Ethical and Practical Challenges Representing Trade Associations and Their Members

Christopher J. MacAvoy

Attorneys who represent trade associations in antitrust investigations or litigation may face a variety of ethical and practical challenges. Most counsel are alert to situations that raise obvious ethical issues—for example, where a member asks the association's counsel to take a position that is adverse to the interests of the association. But other issues present themselves more subtly and, in the worst cases, escape counsel's notice until they have blown up into waiver-of-privilege or disqualification problems. Sometimes even the most basic questions—e.g., who is my client?—may be hard to answer. Other questions that may be encountered include: whether an attorney may, in the same matter, represent the trade association and a member; whether the attorney may represent a member whose interests are adverse to those of other members; whether an attorney may represent a trade association in a matter adverse to a member; whether an attorney who has represented the trade association may represent a member in a matter that is or may become adverse to the association; and whether an attorney who represented the association may, in a subsequent matter, represent a non-member in a suit against members of the association.

The common interest or "joint defense" privilege brings additional complexities to the trade association lawyer's task. If counsel for a trade association briefs members on the status of an antitrust investigation or lawsuit, will the briefing be privileged? What happens if a member of the association tells the association's counsel something incriminating about the member's company, or about another member, or about association staff? Can the attorney disclose the information to other members or their counsel? If a trade association's lawyer receives confidential information from a member pursuant to a joint defense agreement, will this affect the lawyer's ability to accept a subsequent representation that is adverse to the member?

This article provides an overview of some of the major issues and general rules governing the attorney-client relationship between a lawyer representing a trade association and, potentially, the association's individual members. It is not, of course, a summary or survey of all states' applicable rules of professional ethics. Some of these issues were addressed by the Legal Ethics Committee of the District of Columbia Bar in Opinion 305, issued in January 2001. This article utilizes Opinion 305 as a reference.

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Trade Associations Present Special Challenges

Black's Law Dictionary defines a trade association as "an association of business organizations having similar problems and engaged in similar fields formed for mutual protection, interchange of ideas and statistics and for maintenance of standards within their industry." This straightforward definition suggests some of the reasons why trade associations are different from other clients. The similarities or common interests that cause firms or individuals to join trade associations in the first place suggest they will have common legal interests, but this is by no means inevitable. Especially if the members of a trade association are competitors, their legal interests may conflict in an antitrust matter.

Many trade associations have legal counsel on staff or retainer, and access to the association's counsel may be considered a significant benefit of membership. Frequently, the association's counsel has extensive experience with the legal and regulatory issues confronting a particular industry, and members view the association's counsel as a key source of guidance. The close and trusting relationship that often exists between an association's counsel and the members can, however, sow trouble in an antitrust investigation or litigation. To some degree, the issues that arise in this context are the same as those that arise between a corporation's lawyer and the corporation's employees. The trade association context, however, brings added complexities and cross-pressures, not the least of which are the financial incentives for an attorney to represent the association and one or more members, either simultaneously or seriatim.

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Who Is the Client?

A lawyer has an obligation to maintain the confidences of his or her client and to avoid conflicts of interest. But when a trade association is involved, who is the client? And once the client or clients are identified, what happens if the attorney wants to represent additional clients, either in the same matter or in a subsequent but related matter? These issues were comprehensively addressed in District of Columbia Ethics Opinion 305.

Important consequences may follow a determination that an attorney-client relationship exists between trade association counsel and a member. If the matter would require the lawyer to advance two adverse positions, the representation is prohibited.[1] If the lawyer would not be required to advance adverse positions in the same manner, the representation may nevertheless call into question his or her ability to represent each client wholeheartedly and zealously. The D.C. Rules of Professional Conduct, for example, prohibit a lawyer from representing, without disclosure and consent, a client with respect to a matter if:

1. that matter involves a specific party or parties and a position to be taken by that client in that matter is adverse to a position taken or to be taken by another client in the same matter even though that client is unrepresented or represented by a different lawyer;
2. such representation will be or is likely to be adversely affected by representation of another client;
3. representation of another client will be or is likely to be adversely affected by such representation; or
4. the lawyer's professional judgment on behalf of the client will be or reasonably may be adversely affected by the lawyer's responsibilities to or interests in a third party or the lawyer's own financial, business, property, or personal interests.[2]

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[1] D.C. R. of Prof'l Conduct 1.7(a).

