the leadership of Assistant Attorney General Pate. I think our number one challenge is to continue our cartel enforcement efforts, not only in the United States but around the world. We have been successful in encouraging other countries to adopt or strengthen their cartel programs, to enhance penalties, and to adopt effective leniency programs, which are such a potent investigative tool in cartel enforcement. That has been a challenge, albeit a rewarding one, and it's one that I hope we can continue to meet.

I'll also answer the question with respect to myself and the civil enforcement activities for which I'm responsible. There are indications that merger activity is picking up, and our priority and our challenge is to stay on top of that, to continue to identify those cases that we can quickly allow to proceed, and in situations where we conclude that a transaction is likely anticompetitive, to put together the best, most persuasive case that we can, and to try to fix the deal as quickly and expeditiously as possible.

ANTITRUST SOURCE: Is there anything further you'd like to add to the conversation today?

BARNETT: I had heard very good things from people who had worked in the Division about the ability and the professionalism of the folks here, particularly the career staff, and about the interesting issues that you get to tackle in a job like this one. My experience at the Division over the past year has certainly lived up to those descriptions—in many ways it has exceeded them—and I feel very fortunate to have been given the opportunity to serve here. ●

Adding Bite to Exclusive Dealing?: An Analysis of the Third Circuit's *Dentsply* Decision

Scott A. Sher and Scott D. Russell

The recent decision of the Court of Appeals for the Third Circuit in *United States v. Dentsply International, Inc.*¹ provides new guidance regarding the legality of exclusive dealing and insight into what constitutes sufficient evidence of “exclusionary conduct” to demonstrate a violation of Section 2 of the Sherman Act. The *Dentsply* decision, along with other prominent cases that recently condemned dominant firm conduct, including *United States v. Microsoft Corp.*,² *LePage's v. 3M*,³ *Conwood v. United States Tobacco Corp.*,⁴ and *United States v. Visa U.S.A., Inc.*,⁵ reveals a common theme. Dominant firms that restrict access to a significant portion of a relevant market, efficient distribution channels, or scarce retail space, likely will be sanctioned if plaintiffs can support their claims with evidence of stable market shares and the defendant's subjective bad intent. *Dentsply* is also important because it takes a markedly different approach from past exclusive dealing cases both to defining the relevant market where a dominant firm restricts access to distribution channels and analyzing the potential harm to competition resulting from such conduct.

Exclusive dealing arrangements are vertical nonprice restraints that require a buyer to purchase products or services for a period of time exclusively from one supplier. By its nature, exclusive dealing “forecloses” rival suppliers and/or new entrants from marketing their goods to a particular buyer. This does not, however, automatically mean that such practices are inherently suspect. After all, sufficient alternatives may exist, and there are many well-recognized economic benefits that flow from exclusive dealing arrangements, including the enhancement of inter-brand competition. Thus, from an antitrust perspective, the concern with exclusive dealing is that the degree of market foreclosure can rise to a level where new entry is discouraged and existing sellers are left without sufficient alternatives to secure low-cost resources or compete for sales on the merits, thus injuring the competitive process and increasing the probability that prices will rise.

Exclusionary conduct raises additional concerns when the exclusive supplier has a substantial market position in the upstream market. Indeed, several recent decisions have found antitrust liability under Section 2 where defendants used their monopoly power to exclude rivals from accessing end-users or a significant fraction of the available distribution chain, usually through contractual or quasi-contractual (e.g., discount incentives) means. For example, in *Microsoft*, the

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¹ 399 F.3d 181 (3d Cir. 2005) (Dentsply's recent petition for rehearing *en banc* is pending).

² 253 F.3d 34 (D.C. Cir. 2001) (en banc).

³ 324 F.3d 141 (3d Cir. 2003) (en banc), *cert. denied*, 124 S. Ct. 2932 (2004).

⁴ 290 F.3d 768 (6th Cir. 2002), *cert. denied*, 537 U.S. 1148 (2003).

⁵ 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

defendant company used its monopoly power in the operating system market to tie up OEMs, IAPs, and ISPs—the distributors—via exclusive dealing contracts, requiring these distributors to carry only Microsoft’s Internet Explorer product (to the exclusion of Netscape Navigator).⁶ In *Conwood*, United States Tobacco Corporation used its position as category manager over moist snuff racks in retail stores to restrict point-of-sale advertising and shelf space of competitive moist snuff products (including those offered by Conwood).⁷ *LePage’s* illustrates how 3M leveraged its position as a market leader in a variety of office supply products to provide incentives to retailers through significant bundled discounts to carry 3M’s nonbranded transparent tape to the exclusion of LePage’s competitive product.⁸

In decades past, courts analyzed nonprice related exclusionary conduct simply by inferring competitive harm where a substantial percentage of the market was foreclosed to rivals.⁹ Today, courts take the analysis one step further. Rather than simply calculating the percentage of the market foreclosed, courts also examine how the exclusionary conduct affects competition and whether any competitive harm results from the exercise of market power, rather than from unrelated factors (e.g., consumer choice, inefficiency of competitors). Similarly, when market foreclosure occurs at the distribution level, courts assess whether competitors can simply circumvent the foreclosed distribution channels and reach end-users through alternative means (i.e., whether entry into the distribution of the product is easy).

This trend toward a more probing analysis of competitive effects is not surprising with the advent of more sophisticated economic analyses. As noted by Jonathan Jacobson, the focus of the antitrust inquiry has moved from considering whether the conduct foreclosed competition, to whether “the foreclosure or other aspect of exclusion was imposed in a way designed to lead to an increase in prices or restriction of output in the market as a whole.”¹⁰

This article synthesizes some of the significant issues raised by recent cases addressing dominant firm conduct, focusing on the *Dentsply* decision, and highlights areas of concern for parties contemplating exclusive dealing and other forms of exclusionary conduct.

The *Dentsply* Decision—Facts and Procedural History

Dentsply was the leading manufacturer of prefabricated artificial teeth, accounting for 75–80 percent of sales of such teeth.¹¹ Dentsply sold its artificial teeth to twenty-three independent dental dealers. Dentsply’s distribution network consisted of two large national dealers that together accounted for 67 percent of Dentsply’s sales, as well as twenty-one smaller regional dealers, twenty of which accounted for no more than 4 percent of Dentsply’s sales individually. The dealers in turn distributed the teeth to dental laboratories for use in the creation of dentures. Notwithstanding the absence of written contracts requiring dealers to purchase Dentsply teeth exclusively, Dentsply prohibited its dealers from carrying the teeth of competitors. Dentsply’s dealers were at liberty, however, to end their relationship with Dentsply at any time, for any reason, and without

⁶ *Microsoft*, 253 F.3d at 60–74.

⁷ *Conwood*, 290 F.3d at 783–85.

⁸ *LePage’s*, 324 F.3d at 155–58.

⁹ See, e.g., *Standard Oil Co. v. United States*, 337 U.S. 293, 298 (1949).

¹⁰ Jonathan Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L.J. 311, 327 (2002).

¹¹ 399 F.3d at 185.

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penalty. Since adopting exclusive dealing criteria in 1993, no dealer dropped the Dentsply product line in favor of competing brands of artificial teeth.

The Department of Justice filed suit against Dentsply in 1998, contending that Dentsply's dealer program amounted to illegal exclusive dealing. The district court denied Dentsply's motion for summary judgment, and conducted a five-week bench trial. At trial, the DOJ attempted to prove that Dentsply's exclusive dealing practices were anticompetitive and precluded entry given that (1) its dealers were unlikely to drop the popular Dentsply tooth line in favor of carrying the products of competitors, and (2) Dentsply's competitors were unable to compete effectively without access to Dentsply's distributors, which the DOJ maintained were relatively more efficient and better received by dental laboratories than other dealers, and certainly were more effective than direct dealing.¹²

In a 168-page fact-intensive opinion, the district court rejected each of the Division's antitrust claims, concluding that the facts undermined the general presumption that the foreclosure of 75 percent of a market causes anticompetitive harm. Importantly, the district court found that Dentsply's competitors had sufficient access to end-users, given the availability of direct dealing (which, according to the court, could be more efficient than selling through distribution) and access to a number of other distributors who were not locked up by Dentsply.¹³

In addition, the court concluded that Dentsply could not be held accountable for its competitors' failure to offer a better product that could entice the dealers to switch brands. The fact that the dealers could leave at any time without penalty—and chose not to—is a theme discussed often in the district court's analysis. Finally, when focusing on price—the touchstone of antitrust analysis—the district court found no evidence of supracompetitive pricing that might indicate the exercise of exclusion, tacit collusion, or monopoly pricing.¹⁴ Interestingly, the court determined that Dentsply's proffered business justifications were pretextual and that Dentsply intended to exclude its rivals through its exclusivity arrangements. However, given the absence of anticompetitive effects, termination penalties, or fixed exclusivity durations, the district court discounted Dentsply's failure to provide a valid justification for its practices.¹⁵

On February 24, 2005, the Court of Appeals for the Third Circuit issued its decision reversing the judgment of the district court.¹⁶ Specifically, the Third Circuit held that Dentsply's exclusivity arrangements with its twenty-three distributors ("dealers"), in light of Dentsply's ability to exercise market power, qualified as an illegal monopoly maintenance scheme in violation of Section 2 of the Sherman Act.

The Third Circuit's decision is premised on a straightforward application of a Section 2 monopolization analysis, focusing entirely on whether (1) Dentsply wielded monopoly power in the relevant market and (2) Dentsply's exclusive dealing harmed competition. While noting that a dominant firm may engage in exclusive dealing when the conduct is justified by legitimate business concerns, the Third Circuit also cautioned that "[b]ehavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist."¹⁷

¹² *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d 387, 450–52 (D. Del. 2003).

¹³ *Id.* at 450, 452–53.

¹⁴ *Id.* at 452.

¹⁵ *Id.* at 453.

¹⁶ *Dentsply*, 399 F.3d at 184.

¹⁷ *Id.* at 187.

Issues Raised by *Dentsply* and Their Relation to Section 2 Jurisprudence

Market Definition. The first element of a monopoly maintenance claim is the existence of market power, which is defined as the ability to control prices or exclude competitors. In the absence of direct evidence, courts typically infer market power from market structure. As a general rule, a market share of at least 55 percent is required to demonstrate market power, though this threshold can vary significantly depending on the size and strength of competitors, entry conditions, pricing, elasticity of demand, and substitutability limitations.¹⁸

THE DENTSPLY DECISIONS: The Third Circuit confirmed the heart of the district court's market structure findings, namely, that Dentsply had a 75–80 percent share of the relevant market on a revenue basis (67 percent on a unit basis); none of the remaining competitors accounted for more than 5 percent of the market; and dental laboratories constituted the end-use consumers of pre-fabricated teeth. Nevertheless, the Third Circuit reversed one aspect of the district court's findings that arguably played a significant role in the outcome of the case.¹⁹

Rather than define the relevant market in terms of aggregate sales to end-use customers (i.e., dental laboratories) as the district court seemed to do, the Third Circuit included distributors in the relevant market.²⁰ Specifically, the Third Circuit defined the relevant market as “total sales of artificial teeth to the laboratories and the dealers combined,” thus attributing 75 percent market share to Dentsply's dealers.²¹ By defining the market to include distributors and end-users, the Third Circuit expressly adopted the view that Dentsply's exclusive dealing did more than simply foreclose a primary means of distribution; it also precluded rivals from accessing 75 percent of the customers in the relevant market, thus implying harm to competition. According to the Third Circuit, the district court's failure to recognize that the relevant market necessarily included sales to dealers led the court into clear error in its analysis of monopoly power and competitive harm.

This is a significant point and cannot be over-emphasized: the Third Circuit assumed that the only way to reach 75 percent of false teeth customers was by using Dentsply's distributors. By placing the distributors in the relevant market, the court presumed that direct dealing or alternative means of distribution were not available as alternatives to reach these customers, thus leaving to rival manufacturers only a small portion of the total market.

OTHER RECENT SECTION 2 CASE LAW: The Third Circuit's perspective on defining relevant markets departs from other decisions in both the exclusive dealing context and in Section 2 cases more generally. In two other exclusive dealing cases, *United States v. Microsoft Corporation*,²² and *CDC Technologies, Inc. v. Idexx Laboratories, Inc.*,²³ courts defined the relevant market to include end-users only. This is a subtle, but critical, difference. When the market is defined to include only end-users, courts can more freely analyze the viability of alternative methods of distribution to end-

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¹⁸ *Id.*

¹⁹ *Id.* at 188.