[2] R. 1.7(b).

If a trade association's attorney also has an attorney-client relationship with a member, she may be required to withdraw from one or perhaps both representations if a conflict arises and consent is not obtained.[3]

General Rule: A Lawyer Who Represents an Association Does Not, Without More, Represent the Members. Ethics Opinion 305 reiterates the rule, stated in the District of Columbia Rule of Professional Conduct 1.13 and similar rules in other jurisdictions, that a lawyer who represents a trade association or other organization "represents the organization acting through its duly authorized constituents." Further, as stated in a comment to Rule 1.7, a lawyer who represents a trade association "is deemed to represent that specific entity, and not its . . . members or 'other constituents.'"

Several principles flow from the basic rule. Information that the trade association's attorney obtains from a member while the attorney is acting for the association is protected by the attorney-client privilege and the lawyer's duty to maintain her client's confidences. The privilege belongs to the trade association and not the member.[4] In addition, a lawyer for a trade association is not prohibited from representing the association in a matter adverse to a member.[5] In this circumstance, though, the association's lawyer should advise the member whose interest is adverse to that of the association of the conflict or potential conflict, that the lawyer cannot represent the member, and that the member may wish to obtain independent representation.[6]

Under What Circumstances Will an Attorney-Client Relationship Be Implied Between an Association's Attorney and a Member? Even though an attorney is deemed to represent the organization and not individual members of the organization, in some circumstances a trade association's lawyer will be found to represent a member of the association even though no retainer agreement has been executed and no invoices have been sent. If the circumstances surrounding the communications between the association's lawyer and the member are such that the member had a reasonable expectation of confidentiality and that the lawyer was acting on the member's behalf, an attorney-client relationship may be found by implication. In light of the potential consequences of being found to have an implied attorney-client relationship with a member, trade association counsel must guard against unwittingly stumbling into such situations.

In the leading case, *Westinghouse Electric Corp. v. Kerr-McGee Corp.*, 580 F.2d 1311 (7th Cir. 1978), a law firm for an association also represented a party in a law suit adverse to some of the association's members. The members had previously provided confidential information to the law firm in connection with the association's legislative efforts. Emphasizing that the members had an expectation of confidentiality as well as a reasonable belief the law firm was acting for both the association and the members, the court upheld the law firm's disqualification.

The *Westinghouse* approach has been followed by the Legal Ethics Committee of the District of Columbia, which has said that: "[w]hat is most important is whether the member of the trade association disclosed confidential information to the association's lawyer, and the surrounding circumstances and expectations."[7] Relevant factors in the analysis include:

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[3] D.C. R. of Prof'l Conduct 1.7, Comment [22].

[4] D.C. Bar Ethics Op. No. 305, at 2 n.3.

[5] *Id.* (citing Comment [13] to D.C. R. of Prof'l Conduct 1.7 and D.C. Bar Ethics Op. No. 216 (1991)).

[6] D.C. R. of Prof'l Conduct 1.13, Comment [8].

[7] D.C. Bar Ethics Op. No. 305, at 4.

- whether the lawyer affirmatively assumed a duty of representation to the member;
- whether the member had separate legal representation;
- whether the lawyer represented the member before he or she began representing the association;
- the nature of the disclosures that were made by the member to the attorney;
- the member's expectations of the attorney, and the reasonableness of those expectations;
- whether the member relied upon the attorney to represent its individual interests; and
- the size of the association (which may bear on the reasonableness of the member's expectation that the attorney was representing the member's individual interests).[8]

In *United States v. ASCAP*, 129 F. Supp. 2d 327 (S.D.N.Y. 2001), however, the court held that counsel for the American Society of Composers, Authors and Publishers did not have an attorney-client relationship with a member who was suing the association to recover royalties. The member argued that an attorney-client relationship existed because he had disclosed confidential information regarding his income and debts to ASCAP in order to receive advances against future royalties. In denying plaintiff's motion to disqualify ASCAP's counsel, the court pointed out that ASCAP's Articles of Association included a provision stating that ASCAP's counsel acts only on the association's behalf in all proceedings, including matters in which ASCAP and a member are adverse. *Id.* at 336.[9]

Are There Other Grounds on Which an Association's Lawyer Risks Disqualification? Even where an attorney-client relationship does not exist between the association's lawyer and a member, it may nevertheless be inappropriate for the lawyer to represent a client in a matter adverse to the member. An example of such a case is *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746 (2d Cir. 1981), in which the Second Circuit affirmed the disqualification of an attorney from representing a former executive of an association member in a breach of contract suit against the member company. The same law firm also represented the association in collective bargaining. Applying a "substantial relationship" test, the district court found that plaintiff's counsel likely gained access to confidential information about the member's employment policies and practices through his work for the association, and disqualified the lawyer. Affirming, the Second Circuit stated the test as follows:

> Disqualification will ordinarily be required whenever the subject matter of a suit is sufficiently related to the scope of the matters on which a firm represents an association as to create a realistic risk either that the plaintiff will not be represented with vigor or that unfair advantage will be taken of the defendant. *Id.* at 750.

The "substantial relationship" test is incorporated in the D.C. Rules of Professional Conduct, which provide that, absent consent, a representation that is adverse to a member is improper if:

a. the adverse matter is the same as, or substantially related to, the matter on which the lawyer represents the organization client[;]

b. during the course of representation of the organization client the lawyer has in fact acquired confidences or secrets . . . of the organization client or an affiliate or constituent that could be used to the disadvantage of any of the organization client or its affiliate or constituents, or

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[8] *Id.* at 5. *See also* United States v. ASCAP, 129 F. Supp. 2d 327 (S.D.N.Y. 2001).

[9] *See also* Ocean Club of Palm Beach Shores Condo. Ass'n v. Estate of Daly, 504 So.2d 1377 (Fla. App. 1987) (law firm for association could sue member of association); L'Association Des Proprietaires v. Redwine, 2002 WL 534137 (Cal. App. 2002) (former general counsel of homeowners' association could not represent former directors in suit against the association).

c. such representation seeks a result that is likely to have a material adverse effect on the financial condition of the organization client.[10]

As pointed out by D.C. Ethics Opinion 305, the D.C. Rules of Professional Conduct say that such situations raise "impairment of representation" concerns, without treating the member as an implied or "vicarious" client.[11]

How Does a Joint Defense Agreement Change the Picture?

Counsel representing trade associations or their members in antitrust investigations or litigation often enter joint defense agreements. A complete discussion of the issues surrounding such agreements and the joint defense privilege, as it is commonly known, is beyond the scope of this article.[12] There are several potential problem areas, however, that require highlighting.

What Is the Joint Defense Privilege? The joint defense privilege is an extension of the attorney-client privilege. As described by the Second Circuit, the joint defense privilege serves "to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel. Only those communications made in the course of an ongoing common enterprise and intended to further that enterprise are protected."[13] Similarly, the First Circuit has explained that "in order to establish the existence of the privilege, the party asserting the privilege must show that (1) the communications were made in the course of a joint defense effort, (2) the statements were designed to further the effort, and (3) the privilege has not been waived."[14]

The joint defense privilege belongs to each party to the joint defense effort.

The joint defense privilege belongs to each party to the joint defense effort.[15] Unless each party to the joint defense agreement consents to the privilege being waived, it can be waived only by subsequent litigation between the parties.[16] Thus, the joint defense privilege provides members of a trade association with a protection against disclosure they might otherwise lack, since the general rule, as discussed above, is that the association's lawyer represents only the entity.