²⁰ *Id.* The parties continue to dispute whether the Third Circuit reversed or simply clarified the district court's market findings. As explained in the government's response to Dentsply's petition to the Third Circuit for rehearing en banc, “in rejecting Dentsply's apparent attempt to narrow the market to include only direct sales to laboratories, the panel made clear its agreement with the district court that the market includes all U.S. sales by tooth manufacturers, regardless of the method of distribution.” See Response of the United States to Petition for Rehearing and Rehearing En Banc (May 3, 2005), available at <http://www.usdoj.gov/atr/cases/f208800/208818.htm>.

²¹ *Dentsply*, 399 F.3d at 188.

²² 253 F.3d 34 (D.C. Cir. 2001) (en banc).

²³ 186 F.3d 74 (2d Cir. 1999).

users, and the increased costs to rival manufacturers, if any, of being foreclosed from preferred distribution channels.

Perhaps this issue was not an overly important factor in the Third Circuit's analysis in *Dentsply*—regardless of what level of commerce market shares were calculated, Dentsply still had a market share of end-users sufficient to infer monopoly status. However, the decision to include distributors in the market is a significant departure from recent case law and presupposes lasting market power where such market power may not actually exist. Important questions were left unanswered by the Third Circuit's decision, including a determination of whether distributors unaffiliated with Dentsply could have reached the end-user dental laboratories. For example, when comparing the efficacy of direct dealing to distribution, the Third Circuit focused almost exclusively on the capabilities of Dentsply's two national dealers, making little mention of Dentsply's twenty-one smaller regional dealers and completely ignoring the many other distributors that were not "exclusively" tied to Dentsply. As will be discussed below, market definition becomes critical in determining the extent to which an exclusionary practice is anticompetitive.

Market Power. As mentioned above, market share is only a rough proxy for a determination of market power. In addition to examining market share, courts look at other evidence of market structure that tends to demonstrate market power, including stability of market shares over time, duration of exclusivity provisions, and the ease of entry into the market. On this issue, the *Dentsply* court's analysis of market power failed to consider several important factors articulated by other courts and in the government's own guidelines to determine market power.

THE DENTSPLY DECISIONS: Both the district court and the Third Circuit concluded that Dentsply's 75 percent market share was sufficiently high to support a prima facie claim of market power. Far more compelling to the Third Circuit's analysis, however, was Dentsply's ability to maintain such a commanding market share for over ten years, a fact the court treated as near-definitive proof that Dentsply possessed the power to exclude competitors. Indeed, without evaluating the comparative quality or price of competing products, the Third Circuit concluded that Dentsply possessed the requisite monopoly power based solely on (1) the "paltry level" of rival competition, (2) the failure of any dealer to drop the Dentsply product-line in favor of a rival's pre-fabricated teeth, and (3) Dentsply's clear intent to keep competition from gaining a "toehold" with the dealers.²⁴ Interestingly, the Third Circuit did not challenge the district court's findings that rival manufacturers failed to prosper due to their failure to adapt the texture, shading, or mold of their products to the preferences of American consumers (even though the DOJ's briefing on this issue was quite extensive).

Continuing with the same line of reasoning, the Third Circuit acknowledged that such "evidence of exclusion is stronger than that of Dentsply's control of prices," but even without evidence of monopoly pricing, "[t]he record of long duration of the exclusionary tactics and anecdotal evidence of their efficacy make it clear that power existed and was used effectively."²⁵ On this point, the Third Circuit's standard for determining market power and anticompetitive effects appears more lenient than that of other jurisdictions, such as the Seventh and Ninth Circuits, which premise antitrust liability for exclusive dealing on evidence of exclusion and supracompetitive pricing.

²⁴ *Dentsply*, 399 F.3d at 190.

²⁵ *Id.* at 190–91.

In addition, although exclusive dealing arrangements of short duration typically pose little risk of anticompetitive harm, particularly when they can be canceled at-will and without penalty—as was the case in *Dentsply*—the Third Circuit concluded that the terms of the actual contracts were not relevant.²⁶ In contrast, in dismissing the government's claims, the district court relied heavily on the ability of customers to cancel the contracts, concluding that the exclusivity arrangements did not impede rival manufacturers from competing for dealer services by offering a better or cheaper product. Rejecting the district court's findings, the Third Circuit embraced its analysis in *LePage's*,²⁷ explaining that the absence of a formal commitment or specified contractual duration was irrelevant in the face of compelling economic incentives that made the prospect of continued exclusivity a virtual certainty. To illustrate *Dentsply's* ability to impose exclusivity on its dealers without specified commitments, the Third Circuit highlighted the fact that no rival manufacturer commanded anywhere near enough sales to offer *Dentsply's* top two dealers, which accounted, respectively, for 28 percent and 39 percent of *Dentsply's* annual sales, a better deal. The court failed to apply the same reasoning, however, to nineteen of *Dentsply's* regional dealers, all of which accounted for less than 4 percent of *Dentsply's* annual sales.

The duration of exclusivity agreements can be a critical factor in assessing the potential for competitive harm, with many courts treating arrangements that last less than one year as presumptively legal.²⁸ These courts reason that frequent re-bidding provides sufficient opportunity for entry and eliminates the potential for lasting foreclosure effects, as well as the potential for price collusion. Nonetheless, the duration of an agreement is simply a proxy for whether market conditions are such that a buyer realistically will (or even can) exercise a short-notice termination provision in the face of aggressive competition.²⁹ As explained by the Third Circuit, compelling economic incentives precluded the dealers from switching freely, making it likely that *Dentsply's* exclusive dealing would extend into perpetuity.³⁰ For this reason, the court's decision largely to ignore the at-will nature of the exclusive dealing arrangements was justified.

OTHER FACTORS TO CONSIDER: In finding that *Dentsply* possessed market power, the Third Circuit relied on assumptions where a more thorough inquiry could have yielded a better understanding of *Dentsply's* ability to control price or restrict output. For example, rather than presume that ten years of relative stability in *Dentsply's* market shares resulted from *Dentsply's* exclusive dealing arrangements, the court should have looked more carefully at the reasons why *Dentsply* was able to maintain that share and keep its distributors, even though the agreements were limited in duration and terminable at will. The Third Circuit brushed aside the district court's findings that *Dentsply's* competitors failed to win business because their products were not as well-suited for the American market, and not as high quality as *Dentsply's*. This analysis, however, is essential in

²⁶ *Id.* at 193–94 & n.2.

²⁷ *LePage's*, 324 F.3d at 157–58.

²⁸ See *Omega Env'tl, Inc. v. Gibarco, Inc.*, 127 F.3d 1157, 1164 (9th Cir. 1997); see also *Roland Mach. Co. v. Dresser Indus. Inc.*, 749 F.2d 380, 394–95 (7th Cir. 1984) (one-year contracts presumptively legal); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 596 (1st Cir. 1993) (termination on 30 days notice normally a *de minimis* constraint); *Beltone Elecs. Corp.*, 100 F.T.C. 68, 271 (1982) (termination on thirty days notice an “escape valve dilut[ing] somewhat the limitation on . . . access to” distributors).

²⁹ See Jacobson, *supra* note 10, at 351–52 for a thorough discussion.

³⁰ Conversely, in *Omega*, the court was presented with a far more competitive and fluid market, which was deemed unlikely to be affected by exclusive dealing, given undisputed evidence of “increasing output, decreasing prices, and significantly fluctuating market shares among the major manufacturers.” 127 F.3d at 1164–65. Further, rival distributors had proven themselves equally efficient to one another, distinguished only by their reputations, and capable of growth notwithstanding the 90-day duration of most of the exclusive arrangements at issue.

any determination of what caused the stability in market shares. While it certainly may be true that Dentsply used bully tactics to lock up the most efficient means of distribution, the court did not inquire whether distributors would have switched—or pushed back against Dentsply's exclusivity policy³¹—if competitors' products were better, cheaper, or more suited for end-use customers than Dentsply's.

As explained by the Third Circuit, a determination of market power must also include an examination of whether there are barriers to entering the market. Here, the Third Circuit only looked at whether Dentsply had created barriers to obstruct competitors from “flipping” dealers already locked up with exclusive agreements. As the court held: “Entrants into the marketplace must confront Dentsply's power over the dealers” who have been locked up with Dentsply exclusives.³² Nowhere in the opinion did the court consider whether competitors could have (a) established a rival distribution chain, (b) built up existing distributors not privy to Dentsply's exclusive arrangements, or (c) entered through a hybrid approach of selling directly (which the court acknowledged was profitable) and through expansion of alternative distribution methods. Likewise, the court did not analyze whether existing non-Dentsply dealers were capable of quickly repositioning their operations to provide laboratories with distribution services comparable to Dentsply's dealers, in terms of speed, quality, and cost efficiency.

Exclusive dealing arrangements affect markets in the same manner as do vertical mergers. Consequently, the Department of Justice's 1984 Vertical Merger Guidelines should provide relevant guidance as to how to examine the effects of such arrangements. If the Third Circuit had embraced the Guidelines' approach when analyzing Dentsply's exclusive dealing policy—a policy which in effect accomplished the same objective as a vertical integration of services—the analysis would have been more complete and informative. The Guidelines provide that a vertical merger can produce horizontal anticompetitive effects by making entry less likely if (1) as a result of the merger, a new entrant would have to enter simultaneously into two or more markets, and (2) such simultaneous entry would make entry less likely. Essential to this vertical theory of harm is an analysis of whether the merger creates new and significant barriers to entry.³³ In addition, under the Guidelines, the government must also demonstrate that a market is highly concentrated and therefore, “so conducive to noncompetitive performance that the increased difficulty of entry will likely affect its performance.”³⁴

After determining whether alternative distribution methods could support sufficient and timely entry (merely demonstrating fringe entry is insufficient under a Guidelines approach), expansion or repositioning, a Guidelines analysis asks whether rival manufacturers are currently in a position—or could position themselves—to generate enough gross sales to entice such uncommitted entry. This is where the *Dentsply* decision is most lacking: the court did not consider the scale and scope of operations necessary for a manufacturer to produce at a cost-efficient level. These same considerations are relevant to considering whether a rival manufacturer can generate sufficient market penetration to entice any of Dentsply's smaller regional rivals (nineteen of which

³¹ The district court opinion noted that Dentsply was forced to abandon its plans to distribute directly to certain accounts due to fear of backlash from its larger dealers. See *Dentsply*, 277 F. Supp. 2d at 405–06.

³² *Dentsply*, 399 F.3d at 194.

³³ U.S. Dept. of Justice, Antitrust Division, Non-Horizontal Merger Guidelines (1984), available at <http://www.usdoj.gov/atr/public/guidelines/2614.htm> (commonly referred to, and hereinafter cited, as 1984 Vertical Merger Guidelines).

³⁴ *Id.* § 4.21.

comprise less than 4 percent of Dentsply's sales) and remain competitively viable. The Third Circuit properly dismissed the likelihood that a rival manufacturer could recruit one of Dentsply's national dealers, but the same analysis was not extended to all dealers.

In contrast, the Second Circuit in *Visa* determined that the cost of developing an alternative network capable of generating sufficient sales volume and merchant acceptance to challenge Visa and MasterCard's extensive nationwide credit network was overwhelming.³⁵ Further, the court explored the infeasibility of one-tier entry, finding that Visa and MasterCard's control over member banks precluded rival networks from offering a variety of valuable, and highly coveted, services related to the integration of credit cards and customer bank accounts.³⁶

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Anticompetitive Effects.

THE DENTSPLY DECISIONS: The district court found that Dentsply's exclusive dealing did not harm competition, citing the absence of supracompetitive pricing and the availability of alternate means of accessing end-use customers. The Third Circuit reached the opposite conclusion, finding Dentsply's twenty-three dealers to be a necessary "gateway" to accessing dental laboratories and critical for a rival manufacturer to make enough sales "to pose a real threat to Dentsply's market share."³⁷ As such, the Third Circuit likened Dentsply's "authorized dealers" to "high volume retailers." The fact the dealers were distributors and not retailers "is a distinction in name without a substantive difference." As was true in *LePage's*, "[s]elling to a few prominent retailers provided substantially reduced distribution costs and cheap, high volume supply lines."³⁸ From this perspective, the Third Circuit's analysis reveals the dual concern that Dentsply's exclusionary conduct increased distribution costs for rivals and denied competitors access to a significant group of consumers—a perspective that partially reveals the court's unique view that dealers should be included in the relevant market. Curiously absent from the Third Circuit's analysis, however, is a discussion of the significance to consumers of rivals the district court found to be inefficient and unwilling to compete aggressively. In this respect, the Third Circuit missed an opportunity to explain that even inefficient competitors offer some level of restraint against dominant firms, thus benefiting consumers.³⁹

In explaining the manner in which competition was harmed, the Third Circuit relied heavily on the comparative advantage of distribution through dealers. While recognizing that direct dealing was both possible and theoretically more cost effective (i.e., by eliminating a "middle man"), the Third Circuit concluded that direct dealing was economically infeasible in the market for artificial teeth.⁴⁰ The court held that rival manufacturers were incapable of replicating Dentsply's comprehensive contact list or business relationships. Further, the court held that a rival manufacturer would not be well equipped to offer laboratories similarly attractive credit financing packages, return policies, or the convenience benefits of one-stop shopping.