Applications and Problems in the Trade Association Context.

• *Joint Defense Agreement as Basis for Antitrust Liability?* Counsel for trade association members sometimes react negatively when a joint defense agreement is proposed, out of concern that their company will incur antitrust exposure because it has signed a joint defense agreement and participated in a joint defense effort. Such concerns often are traceable to an early decision, *Jones Knitting Corp. v. Morgan*, 244 F. Supp. 235 (E.D. Pa. 1965), *aff'd in part and rev'd in part*, 361 F.2d 451 (3d Cir. 1966). The court held that restrictions contained in a joint defense agreement constituted a per se Sherman Act violation. The restrictions prevented signatories from entering settlement negotiations with a patent holder. The *Jones Knitting* decision has been criticized,[17] and

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[10] D.C. R. of Prof'l Conduct 1.7, Comment [14].

[11] D.C. Bar Ethics Op. No. 305, at 8 n.6.

[12] *See generally* ABA Section of Antitrust Law, Antitrust Evidence Handbook 92–95 (2d ed. 2002); ABA Section of Antitrust Law, Handbook on Antitrust Grand Jury Investigations ch. 9 (3d ed. 2002).

[13] United States v. Schwimmer, 892 F.2d 237, 243 (2d Cir. 1989) (citation omitted).

[14] United States v. Bay State Ambulance, 874 F.2d 20, 28 (1st Cir. 1989) (quoting *In re* Bevill, Bresler & Shulman Asset Mgmt. Corp., 805 F.2d 120, 126 (3d Cir. 1986)).

[15] *In re* Grand Jury Subpoenas, 902 F.2d 244, 248 (4th Cir. 1990).

[16] The Evidence Project, 171 F.R.D. 330, 525 (1997).

[17] Gould v. Control Laser Corp., 462 F. Supp. 685, 690–91 (M.D. Fla. 1978), *aff'd*, 650 F.2d 617 (5th Cir. 1981).

it appears inconsistent with current jurisprudence regarding the applicability of the per se rule to concerted refusals to deal. A more recent case, *Lemelson v. Bendix Corp.*, 621 F. Supp. 1122 (D. Del. 1985), involved a joint defense agreement to which a trade association and co-defendants in a patent infringement case were parties. The joint defense agreement required any party settling with the plaintiff to disclose the terms of the settlement to the other parties to the agreement. Rejecting the broad rule stated in *Jones Knitting*, the court held that the joint defense agreement did not support a claim of unlawful conspiracy under the Sherman Act.

• *Is Member Information Held by the Association Protected Against Disclosure?* As discussed above, the general rule is that the association alone, and not the individual association member, is the association lawyer's client. D.C. Bar Ethics Opinion 305 states that "[i]nformation obtained from a member while the lawyer is acting for the trade association is protected by the attorney-client privilege" and the lawyer's obligation to maintain her client's confidences.[18] The opinion further points out, however, that "it is the trade association that holds the privilege, not the member."[19] As previously discussed, in some circumstances, the member may have formed a reasonable belief that it was being represented individually by the attorney, in which case the attorney-client privilege and the lawyer's duty to maintain confidences apply to the member as well.[20] But in the absence of an implied representation, may the member's confidential communications be disclosed if the association decides to waive the attorney-client privilege? In this circumstance, the joint defense privilege is available to protect members against disclosure of their confidential information, provided appropriate steps have been taken to establish and preserve the privilege.

[C]ounsel representing trade associations or individual members must understand that a joint defense agreement may affect his or her ability to accept subsequent representations.