³⁵ See 344 F.3d at 240–41.

³⁶ See *id.* at 241.

³⁷ *Dentsply*, 399 F.3d at 191.

³⁸ *Id.* at 196 (internal quotation marks and citations omitted).

³⁹ See Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L.J. 941 (2002).

⁴⁰ In its petition for rehearing, Dentsply argues that the Third Circuit erred in setting aside the district court's findings that direct distribution is viable, a claim the government views as nothing more than "a disagreement about the application of the clear error standard." See *supra* note 20.

That other competitors were profitable despite relying primarily, if not exclusively, on direct dealing was also deemed irrelevant by the Third Circuit, given that such dealers had not yet grown to a level capable of challenging Dentsply in the marketplace. Notably, the court did not point to evidence that reliance on dealers resulted in lower prices—in fact, the court specifically concluded (adopting the district court’s findings), that Dentsply’s prices were not the lowest in the industry, and there is no specific finding that Dentsply’s margins were more attractive than those of other manufacturers.

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OTHER RECENT SECTION 2 CASE LAW: According to the Third Circuit in *Dentsply*, when determining whether a challenged restriction creates anticompetitive effects, the court need not conclude that there is “total foreclosure, but [instead,] whether the challenged practices bar a substantial number of rivals[,] . . . severely restrict the market’s ambit[,]” or raise the costs of rivals to do business.⁴¹ A survey of recent Section 2 case law shows that the most significant types of harm stemming from a defendant’s exclusionary conduct include:

1. *Downstream Effects:* the exclusion of rivals from a substantial portion of the market, making entry unlikely or precluding competitors from achieving the economies of scale and scope necessary to achieve efficient levels of operation, making it more likely that a dominant firm can exercise market power unilaterally (i.e., raise prices or reduce quality), and
2. *Upstream Effects:* raising the costs for other firms to compete against the defendant by tying up low-cost resources or the most economical and efficient methods of reaching end-users (i.e., “raising rivals’ costs”).

When analyzing the anticompetitive effects that flow from a monopolist’s exclusive dealing, courts generally limit their focus to the harm that stems from foreclosing access to end-users and methods of distribution. Where an exclusive dealing arrangement impairs the ability of competitors to access a substantial portion of the market, which therefore reduces their ability to constrain a dominant firm’s market power by diminishing the competitor’s customer base or economies of scale, courts conclude that such exclusive arrangements harm competition (harm #1 above). On the other hand, courts have been less concerned with exclusive dealing contracts that occur at the distribution level, believing that direct dealing and new entry can counteract or undermine the anticompetitive effects that might typically follow from a similar degree of foreclosure at the end-user level. Only where such exclusive arrangements tie up existing and more efficient avenues of distribution,⁴² resulting in rivals’ costs being raised because they must either create new avenues of distribution, or use higher-cost distributors, do courts find harm to competition in such circumstances (harm #2 above).

In *Visa*, the defendants established exclusivity provisions with banks that prohibited American Express and Discover, most prominently, from being able to distribute their credit cards through member banks. Because all banks in the United States were member banks, American Express and Discover ostensibly were foreclosed from distributing their cards through every bank in the

⁴¹ *Dentsply*, 399 F.3d at 191.

⁴² The concept that primary lines of distribution can evolve into a necessary, low-cost delivery alternatives is not unfamiliar to Section 2 jurisprudence. See *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 604 n.31 (1985) (“In any business, patterns of distribution develop over time; these may reasonably be thought to be more efficient than alternative patterns of distribution that do not develop. The patterns that do develop and persist we may call the optimal patterns. By disturbing optimal distribution patterns one rival can impose costs upon another, that is, force the other to accept higher costs.”) (quoting ROBERT BORK, *THE ANTITRUST PARADOX* 156 (1978)); *Microsoft*, 253 F.3d at 63–64; see also Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986).

country.⁴³ The defendants argued that a demonstrated increase in the price of network card services provided to banks after exclusivity was imposed did not constitute consumer harm because network card services was not a relevant market. Instead, the defendants contended that the banking network represented nothing more than a distribution method to reach credit card end-users. Therefore, the correct relevant market, according to the defendants, included all end-users of credit cards, with whom American Express and Discover dealt “directly” through mailings. In fact, American Express and Discover were so successful that they were, respectively, the first and fifth largest dispensers of credit cards in the country.⁴⁴

The Second Circuit disagreed, concluding first that there was a separate market for network services, and that the network service banks indeed represented end-users who were harmed by not being able to offer American Express or Discover Cards. More pertinent for purposes of our *Dentsply* analysis, the Second Circuit held that access to network services was essential to competing in the market to attract sufficient numbers of end-users: “Nor do we fault the district court’s determination that certain types of products combining unique features of cards offered by Amex and Discover with the advantages of linkage to cardholders’ bank accounts would likely become available” if American Express and Discover had access to that distribution channel.⁴⁵ In other words, the “distributors” in the *Visa* case did far more than simply “ship” the credit cards to end-users; they provided important value-added services, enhancing the end-use product. The foreclosure of the distribution channel raised competitors’ costs significantly.

In *Conwood*, the Sixth Circuit concluded that United States Tobacco Corporation (USTC) had sufficient market power in the market for moist snuff to make its practice of foreclosing competitors from retail rack space sufficiently exclusionary. The plaintiff maintained that USTC harmed competition through exclusion when it:

- (1) removed racks from stores without the permission of store management and discarded and/or destroyed these racks, while placing Conwood products in USTC racks in an effort to bury Conwood’s products and reduce their facings;
- (2) trained their operatives to take advantage of inattentive store clerks with various “ruses” such as obtaining nominal permission to reorganize or neaten the moist snuff section, in an effort to destroy Conwood racks;
- (3) misused its position as category manager by providing misleading information to retailers in an effort to dupe retailers into believing, among other things, that USTC products were better selling so that retailers would carry USTC products and discontinue carrying Conwood products; and
- (4) entered into exclusive agreements with retailers in an effort to exclude rivals’ products.⁴⁶

Although *Conwood* involved radically different exclusionary behavior than *Visa*, the court applied the same rationale. The Sixth Circuit held that USTC used its market power in the moist snuff market to affect materially the downstream point-of-sale advertising and racks that housed the moist snuff tobacco products. USTC effectively stifled competition by abusing its position as

⁴³ 344 F.3d at 242.

⁴⁴ *Id.* at 242–43.

⁴⁵ *Id.* at 243.

⁴⁶ 290 F.3d at 783.

market leader by improperly taking “shelf presence” that served to “keep [] products off the shelf, and once it's there to get rid of it.”⁴⁷

In *PepsiCo, Inc. v. Coca Cola Co.*,⁴⁸ Pepsi challenged Coca-Cola's exclusive arrangements with independent foodservice distributors (IFDs). Coca-Cola prohibited its IFDs from carrying any competitive products, including those offered by Pepsi. Pepsi contended that IFD delivery was cheaper than other forms of delivery, thus raising Pepsi's costs to compete against Coca-Cola because Pepsi could not make use of Coca-Cola's IFDs. The district court rejected Pepsi's contentions, concluding that the IFDs were but one way for soft drink vendors to reach end-use customers, and Pepsi failed to demonstrate that its so-called increased costs either resulted in lower margins than Coca-Cola maintained, or higher prices for end-use consumers. The court methodically examined the market, and concluded that IFD delivery did not foreclose Pepsi from the soft-drink market in any material respect and did not affect the ultimate end-use prices adversely (nor did it affect Pepsi's margins) in the soft-drink market.⁴⁹ In other words, Coca-Cola's exclusive arrangements did not raise Pepsi's costs.

In another example, *Omega Environmental, Inc. v. Gilbarco, Inc.*, although the defendant's exclusive dealing contracts with distributors “foreclosed roughly 38 percent of the relevant market for sales,” the court declined to find that this level of foreclosure was likely to cause anticompetitive effects because alternative means of distribution existed, including direct sales and other (less frequently utilized) distributors, which “eliminate[d] substantially any foreclosure effect Gilbarco's policy might have.”⁵⁰ Similarly in *CDC Technologies v. Idexx*, the Second Circuit held that “if competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether [such arrangements] foreclose from competition any part of the relevant market.”⁵¹ Central to the *Idexx* decision, however, was compelling evidence that direct dealing was far more efficient and profitable than third-party distribution. Again, in these cases, the courts concluded that the foreclosure in distribution did not raise rivals' costs.

Business Justification/Role of Intent. A valid business justification that serves to offset the perceived harm of exclusionary conduct can serve as a defense to a monopoly maintenance claim, provided that the defendant can demonstrate that the exclusivity provisions are efficiency enhancing, reasonably necessary to the agreement, and ultimately are procompetitive. By recognizing that justified exclusivity provisions can have a net beneficial effect on competition, monopolization analysis closely resembles the Guidelines' approach to balancing the harm likely to occur through market foreclosure against the benefits of merger-specific efficiencies.⁵² Accordingly, courts have held that the use of exclusivity provisions to, for example, safeguard asset value, control quality, and pursue efficiency “might be legitimate competitive reasons” to impose restrictions

⁴⁷ *Id.* at 789–90.

⁴⁸ 114 F. Supp. 2d 243 (S.D.N.Y. 2000), *aff'd*, 315 F.3d 101 (2d Cir. 2002).

⁴⁹ *Id.* at 255–58 (citations omitted).

⁵⁰ 127 F.3d at 1162–63; *see also supra* note 30.

⁵¹ 186 F.3d at 80 (quoting *Omega Env'tl, Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997)).

⁵² *See* 1984 Vertical Merger Guidelines, *supra* note 33, § 4.24; *see also* Kratenmaker & Salop, *supra* note 42 (advancing a consumer welfare test for analyzing exclusionary conduct); *but see infra* note 60 (describing the DOJ's profit-sacrifice test for identifying anticompetitive conduct).

on a distributor's ability to carry competitive lines, while, on the other hand, "the desire to maintain a monopoly market share or thwart the entry of competitors would not."⁵³

In some cases, it is easy for plaintiffs to demonstrate that proffered business justifications are pretextual because there is direct evidence that the restraints imposed are unrelated to efficiency concerns. For example, in *Dentsply*, each of the "grandfathered" dealers (i.e., those allowed to continue their prior practice of distributing competitive products) proved to be equally efficient and effective as those carrying Dentsply's artificial teeth exclusively. With this evidence the Third Circuit summarily affirmed the district court's findings that Dentsply's proffered justification was mere pretext.⁵⁴ Based upon similar evidence, the Second Circuit dismissed the justification for exclusivity offered by defendants in *Visa/MasterCard*, given that "there is no evidence that the defendants' network cohesion has been harmed overseas, where, in the absence of exclusionary rules, Amex has contracted with Visa and MasterCard member banks to issue Amex-branded payment cards."⁵⁵

[C]ourts often fall back on evidence of subjective intent to determine whether consumer welfare has been enhanced or harmed by exclusionary conduct.

Apart from cases like *Dentsply* and *Visa*, where there is direct evidence that the defendants' proffered business justifications were unnecessary to meet their legitimate business goals, courts often fall back on evidence of subjective intent to determine whether consumer welfare has been enhanced or harmed by exclusionary conduct. Most notably, in *Image Technology Services, Inc. v. Eastman Kodak Co.*, the Ninth Circuit held that Kodak's refusal to license its intellectual property to competing service technicians was actionable because Kodak's conduct was motivated solely by a subjective intent to deny market access, rather than a bona fide attempt to safeguard the quality or value of its IP assets.⁵⁶

More fundamental to the development of Section 2 jurisprudence, however, is the increasing significance that intent evidence is accorded in establishing the prima facie elements of a monopoly maintenance claim. As previously noted, hornbook antitrust law instructs that the focus of Section 2 should be on the effect that exclusionary conduct has on competition, not upon the intent behind it. Nonetheless, "[e]vidence of [] intent . . . is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct."⁵⁷ Indeed, recent case law reveals that intent evidence, when coupled with a clear demonstration of market power, seemingly reduces a plaintiff's burden to prove competitive harm, presumably based upon the theory that a monopolist—which by definition is unconstrained by market forces—is capable of succeeding in its goal to prevent one or more new or potential competitors from gaining a foothold in the market.⁵⁸

⁵³ *LePage's*, 324 F.3d at 163 (internal quotations and citations omitted); see also *id.* at 159 ("When a monopolist's actions are designed to prevent . . . competitors from gaining a foothold in the market by exclusionary, i.e., predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general.")

⁵⁴ *Dentsply*, 399 F.3d at 197.

⁵⁵ *Visa*, 344 F.3d at 243.

⁵⁶ 125 F.3d 1195, 1219 (9th Cir. 1997) ("Neither the aims of intellectual property law, nor the antitrust laws justify allowing a monopolist to rely upon a pretextual business justification to mask anticompetitive conduct.")

⁵⁷ *Microsoft*, 253 F.3d at 59 (citing *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918), for the proposition that "knowledge of intent may help the court to interpret facts and to predict consequences")

⁵⁸ See, e.g., Andrew I. Gavil, *A Comment on the Seventh Circuit's Republic Tobacco Decision: On Utility of "Direct Evidence of Anticompetitive Effects,"* ANTITRUST, Spring 2005, at 59; David L. Meyer, *Direct Evidence of What?: Republic Tobacco and the Proper Use of "Direct Evidence" of Anticompetitive Effects,* ANTITRUST, Spring 2005, at 67.

Dentsply and *LePage's* prove the point well. In each of those cases, the defendants had market power, and demonstrated the intent to harm competition. The courts in both cases were confronted, however, with countervailing evidence that the defendants' rivals were relatively inefficient, and the courts were forced to decide whether the market structure was *caused or maintained* by the exclusivity provisions or by inefficient competition. For example, in *Dentsply*, the court concluded that Dentsply had the best artificial teeth products on the market (and in fact, its competitors' products were not adapted for American customer preferences, including their size, shape, color, and texture), which it offered at a price below many of its rivals. Further, the Third Circuit recognized that there was little evidence of supracompetitive pricing, although both parties' experts indicated that prices to end-users might drop if the exclusivity provisions were invalidated. The combination of these facts (i.e., relatively strong products, inefficient competitors, and comparable prices) could have explained Dentsply's ability to maintain high margins and market shares, as well as the failure of Dentsply's rivals to convince Dentsply's exclusive dealers to carry their competitive offerings. Nevertheless, the Third Circuit cited to and relied upon pervasive testimonial evidence of Dentsply's predatory intent to "block competitive distribution points" and "not allow competition to achieve footholds in dealers"⁵⁹ as a primary means to solidify the government's theory of competitive harm, without addressing the government's proffered "profit-sacrifice" test⁶⁰ or delicate questions of antitrust causation.

Likewise, in *LePage's*, the plaintiff produced substantial evidence that 3M intended to harm the plaintiff's competitive position through its bundled rebate program, which factored prominently in the court's analysis of competitive harm.⁶¹ This evidence of intent overcame evidence proffered by the defendant (and relied upon extensively in a dissent that sought to thoroughly discredit the majority's opinion and its reliance on such intent evidence) that the market structure was not caused by defendant's bundled rebates, but rather by plaintiff's status as an inefficient competitor. (It was a high cost producer.)⁶²

Conclusion

Dominant firms are increasingly finding their practices challenged by smaller competitors and scrutinized carefully by the courts and antitrust agencies—a trend that may gather momentum following *Dentsply* and other recent exclusionary conduct cases. Nonetheless, Section 2 jurisprudence appears far from settled, as the courts have yet to resolve a number of significant analytical issues highlighted by *Dentsply's* treatment of exclusive dealing:

⁵⁹ See *Dentsply*, 399 F.3d at 189–90 (quoting testimony of former Dentsply managers). Intent also mitigates causation problems in damages cases. For example, in *Conwood*, it was apparent that plaintiff's damages award was not reduced, despite (a) a relatively weak case on the merits in terms of antitrust liability, and (b) more importantly, a problem with demonstrating that the anticompetitive conduct was the cause of the consumer harm. The Sixth Circuit relied upon evidence of bad intent in its decision to avoid mitigating the damages award. See *Conwood*, 290 F.3d at 797–98.

⁶⁰ In addition to testimonial evidence, the government also attempted to prove predatory intent circumstantially, using a "profit-sacrifice" test. At trial and in its appellate briefing, the government offered extensive evidence that Dentsply incurred significant costs (in terms of time, costs, and good-will) to enforce its exclusivity policies and deny rival teeth manufacturers access to under-utilized dealers. Given the absence of any efficiency-enhancing business justifications, the government argued that Dentsply imposed exclusivity as a means of fortifying its monopoly position; sacrificing short-term profits for greater rewards in the future.

⁶¹ *LePage's*, 324 F.3d at 144–45.

⁶² See *id.* at 173 (Greenberg, J., dissenting) ("[T]he evidence [] demonstrates that LePage's lost business for reasons that could not possibly be attributable to any unlawful conduct by 3M.").

(1) Although it is likely that the Third Circuit reached the correct conclusion in *Dentsply*, its market definition analysis is problematic and at odds with the decisions of several other courts. Specifically, the court's decision to define the market to include both end-users of artificial teeth (i.e., laboratories) and distributors of such teeth runs counter not only to recent case law, but also to the emerging understanding of how foreclosure harms competition.

(2) In recent cases, including *Dentsply*, the plaintiffs prevailed because they demonstrated that the defendant had market power, rather than simply relying on evidence that the defendant's exclusive arrangements created a high degree of market foreclosure. Plaintiffs proved that this market power, in turn, enabled the defendant to foreclose competitive alternatives in a manner that could not be countered by the defendant's rivals, even using more efficient means.

(3) When making the determination of whether a defendant has market power and whether the challenged conduct harmed competition, courts are not consistent or clear in their analysis, including *Dentsply*. The DOJ's 1984 Vertical Merger Guidelines offer a useful approach for analyzing market power and competitive effects in the exclusive dealing context. Specifically, courts should undertake (1) a rigorous market definition analysis as prescribed by the Guidelines, (2) a prospective evaluation of whether the exclusivity arrangements make it more difficult to compete by requiring either simultaneous entry into not only the product market, but the distribution market as well, and (3) a factual analysis of whether, as a result of the exclusivity, the defendant's conduct harmed competition.

(4) Intent is relevant in exclusionary conduct cases. Even though intent is not an affirmative element of a monopoly maintenance claim under Section 2, courts do rely upon evidence of a defendant's predatory intent in their analyses. Obviously, such evidence is viscerally important—even to a judge sitting as trier of fact. Recent cases reveal, however, that intent evidence may play a more significant role in the affirmative examination of whether the monopolist's exclusionary conduct harms competition (again, even though intent is not an element of monopoly maintenance), or advances legitimate efficiency-enhancing business concerns (which under Section 2 serves as a defense to otherwise illegal conduct). Interestingly, the district court in *Dentsply* properly ignored evidence of predatory intent, concluding that even though the business justifications offered by Denstply for its exclusive dealing arrangements were pretext, such evidence was irrelevant if competition was not actually harmed by the conduct.⁶³ ●

⁶³ *Dentsply*, 399 F.3d at 196–97.

FTC/DOJ Organization Charts and Photos

Editor's Note: As a feature of The Antitrust Source, we periodically offer the most up-to-date guide to the leadership of the federal antitrust enforcement agencies. On the following pages, we provide organization charts, photographs, and links to the top enforcers' publicly available speeches, all found on the agencies' Web sites. Just a click on the appropriate link will give readers access to these speeches. Notably, these charts and links would not be complete without a notice of changes to come: the U.S. Department of Justice recently announced the resignation of R. Hewitt Pate from the Antitrust Division, effective June 30, 2005.¹

—MIKE BARNETT

For the FTC, speeches are available for:

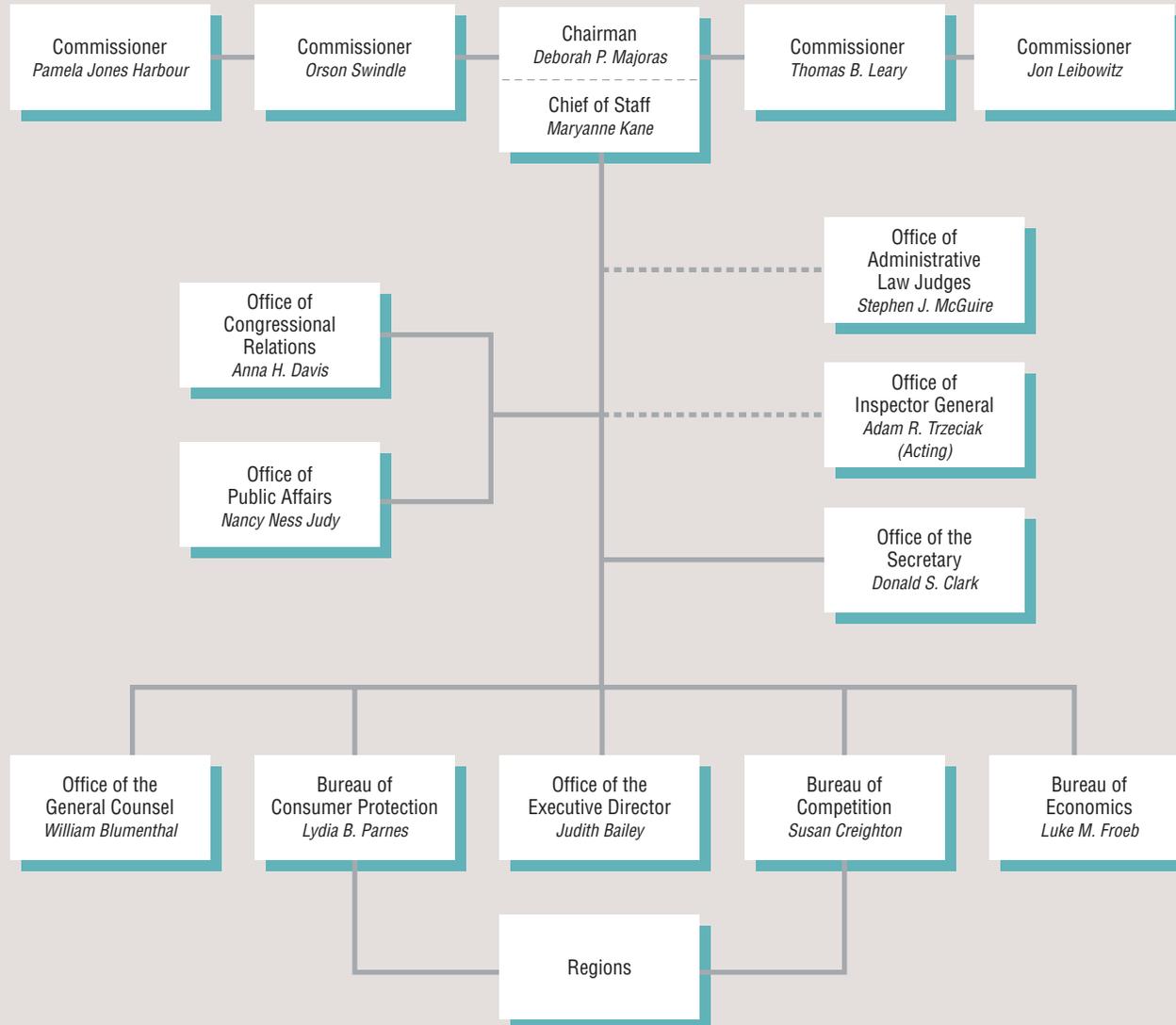
- Deborah Platt Majoras, Chairman: <http://www.ftc.gov/speeches/majoras.htm>
- Orson Swindle, Commissioner: <http://www.ftc.gov/speeches/swindle.htm>
- Thomas B. Leary, Commissioner: <http://www.ftc.gov/speeches/leary.htm>
- Pamela Jones Harbour, Commissioner: <http://www.ftc.gov/speeches/harbour.htm>
- Jon Leibowitz, Commissioner: <http://www.ftc.gov/speeches/leibowitz.htm>
- Susan A. Creighton, Director, Bureau of Competition: <http://www.ftc.gov/speeches/creighton.htm>
- Lydia B. Parnes, Director, Bureau of Consumer Protection: <http://www.ftc.gov/speeches/parnes.htm>
- Luke M. Froeb, Director, Bureau of Economics: <http://www.ftc.gov/speeches/froeb.htm>
- William Blumenthal, General Counsel: <http://www.ftc.gov/speeches/blumenthal.htm>

For the Antitrust Division, speeches are available for:

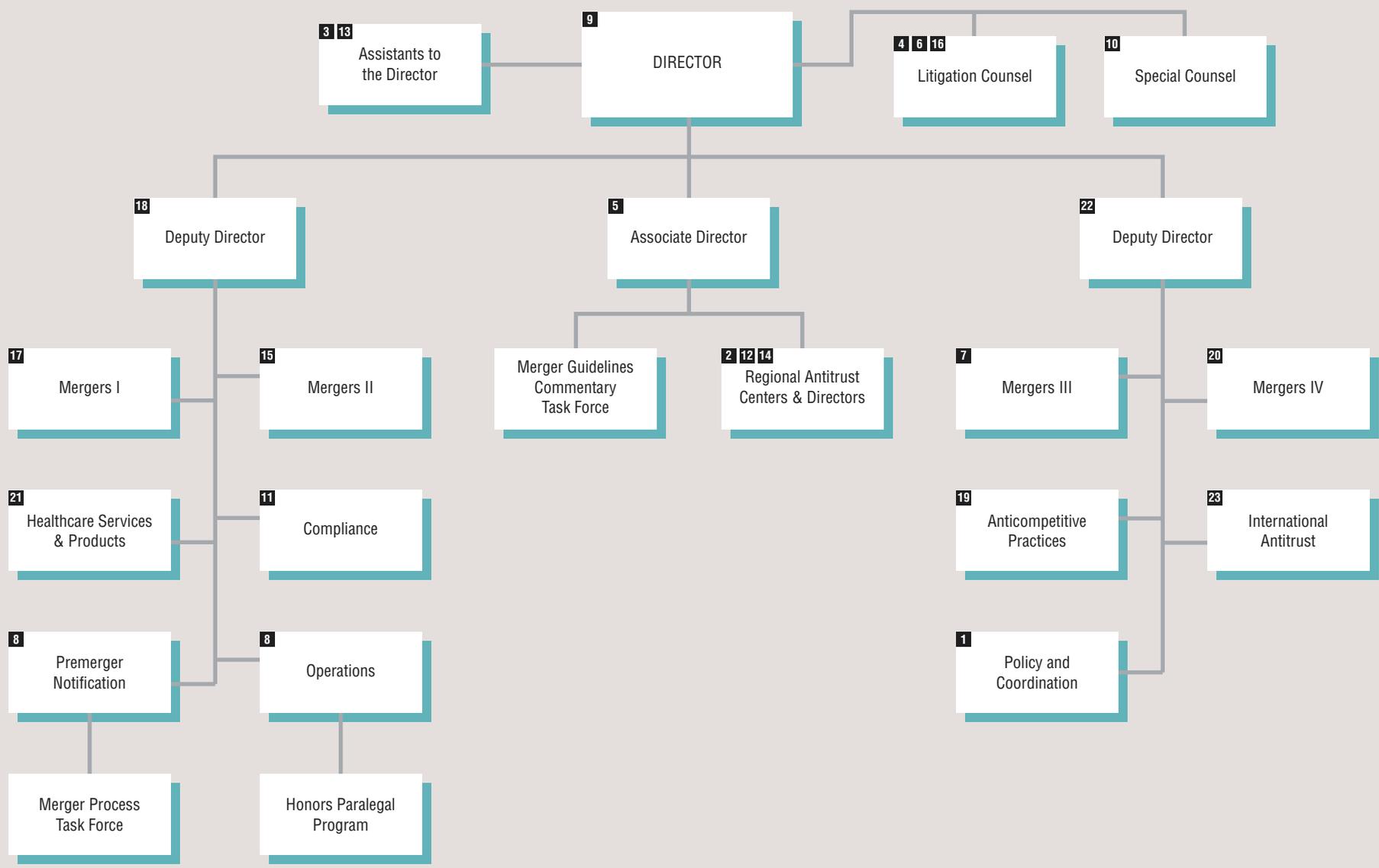
- R. Hewitt Pate, Assistant Attorney General: http://www.usdoj.gov/atr/public/speeches/speech_pate.htm
- Thomas O. Barnett, DAAG: http://www.usdoj.gov/atr/public/speeches/speech_tbarnett.htm
- Makan Delrahim, DAAG: http://www.usdoj.gov/atr/public/speeches/speech_delrahim.htm
- Scott D. Hammond, DAAG: http://www.usdoj.gov/atr/public/speeches/speech_hammond.htm
- J. Bruce McDonald, DAAG: http://www.usdoj.gov/atr/public/speeches/speech_mcdonald.htm
- Mark J. Botti, Chief, Litigation I Section: http://www.usdoj.gov/atr/public/speeches/speech_botti.htm
- Roger Fones, Chief, Transportation, Energy and Agriculture Section:
http://www.usdoj.gov/atr/public/speeches/speech_fones.htm
- J. Robert Kramer, II, Office of Operations: http://www.usdoj.gov/atr/public/speeches/speech_kramer.htm
- Douglas Ross, Special Counsel for Agriculture: http://www.usdoj.gov/atr/public/speeches/speech_ross.htm

¹ http://www.usdoj.gov/atr/public/press_releases/2005/208940.htm

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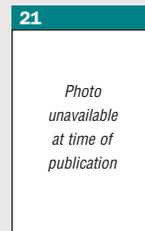
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Practices



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Chul Pak
Assistant Director,
Mergers IV



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Photo
unavailable
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publication
David R. Pender
Acting Assistant
Director, Healthcare
Services & Products

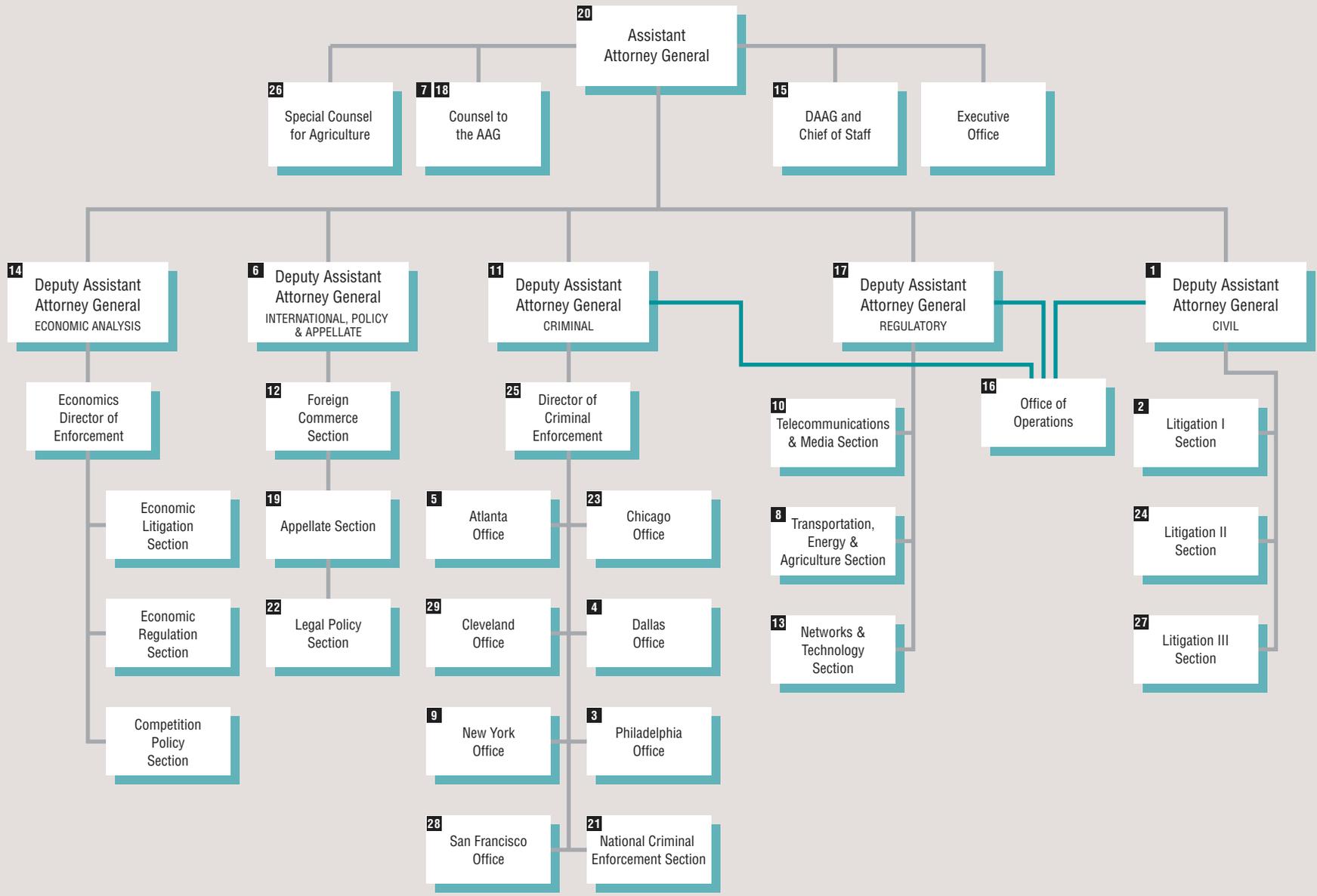


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Challenging a Competitor's Advertising Claims

John E. Villafranco

You are an in-house attorney or outside counsel and your client identifies a competitor's advertising claim that your client is convinced cannot be substantiated. You are asked to take action to prevent further damage to your client's market position. What are your options and what factors will influence your recommended course of action?

Assuming some action is warranted, there are five principal options that can be pursued: (1) send a letter demanding that your competitor cease and desist, (2) initiate a proceeding before the National Advertising Division (NAD), (3) alert state and/or federal regulators, (4) notify the networks (if the issue involves broadcast advertising), or (5) litigate. These options are not exclusive and often more than one can be pursued simultaneously. Failure to obtain the desired result while pursuing one option may require a company to proceed with a second option.

In response to a recent campaign by a competitor, BellSouth Telecommunications, Inc. attempted nearly all of these options with a mixture of success and frustration, culminating in a decision by Judge Marvin Shoob of the U.S. District Court for the Northern District of Georgia preliminarily enjoining Hawk Communications, LLC from making certain claims about its Joi Internet dial-up service. Specifically, the court enjoined Hawk from claiming that Joi Internet provides "Dial-Up at DSL Speed." *BellSouth Telecommunications, Inc. v. Hawk Communications, LLC*, No. 1:04-CV-280-MHS, 2004 U.S. Dist. LEXIS 9413, at *40 (N.D. Ga. Apr. 12, 2004). The order successfully stopped Joi Internet from making a claim that BellSouth asserted was false. BellSouth's experience is instructive for the practitioner who is called upon to chart a course of action to protect an advertiser's market position from a competitor's false or deceptive campaign.

Demand Letter

The *BellSouth* case started with a simple demand—cease and desist—and an understandable degree of optimism. The legal argument, presented in a short letter to Hawk's CEO, was straightforward: consumers understand the claim "Dial-Up at DSL Speed" to mean that Joi Internet delivers DSL speed for all online functions, which it does not; Hawk should modify or discontinue the claim or suffer the consequences.

Under similar circumstances, the demand letter makes a lot of sense. It is inexpensive because it does not usually require a great deal of lead time. It can be prepared and transmitted quickly, the sender can determine when a reply will be required, and it does not carry with it any obligation to respond to counter-complaints. In addition, there is no bar to publicizing the dispute, although any such publicity is likely to reduce the chances of a quick resolution.

There are, however, attendant costs. You can almost always expect your competitor to reply that your client's (or your company's) advertising is false and deceptive, which will require some back-and-forth letters disputing such points. You also will require internal assistance (i.e., time and effort) to help marshal facts relating to product testing and documents.

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In addition, the demand letter is not likely to cause a competitor to admit any wrongdoing. The best outcome is usually a statement that the campaign has “run its course and will be discontinued” or will be modified “for other reasons.” Even if the demand is unsuccessful in eliciting such statements, the letter sends a signal to your competitor that your company is monitoring claims. This could cause your competitor to exercise moderation in future advertising.

*The [demand] letter
sends a signal to your
competitor that your
company is monitoring
claims.*

Demand letters also are useful because they often establish a dialogue with an established competitor that you respect. It may foster a relationship with your competitor’s counsel and increase the likelihood that you will be contacted first—before resorting to litigation—if your competitor takes issue with a claim that your company might make in the future.

In response to the BellSouth demand, Hawk disputed the claim and continued on its course with one important modification of its practices. Television advertising that featured the claim stopped, suggesting that the demand letter partially achieved its objective. BellSouth next turned to industry self-regulation and the National Advertising Division (NAD) to address the print and other forms of advertising that continued.

The National Advertising Division

The NAD, a division of the Council of Better Business Bureaus, Inc., is a self-regulatory body that commands the respect of national advertisers, advertising attorneys, federal and state regulators, and the judiciary. Advertising issues brought to the NAD’s attention will receive thorough review by highly competent attorneys who will apply relevant precedent in reaching a determination of whether an advertising claim is truthful, non-misleading, and substantiated.

The process provides for briefing and (if desired) meetings. A well-reasoned decision is issued, usually within 60 to 75 days of a challenge, and it is accompanied by a press release. Advertisers are asked to provide a statement that will indicate whether it intends to comply with the NAD decision. The decision can be appealed to the National Advertising Review Board.

NAD rules do not permit counterclaims, but, in practice, challengers are sometimes the target of retaliatory counter-challenges. To the extent the NAD accepts the counter-challenge, the NAD assigns a different case review specialist to ensure the proceedings do not bleed into each other.

Significantly, no discovery is permitted at the NAD. This results in cost savings and relieves the challenger of having to produce documents to a competitor. Costs vary according to the nature of the complaint, but a challenger should expect to spend more for an NAD resolution than it would if it were pursuing a remedy through a demand letter but less than if it were forced to litigate. There is an NAD filing fee of \$2,500 for members of the Council of Better Business Bureaus, Inc., and \$6,000 for non-members.

Participants must sign a statement at the outset of the case that confirms that the proceedings are not to be used for publicity during or after the case. Crowing after a victory at the NAD is considered bad form and can work against a successful party in future cases.

There often is a fear that an NAD proceeding is simply a fishing expedition by the challenger. The NAD has rules concerning the treatment of confidential materials so that proprietary information is protected. With regard to preparation, internal assistance will likely be required to marshal facts and gather testing documents. Extrinsic evidence (e.g., consumer surveys) is not required but highly recommended when challenging implied claims.

At the NAD, BellSouth pressed its claim, noting that Joi Internet does not offer “Dial up at DSL speed” because, among other things, it does not accelerate downloads, streaming media, secure Web sites, virtual private networks, or Web-based applications, and that these were material limitations that should have been clearly and conspicuously disclosed to consumers. In January

2004, the NAD issued its decision in favor of BellSouth, recommending that Hawk “discontinue its ‘Dial-Up at DSL Speed’ [claim] or modify its advertising to provide clear qualification in order to avoid conveying the misleading message that Joi Express performs as fast as DSL overall and with regard to all online activities.” *Hawk Communications, LLC*, NAD Case Report No. 4131 (Jan. 8, 2004).

At this juncture, BellSouth had reason to be optimistic. NAD has an excellent compliance record. Advertisers of reputation honor NAD decisions even if they do not always agree with them. When an advertiser indicates that it will not comply—a rarity (less than 5 percent of decided cases)—the NAD forwards the case decision to the Federal Trade Commission or to a state regulator for action. Hawk was one of those rare advertisers that did not abide by the NAD decision. The advertising continued and BellSouth was required to consider its remaining options.

Complaints to State/Federal Regulators

Issues with advertising can always be brought to the attention of regulators in the hope that the FTC or state officials will use their statutory authority to end an offending practice. There are advantages to this course of action. Complaints to federal and state regulators can be made at virtually no cost, and there are many government attorneys who have the skills that will enable them to understand the implications of your complaint and accurately assess the potential for consumer harm.

There are, however, significant disadvantages to proceeding solely in this fashion. Once the complaint is made, you have no control over how (or if) the investigation will proceed. Indeed, an investigation can carry on for years without your knowledge that it is even underway. Statutes and regulations regarding maintenance of confidentiality during investigations prohibit regulators from sharing information about progress. And if publicity is important to your company’s challenge, this is not the correct forum.

Further, while there is no risk of a counterclaim here, there is always the risk that arises when you grab the tiger by the tail. Educating the government about an industry concern poses risk of increased scrutiny of the entire industry. In other words, your company’s advertising (and related documents) should be clean before you alert a regulator to your competitor’s advertising practices.

In terms of preparation, you likely would want to present a white paper outlining your position. This may require internal assistance with facts and testing. Meetings with regulators also may be to your advantage.

Whether a regulator will proceed depends on a variety of factors, with consumer harm the most critical. Last year’s FTC action against Kentucky Fried Chicken Corp., FTC File No. 042 3033 (filed Sept. 17, 2004), *available at* <http://www.ftc.gov/os/caselist/0423033/0423033.htm>, is a good example of the type of case that will capture a regulator’s attention. In that case, the FTC charged KFC with making false claims in a national television advertising campaign about the relative nutritional value and healthiness of its fried chicken. The Commission also charged the company with making false claims that its fried chicken is compatible with certain popular weight-loss programs. Because the public health was implicated, the FTC was quick to jump in.

Conversely, if the dispute is perceived as a matter between competitors only, regulators are less likely to commit limited resources to investigation and resolution. Instead, they will expect the parties to resolve the issue through other means (i.e., negotiation, self-regulation, litigation, etc.).

Earlier in the process, BellSouth had concluded that the FTC and state regulators would likely consider this to be a matter resolved best between competitors. With Hawk’s snub of the NAD

decision, however, the self-regulatory process—which the FTC consistently champions as an effective tool of consumer protection—had been disregarded. Thus, the chances of FTC involvement improved markedly and, after the NAD decision was forwarded to the FTC and Georgia state authorities, BellSouth submitted materials on its own, hoping to initiate an investigation into the conduct at issue.

Complaint to Networks

When the issue involves claims made in broadcast advertising, an advertiser should consider going directly to the networks. A network challenge involves relatively little cost, is fast, and can be publicized.

The principal networks have advertising standards and procedures that apply to challenges. A well-constructed argument with relevant documentary or other extrinsic evidence can lead to a temporary cessation of an advertising campaign while the network decides the challenge.

Often, what your client wants most is to “make it stop.” A network challenge can end a campaign—even if it is only temporarily. In this regard, it has the same effect as a temporary restraining order but at a fraction of the cost.

Much like a demand letter, a network challenge often leads to a counter-complaint. It also may require internal assistance from your client in collecting facts and conducting testing. Finally, some would argue that success at the networks is more difficult due to the network’s financial interest in running national advertisements. While this has not been my experience, it is a common perception.

As previously noted, the discontinuance of the Joi Internet television advertising made a network challenge moot. The only option that remained that could end the Joi Internet national advertising campaign was litigation under the Lanham Act.

Lawsuits Under the Lanham Act

The Lanham Act permits an advertiser to recover for injury sustained as a result of false and/or misleading claims made by competitors. 15 U.S.C. § 1125(a). Under the Lanham Act, liability arises if the commercial message or statement is either (1) literally false or (2) literally true, or ambiguous, but has the tendency to deceive consumers because of an implied message. *See Johnson & Johnson-Merck Consumer Pharms. Co. v. Rhone-Poulenc Rorer Pharms., Inc.*, 19 F.3d 125, 129–30 (3d Cir. 1994). If a claim is literally or expressly false, courts may enjoin the claim without reference to its impact on the buying public. Otherwise, the plaintiff bears the burden of proving, usually through the use of a consumer survey, that consumers are actually receiving the challenged implied claim and that the claim is false. *Id.*

While Lanham Act litigation will lead to resolution, it will take 10–12 months on average, if not longer, to resolve. It also will lead to reflexive counterclaims and the attendant discovery, which could substantially disrupt a company’s business operations and lead to disclosure of potentially damaging documents. Money damages are rare. Finally, like all litigation, it is expensive. For these reasons, the Lanham Act litigant should proceed only with the strongest of claims and with full expectation that counterclaims will follow.

When your competitor’s false advertising threatens to cause irreparable injury, you can move for a preliminary injunction (PI), which, if granted, would end the campaign immediately. To prevail on a PI motion, a plaintiff must show, among other things, likelihood of success on the merits. This showing will require the plaintiff to argue the entire case, supported by relevant evidence, in a very tight time frame—usually about thirty days.

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The filing of a PI motion sends a very clear signal to the marketplace and to the court: (a) the challenged advertising is false and/or misleading, (b) we are prepared to prove this allegation through testimony, documents, and extrinsic evidence, (c) irreparable injury will result if the claims continue, and (d) we are prepared to incur the associated costs of bringing this case.

The costs can be substantial. Most importantly, there will be substantial disruption in the company's business, as both parties prepare to present their respective cases. This will include depositions, document discovery (including e-mails), interviews, development of expert testimony, etc. In addition, counterclaims are a near certainty, which requires a careful plaintiff to identify potential vulnerabilities and weigh the associated costs of opening up these areas of inquiry.

Having failed to achieve its purpose through a demand letter, an NAD proceeding, or by complaints to regulators, BellSouth had little choice but to turn to litigation. Its perseverance paid off: not only was BellSouth successful in enjoining the challenged conduct in court, it made new law in the Eleventh Circuit.

Under past advertising doctrine, an advertiser may have felt reasonably secure from a Lanham Act challenge demanding substantiation for an advertising claim. The traditional rule had been that the plaintiff has the burden to prove the falsity of advertising claims. In the past, an advertiser may have believed, for example, that a claim did not require substantiation if it was a vague statement of general superiority and therefore was not actionable as "puffing." Or, an advertiser may have some substantiation for what it believes or intends its claims to mean, but not for other possible implied meanings. Judge Shoob rejected this view of the law and instead held as per se false Joi Internet's claim that its dial-up service was as fast as DSL-based Internet service. The print and billboard advertising were ordered to be taken down immediately.

Conclusion

While an impartial observer would correctly catalogue the advertiser's frustrations in pursuing its objective in the *Hawk Communications* case, the overall effort is properly measured by the result—the challenged advertisements were discontinued—and by the company's restraint in resorting to litigation only as a last resort. All available options were considered in sequence and a cost-effective strategy was devised. Lack of success early on was impossible to predict and only after less costly and disruptive options were ruled out did it turn its attention and resources to a litigation. ●

States and the Antitrust Modernization Commission

Robert L. Hubbard

The Antitrust Modernization Commission (Commission or AMC) has embarked on its examination of the federal antitrust laws and its consideration of whether any of those laws should be modified or eliminated. In its work to date, the Commission has focused on certain aspects of state antitrust law and enforcement as among the topics that should be reviewed. This work has prompted state antitrust enforcers to respond in various ways. In particular, the attorneys general from forty-two jurisdictions submitted comments to the AMC in October 2004, and the attorneys general, under the auspices of the National Association of Attorneys General (NAAG), unanimously adopted a resolution on state antitrust enforcement in March 2005. In addition, states have taken other steps that relate to or might have an impact on the Commission's work. This article describes each of these activities.

Formation of the AMC

The legislative history of the statute creating the Commission¹ and the process for choosing commissioners concerned state enforcers. Although the legislation does not specify what topics should be reviewed by the Commission, and does not mention state enforcement, the legislation's sponsor, Representative F. James Sensenbrenner, prominently mentioned state enforcement in his initial press release about the legislation as one of three antitrust topics that merited study.² Representative Sensenbrenner's comments about states at the Commission's first public meeting were more elaborate. He expanded his list of topics for review and characterized state enforcers as "vital," while worrying about "divergent and sometimes inconsistent antitrust standards."³

State attorneys general responded in a number of ways, focusing both on the composition and substantive work of the AMC. As presently constituted, the Commission does not include any commissioner with a state enforcement background. Various state attorneys general, including

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¹ The Antitrust Modernization Commission Act, Pub. L. No. 107-273 §§ 11051–11060, 116 Stat. 1856 (2002), available at http://www.amc.gov/pdf/statute/amc_act.pdf.

² Press Release, F. James Sensenbrenner, Jr., Sensenbrenner Introduces Antitrust Study Commission Legislation (July 27, 2001) (on file with *The Antitrust Source*). Representative Sensenbrenner is Chair of the House's Committee on the Judiciary. His initial press release stated, in part: "Three areas in particular that Chairman Sensenbrenner would like the commission to address are: (1) the role of intellectual property law in antitrust law; (2) how antitrust enforcement should change in the global economy; and (3) the role of state attorneys general in enforcing antitrust laws."

³ Representative Sensenbrenner's comments on state antitrust enforcement at the Commission's first public meeting on July 15, 2004, were as follows: "Fourth, the relationship between federal and state antitrust enforcement efforts is another area of interest. While I believe that states have a vital antitrust enforcement role, interstate commerce may be adversely affected by divergent, and sometimes inconsistent antitrust standards." Antitrust Modernization Commission 1, 8 (July 15, 2004), available at http://www.amc.gov/pdf/meetings/transcript_040715.pdf.

NAAG's officers and the leaders of NAAG's Antitrust Committee, expressed concern about this fact, both before all commissioners were nominated and when Commissioner Deborah Majoras became Chairman of the Federal Trade Commission and a replacement commissioner was to be named.⁴

In addition to a concern about the composition of the AMC, Maine Attorney General G. Steven Rowe wrote letters to Maine's governor and congressional representatives about the substantive work of the Commission. Those letters emphasized that state enforcement and state laws allowing recovery to "indirect purchasers" would be considered by the Commission, and referred to substantial benefits for Maine businesses, consumers, and the state itself secured by state enforcement and Maine's "indirect purchaser" statute.⁵

Staff attorneys responsible for antitrust issues in the offices of the state attorneys general also focused on the Commission. For example, how the Commission should view state enforcement was the subject of a panel jointly sponsored by NAAG and the ABA Antitrust Section's State Enforcement Committee at NAAG's 2004 Antitrust Seminar.⁶ That panel focused on state enforcement generally and on how other nations addressed antitrust enforcement, as well as on how the United States addresses other enforcement regimes.

The NAAG Multistate Antitrust Task Force also formed a committee to address the work of the Commission. The members of that multistate committee drafted and secured approval for the states' comments to the Commission that are discussed in more detail below. The chair of NAAG's Antitrust Committee, Attorney General Mark Bennett of Hawaii, actively participates in the work of that multistate committee.

Suggested Topics for AMC Study

The topic of state antitrust enforcement was proposed in response to the Commission's broad-based request for suggested topics. The American Antitrust Institute, for example, suggested that the Commission probe how state enforcement can be made more effective; the Cato Institute suggested that state enforcers be stripped of their *parens patriae* authority; the leadership of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights stated that "[a]n examination of the proper role of states in enforcing antitrust law would be an important topic for study."⁷ The extensive comments of the ABA Antitrust Section suggested state enforcement as a

⁴ The officers of the National Association of Attorneys General and the leadership of NAAG's Antitrust Committee urged that people with state enforcement experience be appointed to the Commission in three separate letters: Letter from Chief State Legal Officers to George W. Bush, President of the United States (Aug. 17, 2004); Letter from Chief State Legal Officers to George W. Bush, President of the United States (Mar. 4, 2004); Letter from Chief State Legal Officers to Senators Tom Daschle and Bill Frist, and Representatives Tom DeLay and Nancy Pelosi (Mar. 4, 2004), available at <http://www.abanet.org/antitrust/committees/state-antitrust/advocacy.html#oa>.

⁵ 10 M.R.S.A. § 1104. The letter to Governor Baldacci and the letter to Senator Snowe, which is representative of the letters delivered to all of Maine's congressional representatives, are available at <http://www.abanet.org/antitrust/committees/state-antitrust/advocacy.html#oa>.

⁶ The materials for this programs are available at <http://www.abanet.org/antitrust/committees/state-antitrust/pubs.html#wm>.

⁷ The American Antitrust Institute, Comments of the American Antitrust Institute on the Issues to Be Included on the Commission's Agenda, to the Antitrust Modernization Commission 6 (Sept. 30, 2004), available at <http://www.amc.gov/comments/aai.pdf>; Letter from Mark Moller, Senior Fellow in Constitutional Studies, The Cato Institute, to the Antitrust Modernization Commission 2-3 (Sept. 29, 2004), available at <http://www.amc.gov/comments/cato.pdf>; Letter from Mike DeWine, Chairman, and Herb Kohl, Ranking Member, Subcommittee on Antitrust, Competition Policy and Consumer Rights, to Deborah Garza, Chair, Antitrust Modernization Commission, and Jonathan Yarowsky, Vice Chair, Antitrust Modernization Commission 4 (Oct. 1, 2004), available at <http://www.amc.gov/comments/senatesubcomm.pdf>.

topic meriting study and mentioned state enforcement in connection with its discussion of remedies, merger enforcement, and related topics.⁸

The states also submitted comments to the Commission. In this regard, the states did not limit their suggested study topics to state enforcement. Rather, states suggested that the AMC study antitrust federalism, remedies, regulated industries, and merger review.⁹ The states' views on these topics can be summarized as follows:

- **Antitrust Federalism:** The states emphasized that separate enforcers independently exercising judgment leads to powerful synergies if the judgments are similar or the same and, even if the views diverge, potential benefits can be derived from a diversity of views.
- **Remedies:** The states urged the Commission to probe whether (1) monetary remedies matched the remedies' objectives, (2) the disparate and inconsistent treatment of the claims for "indirect" purchasers can be solved by repealing *Illinois Brick*,¹⁰ and (3) injunctive remedies are efficient and effective, particularly in rapidly changing markets.
- **Application of Antitrust Laws to Regulated Industries:** The states specifically mentioned the Telecommunications Act of 1996, the Federal Energy Regulatory Commission, and the Surface Transportation Board as examples of legislation that should be reviewed.
- **Merger Enforcement:** Recognizing continuing criticism of their merger enforcement efforts, the states discussed their efforts to investigate mergers efficiently and effectively, including formal and informal steps to minimize duplication, burden, and delay. The states urged the Commission to consider how to (1) modify merger review procedures to improve effectiveness and minimize burden, (2) streamline confidentiality procedures among enforcement agencies and the parties, and (3) enhance predictability.

AMC Study Topics and Work Plans

Not surprisingly, the Commission included certain aspects of state antitrust enforcement as topics for study. In its published list of issues selected for study, made available on January 13, 2005, the Commission asked two questions focused specifically on state antitrust enforcement:

1. What changes, if any, should be made to the enforcement role that the states play with respect to federal antitrust laws?
2. What role, if any, should private parties and state attorneys general play in merger enforcement?¹¹

The Commission also listed other topics that the states had included in their comments, including remedies and the application of the antitrust laws to regulated industries.

On February 25, 2005, the Commission released a list of six study groups. The first study group was for "Enforcement Institutions." That group will focus on (1) dual federal enforcement (FTC and DOJ), (2) Harmonization of FTC/DOJ rules/procedures, and (3) state attorneys general. Other

⁸ Report of the Section of Antitrust Law of the American Bar Association from Richard J. Walis, Chair, Section of Antitrust Law 2004–05, to the Antitrust Modernization Commission (Sept. 30, 2004), available at <http://www.amc.gov/comments/abaantitrustsec.pdf> and <http://www.abanet.org/antitrust/comments/2004/modernizationcommission.html>.

⁹ American Modernization Commission, Amended Comments of Commission Issues for Study 1, 2 available at <http://www.amc.gov/comments/stateags.pdf> and http://www.abanet.org/antitrust/committees/state-antitrust/final_amended_comments_10-01-04.pdf.

¹⁰ *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

¹¹ Antitrust Modernization Commission, Issues Selected for Study 1, 2, available at http://www.amc.gov/pdf/meetings/study_issues.pdf. Expanding on the merger question, the Commission posed the question of whether "merger enforcement [should] be limited to the federal level, or should other steps be taken to ensure that a single merger will not be subject to multiple private and government enforcers?"

The work plan for the enforcement institutions . . . intends to probe the foundations of state enforcement. For both merger and nonmerger enforcement, the Commission asks for specific examples and evidence of the “burdens, benefits, delay, and/or uncertainty” flowing from state enforcement.

study groups will focus on other topics that states suggested be studied, such as remedies and merger enforcement.¹² Originally expected in March, the Commission’s work group plans were posted on May 6.¹³ The work plan for the enforcement institutions working group provides that the Commission intends to probe the foundations of state enforcement. For both merger and non-merger enforcement, the Commission asks for specific examples and evidence of the “burdens, benefits, delay, and/or uncertainty” flowing from state enforcement.¹⁴

State Antitrust Resolution

The Commission’s work was also the impetus for the unanimous adoption in March 2005 of a NAAG resolution on the principles of state antitrust enforcement.¹⁵ The most recent prior NAAG resolution on an antitrust issue was adopted in 1994,¹⁶ predating most of the current attorneys general. To address the Commission’s work, and to focus the current group of attorneys general on state antitrust enforcement issues, Attorney General Bennett presented the resolution.

The basis for the resolution is established with a series of “whereas” clauses addressing federalism, federal-state cooperation, indirect purchaser statutes, merger review and enforcement, and antitrust exemptions. State sovereignty is identified as inherent in the Constitution’s principles of federalism, which Congress has endorsed in antitrust jurisprudence and the Supreme Court has repeatedly reaffirmed. The resolution notes that cooperation between state and federal antitrust enforcers is both mandated by Congress and implemented in various formal and informal ways. In addition, the resolution points out that state statutes permitting antitrust recovery for purchasers date from the 19th century, about 75 percent of public purchases are “indirect,” and federal law significantly limits those claims. The resolution states that the Supreme Court rejected the argument that state statutes permitting recovery by “indirect” purchasers were preempted and accepted the view that recovery helps deter anticompetitive behavior.

In the case of mergers, the “whereas” clauses identify (1) the jurisdiction and authority of attorneys general to investigate mergers and obtain divestiture as a remedy, (2) the local knowledge that states bring to joint investigations, and (3) the efforts to work efficiently and productively with the federal agencies. Finally, the resolution notes that antitrust exemptions for specific industries have been consistently opposed by NAAG.

Based on these whereas clauses, the attorneys general unanimously resolved that NAAG:

1. Opposes any federal preemption of any state antitrust statutes, including state “indirect” purchaser statutes;

¹² The Commission’s list of study groups is available at http://www.amc.gov/pdf/meetings/list_of_study_groups_rev.pdf. The list of study groups includes a designation of which issues are assigned to each group.

¹³ Commission Study Plans for Enforcement Institutions, Exclusionary Conduct, Immunities & Exemptions, International, Merger Enforcement, New Economy, Regulated Industries, Remedies, and Robinson-Patman Act are available at http://www.amc.gov/commission_documents.htm.

¹⁴ The work plan for the enforcement institutions working group is available at http://amc.gov/pdf/meetings/enforcement_institutions_study_plan.pdf.

¹⁵ NAAG 2005 Spring Antitrust Resolution, available at <http://www.abanet.org/antitrust/committees/state-antitrust/pdf/naag-sp2005-res.pdf>.

¹⁶ NAAG antitrust resolutions are available at <http://www.naag.org/issues/issue-antitrust-resolutions.php> and <http://www.abanet.org/antitrust/committees/state-antitrust/advocacy.html#naag>.

2. Supports increased cooperation between the federal agencies and state attorneys general through mechanisms such as the Merger Protocol;¹⁷
3. Supports the reversal of the *Illinois Brick* decision and supports the enactment of federal legislation that would permit the recovery of antitrust damages by any purchasers suffering such damages;
4. Reaffirms its strong opposition to legislation that weakens antitrust standards for specific industries.

The states remain committed to monitoring and participating in the work of the Antitrust Modernization Commission. The states recognize the Commission both as a potential threat to their authority and as a means to improve antitrust enforcement by eliminating federal limitations on recovery by “indirect” purchasers and various antitrust exemptions. The Commission’s first hearing on specific working group topics—specifically, the issue of “indirect” purchasers—is scheduled for June 27. Watching how this plays out should be interesting. ●

¹⁷ The Merger Protocol is available at http://www.naag.org/issues/pdf/at-state_fed-protocol.pdf and <http://www.abanet.org/antitrust/committees/state-antitrust/mrgprotocol.pdf>.

Paper Trail: Working Papers and Recent Scholarship

Editors' Note: A recent paper by four FTC staffers—including the current Director of the Bureau of Economics—offers a decision-theoretic framework for guiding vertical antitrust policy. That paper has stimulated a lively exchange between its authors and three economists responding on behalf of the American Antitrust Institute, two of whom are former Bureau Directors. Get ready to rumble.

And looking towards European enforcement, we review a paper that proposes a model for predicting the effects of EC Regulation 1/2003 as a result of the changed role of the member states' national courts.

Please send any comments or suggestions for papers to review to: Bill Page (page@law.ufl.edu) or John Woodbury (jwoodbury@crai.com).

—WILLIAM H. PAGE AND JOHN R. WOODBURY, EDS.

Recent Papers

Director vs. Director: Vertical Antitrust Policy

James C. Cooper, Luke Froeb, Daniel P. O'Brien, and Michael Vita, Vertical Antitrust Policy as a Problem of Inference (Vanderbilt Law and Economics Working Paper No. 05-12, Feb. 18, 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=699601

The Cooper et al. paper proposes that the basis for vertical antitrust policy should depend on a comparison of the expected losses from incorrectly challenging a practice that benefits consumers (Type I error) versus the expected losses from incorrectly failing to challenge a practice that harms consumers (Type II error). The expected losses from incorrectly challenging a practice that benefits consumers are the benefits of the practice times the probability (likelihood) that the practice is competitive, given the evidence. Similarly the expected losses from failing to challenge a merger that harms consumers are the harm from the practice times the probability that the practice is anticompetitive, given the evidence.

This is a Bayesian framework for inferring whether a practice might be anticompetitive, one that begins with one's priors on the likelihood that a practice (in general) is anti- or procompetitive, priors that are then adjusted by the evidence of the harm or benefits of a practice. As the paper notes: "A decision to challenge a given restraint is more likely if: (1) the cost of type-II errors is high relative to the cost of type-I errors; (2) there are strong priors that a practice is anticompetitive; and (3) theory suggests a strong likelihood that the evidence was generated by an anticompetitive rather than a procompetitive or benign practice." The paper notes that the values that one places on these three components may vary with the particular restraint at issue (although there is nothing in their Bayesian framework that technically requires that, e.g., one has a "strong" prior that the practice is anticompetitive, only that (other things equal) it be sufficiently strong to result in net expected losses from failing to challenge the practice).

Up until this point, the authors' approach is both even-handed and potentially even helpful to antitrust enforcers. But it's the application of the approach that has generated and no doubt will continue to provoke some controversy. At the outset, the authors note that in the absence of a natural experiment (where there is a "control" group without the vertical restraint that can be compared to an "experimental" group with the restraint) that provides clear evidence of the consumer effects of the vertical restraint, the antitrust enforcer and the courts must infer what the "but-for" world would have been based on the evidence available and the theories offered. But the Cooper et al. paper asserts that as a practical matter, the decision maker may not be able to verify the assumptions of the theories or the likely effects of the practice. If that is true, then game, set, match. Because there is no basis on which to decide whether the practice is anticompetitive (or procompetitive), the default presumption (presumably) is that it is procompetitive.

While it's difficult to disagree with that conclusion (and I, for one, won't try to), the paper's review of the theories describing the possible anticompetitive effects of vertical restraints may lead the reader (or at least this reader) to infer that it is almost impossible to empirically verify any of those theories. Which would immediately lead to the conclusion that the only viable vertical antitrust policy is one that challenges vertical practices maybe once in a millennium.

Assuming the decision maker does have evidence bearing on the relevant conduct, the paper then considers whether there is a greater likelihood that the evidence is generated by anticompetitive behavior than by procompetitive practices. As the authors put it, "this may be a close to an empty set" because vertical theory suggests that many practices can have ambiguous competitive effects—both costs and benefits to consumers. Importantly, the author's substantial discounting of the possible anticompetitive effects of vertical practices results in part from the fact that different assumptions can generate different results. Thus, as the authors point out, some theories of anticompetitive harm depend upon whether competition is assumed to be Cournot or Bertrand, whether pricing is assumed to be linear or non-linear, whether contracts are assumed to be observable or not. It's not clear why the reader should be both surprised and nihilistic because our models depend on assumptions.

Assuming, then, that the likelihood of the evidence being generated by anticompetitive behavior is no higher than the likelihood of it being generated by procompetitive behavior (so at best, it doesn't figure into the cost-benefit calculation), the decision maker must look to prior beliefs and the losses associated with making Type I and Type II errors. To determine what those prior beliefs should be, the paper offers a brief review of twenty-two papers recently published in economics journals and concludes that only one of those twenty-two "purports to find unambiguously an instance where vertical integration was harmful to consumers. And in this case, the losses are miniscule . . ." While "a few" of the studies have results consistent with either a pro- or anticonsumer effect, the review concludes that "instances where vertical controls were unambiguously anticompetitive are difficult to find" and therefore "given strong priors that vertical restraints are efficient, enforcement against vertical restraints should be rare absent direct evidence of harm to welfare."

Finally, the Cooper et al. paper devotes only minimal space to the likely magnitude of the losses from Type I and Type II errors, relying, in a note, on the now-familiar Easterbrook statement that market self-correction of the failure to challenge practices that harm consumers tends to reduce or eliminate the losses associated with Type II errors—without acknowledging the length of time it might take the market to self-correct.

In a response to this paper, three economists, including two former Directors of the Bureau of Economics, raise questions about the survey of empirical work. (William S. Comanor, F.M. Scherer,

and Robert L. Steiner, Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute, Working Paper No. 05-04 (April 2005), <http://www.antitrustinstitute.org/recent2/408.pdf>). First, Comanor et al. suggest that drawing any generalizations about the impact of vertical restraints on consumers is misplaced. Nearly half of the studies deal with practices in only two industries, gasoline and cable television.

Second, the Comanor et al. paper takes issue with the conclusion that the twenty-two studies were virtually unanimous in finding no empirical support for any clear-cut adverse competitive effects of vertical restraints, using the words of the studies' authors as evidence: "the studies [Cooper et al.] review are less than consistent with a one-sided conclusion on the issue."

Third, Comanor et al. argue that there were other studies not reviewed by Cooper et al. that concluded that in fact there could be a risk of anticompetitive effects from vertical restraints, suggesting that the selection of studies in the Cooper et al. paper may not be representative of the universe of empirical studies. And nowhere does the Cooper et al. paper address any of the findings in significant vertical cases (in which prominent economists testified as to competitive effect), such as *Aspen Ski*, *Kodak*, *Toys "R" Us*, *Microsoft*, or even *Trinko*.

In an untitled reply to the Comanor et al. response, Cooper et al. take issue with this last criticism (James C. Cooper, Luke Froeb, Daniel P. O'Brien, and Michael Vita, untitled <http://www.ftc.gov/ftc/economic.htm>). First, the authors argue that only reviewing empirical papers published in peer-reviewed journals (as opposed to book chapters, law journal articles, court opinions, agency studies, and working papers) can insure that the results comply with "the highest standard of evidence." Cooper et al. explain that they did not sample the universe of recent papers—they reviewed all recent peer-reviewed journal papers, with the exception of a paper by Comanor and Riddle (William Comanor and Jon Riddle, *The Costs of Regulations: Branded Open Supply and Uniform Pricing of Gasoline*, 10 INT'L J. ECON. BUS. 135 (2003)), which Cooper et al. characterize as providing additional empirical support of their views on vertical antitrust policy.

Second, the authors take issue with the claims of Comanor et al. that Cooper et al. mischaracterized any of the studies reviewed. Cooper et al. note that they do not always draw the same inferences as the authors of the papers from the evidence presented: "Our goal in writing the paper was to report each study's *evidence*, . . . *not* each study's conclusions (if any) as to enforcement policy."

In response to this reply, Comanor et al. argue that by focusing only on papers in peer-reviewed economics journals, Cooper et al. have set the evidentiary bar far too high. (William S. Comanor, F.M. Scherer, and Robert L. Steiner, Vertical Antitrust Policy: The AAI Reply (Apr. 30, 2005), <http://www.antitrustinstitute.org/recent2/413c.pdf>). There are numerous highly respected papers in, e.g., law journals, law reviews, and books, that should not be ignored simply because they were not published in the "right" place. They note that in their reply, Cooper et al. ironically cite as evidence for their conclusions a working paper by two highly respected economists. And perhaps not surprisingly, Comanor et al. take issue with the view that the Comanor and Riddle paper supports the views of Cooper et al.

At bottom, this debate is identical to many other economic policy debates and most antitrust litigation: It is a debate over the model, the parameters of the model, and the interpretation of the underlying evidence. In particular, among economists today, the prior for various forms of vertical control is that they are more likely than not to benefit consumers. The debate between Comanor et al. and Cooper et al. is about the magnitude of that prior. In the absence of natural experiments demonstrating the contrary, Cooper et al. seem to argue that the prior that these benefits are likely is so large that the best vertical antitrust policy is (virtually) no antitrust oversight.

While I have not reviewed all of the twenty-two studies cited by Cooper et al., it would certainly be impressive if the evidence in every recent study supported the authors' conclusions (although, in my view, Cooper et al. should have, where appropriate, distinguished their non-peer reviewed conclusions from the peer-reviewed conclusions of the reviewed papers' authors).

Comanor et al. seem to believe that the prior that vertical control benefits rather than harms consumers is lower than that suggested by Cooper et al. and the Type II error losses larger than Cooper et al. contend. And I find it difficult to disagree with Comanor et al. that the Cooper et al. literature review was far too narrowly focused. Based on a reading of this broader literature, Comanor et al. conclude that there is justification for a more interventionist policy than that which is suggested by Cooper et al., a policy that relies on a conventional balancing of costs and benefits of a practice, as is done today. This is certainly a policy I would agree with, although I would not necessarily conduct the balancing in the same way as Comanor et al.

Debates about models and the empirical basis of their parameters is one important path to developing some consensus on which models are appropriate when and on the value of the parameters. Which is why this kind of exchange is important in developing policy, even if the debates sometimes result in more heat than light.

My thanks to Bert Foer and Luke Froeb for providing me with the various rounds of replies. All of these papers can be found at www.antitrustinstitute.org.

—JRW

Modeling Post-Modernization Effects

Ben Depoorter & Francesco Parisi, Modernization of European Antitrust Enforcement: The Economics of Regulatory Competition (George Mason Law & Economics Research Paper No. 05-09), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=699802

This short paper proposes a model for predicting the effects of EC Regulation 1/2003 governing European antitrust enforcement. The topic is certainly important. The Regulation abandons the requirement that companies notify the European Commission of certain practices, a procedure that was burdensome for the Commission and that had interrupted some national antitrust proceedings. In addition, it makes Articles 81 and 82 of the EC Treaty “directly applicable” to the member states. Consequently, the national courts of member states now have authority to enforce these provisions, subject to EC coordination and supervision. This authority extends to Article 81(3), which allows regulators to grant “exemptions” for restrictive practices “where the pro-competitive advantages of the licence outweigh any negative impact of the restrictions contained in the agreement.”

The paper's authors argue that these changes are likely to influence negatively the development of the substantive law because of what they characterize as “regulatory externalities.” Under the new system, the national courts are “alternative” rather than “concurrent” authorities because each of them is competent either to condemn or to exempt a practice. According to the authors, a decision to confer an exemption imposes negative externalities on other regulators because it “reduces the value and exploitable rent of another agency”; a decision to condemn a practice imposes a negative externality because it “make[s] a second restriction irrelevant.” Because the first court to act fails to take account of these external effects, the authors suggest that the regulatory actions are likely to be “overprovided” as compared to the actions of a single enforcer. Thus, the authors predict that, paradoxically, both the number of exemptions and the number of findings

of infringement are likely to increase. The authors also argue that decentralization and the elimination of notification gives plaintiffs both the ability and the incentive to shop for the national court with the strictest interpretation of competition law. While coordination and supervision might mitigate regulatory externalities and forum shopping, the “Modernization Package” the EC has instituted for these purposes is, according to the authors, inadequate to the task. The authors conclude that while “the precise direction of substantive competition law is unclear, the overall effect is higher levels of regulatory activity” and “higher expenses for legal counsel and litigation.”

The paper leaves the nature and significance of the “externalities” it identifies unclear. The externalities appear to be related to an assumption that regulators seek (undefined) rents, and the actions of one regulator can affect the rents that are available to others. Even if this were true, however, it is not clear why limiting the rents available to a particular agency is an external cost that results in overprovision of regulatory activity relative to some optimum level. Perhaps these issues, and other possible effects of regulatory competition, can be developed further in a later version of the article. ●

—WHP

ABA Section of Antitrust Law 2005–06 Nominating Committee Report

Each year, the Nominating Committee is charged with the task of selecting the slate of new Officers and Council Members for the upcoming Section year. This is especially challenging this year since there are so many qualified individuals for a small number of positions. Robert T. Joseph served as Chair of this year's Nominating Committee. The other members of the committee were Brian R. Henry, Roxann E. Henry, Douglas C. Ross, and Mozelle W. Thompson. Under the Bylaws, the Immediate Past Chair, the Chair, Chair-Elect, and Vice-Chair serve as ex-officio, nonvoting members.

The Committee has recommended the following slate of Officers and Council Members for 2005–06 for election at the Annual Meeting in August 2005, pursuant to Article IV, Section 1 of the Section's Bylaws:

OFFICERS:

<i>Vice-Chair:</i>	Kathryn M. Fenton, Washington, DC (2005–06)
<i>Secretary and Communications Officer:</i>	Keith D. Shugarman, Washington, DC (2005–06)
<i>Program Officer:</i>	Debra J. Pearlstein, New York, NY (2005–07)
<i>International Officer:</i>	Ilene Knable Gotts, New York, NY (2005–07)
<i>Committee Officer:</i>	Allan Van Fleet, Houston, TX (2005–06)
<i>Section Delegate:</i>	Richard M. Steuer, New York, NY (2005–08)

COUNCIL MEMBERS FOR THREE-YEAR TERMS ENDING IN 2008:

David H. Evans, Washington, DC
Joseph G. Krauss, Washington, DC
Neil P. Motenko, Boston, MA
Leslie C. Overton, Washington, DC
Daniel M. Wall, San Francisco, CA

Certain other officers automatically assume new positions or continue in existing positions for the coming year under the Section Bylaws. These include:

OFFICERS:

<i>Chair:</i>	Donald C. Klawiter, Washington, DC
<i>Chair-Elect:</i>	Joseph Angland, New York, NY
<i>Immediate Past Chair:</i>	Richard J. Wallis, Redmond, WA
<i>Finance Officer:</i>	William L. Greene, Minneapolis, MN
<i>Publications Officer:</i>	Theodore Voorhees, Washington, DC
<i>Section Delegate:</i>	James A. Wilson, Columbus, OH

I would like to thank Bob Joseph and the entire Committee for their careful and thoughtful discussions and deliberations. The Section will benefit for years to come from their good work.

Regards,



Richard J. Wallis
Chair, Section of Antitrust Law