• *Will a Joint Defense Agreement Prevent the Association's Lawyer from Using Confidential Information in a Subsequent Engagement?* Joint defense agreements have obvious value, but counsel representing trade associations or individual members must understand that a joint defense agreement may affect his or her ability to accept subsequent representations. A 1995 formal ethics opinion of the ABA shows how a joint defense agreement may lead to ethical issues for an association's lawyer in subsequent matters.[21] Though the fact pattern addressed by the ABA opinion did not involve a trade association, the opinion would apply in that context. ABA Formal Opinion 95-395 addressed the following situation: a lawyer worked in a firm whose practice concentrated on insurance matters. The lawyer routinely represented Insurance Company in matters where it had common interests with other insurance companies, and frequently participated in a "joint defense consortium." The lawyer then left the firm and was approached by a client that wanted him to file suit against other members of the consortium, on a matter related to consortium matters the lawyer handled while at the firm. Insurance Company, however, would not be involved in the suit.

The ABA opinion analyzed this question in terms of a lawyer's duty to preserve confidences implied in the circumstances of a joint defense, separately addressing the lawyer's obligations to his former client, Insurance Company, and the other members of the consortium. With regard to the former client, the ABA observed that the lawyer had an obligation under Model Rule of Professional Conduct 1.6 not to reveal "information relating to representation of a client" without the client's consent. Information obtained by the lawyer through the joint defense consortium, pur-

[18] D.C. Bar Ethics Op. No. 305, at 2 n.3 (citing Comment [3] to D.C. R. of Prof'l Conduct 1.13 and D.C. Bar Ethics Op. No. 269).

[19] *Id.*

[20] *Id.*

[21] ABA Comm. on Ethics and Professional Responsibility, Formal Op. 95-395 (1995)].

suant to joint defense privilege, would fall within this definition "even though the information came not from Insurance Company but from another member of the consortium that was not represented by Lawyer." Thus, Insurance Company's consent would be required. "As a practical matter," though, the ABA thought it was unlikely Insurance Company would consent to the representation. Having signed a joint defense agreement, it "could not give such consent without exposing itself to liability to the members of the consortium whose confidences were involved."

ABA Formal Opinion 95-395 also addressed the lawyer's responsibilities to members of the joint defense consortium who had not been his clients. The ABA said that even though they were never the lawyer's clients, he had received information from them in confidence. While the lawyer did not owe an ethical obligation to the members of the consortium, he "would almost surely have a *fiduciary* obligation to the other members of the consortium, which might well lead to his disqualification." In light of this, the lawyer would "at a minimum" be obligated to warn his prospective new client of possible limitations on his representation, arising from his prior representation of Insurance Company. Further, the lawyer should consider whether his new representation would be "materially limited" by his responsibilities to Insurance Company or other members of the consortium, thus requiring him to decline the representation.

Similar issues have been addressed in court decisions. In *Wilson P. Abraham Construction Corp. v. Armco Steel Corp.*, 559 F.2d 250 (5th Cir. 1977) (per curiam), an attorney who had represented one of several parties involved in an antitrust grand jury investigation later sought to represent plaintiffs in a civil antitrust case against his former client's co-defendants. The court held that because there was a substantial relationship in the subject matters of the two representations, and confidential information was shared pursuant to joint defense privilege in the first matter, the attorney would breach a fiduciary duty if he later used the information to the detriment of the former client's co-defendants. More recently, in *National Medical Enterprises, Inc. v. Godbey*, 924 S.W.2d 123 (Tex. 1996), the Texas Supreme Court held that a lawyer was disqualified from representing plaintiffs in a lawsuit against a corporation because another lawyer in his firm previously had been retained by the corporation to represent an ex-employee in substantially related matters, and had received confidential information from the corporation pursuant to joint defense privilege. The court held that, even if the attorney could prosecute the suit without breaching the joint defense agreement, there would be a "strong appearance of impropriety." While not involving trade associations, these cases illustrate the potential pitfalls awaiting a lawyer for an association or a member who receives confidential information pursuant to a joint defense agreement, and attempts to undertake a subsequent representation that is adverse to one of the participants in the joint defense effort.

Conclusion

The ethical and practical issues that may arise in the context of an antitrust investigation or lawsuit involving a trade association and its members are complex, but manageable. If representation arrangements are established only on the basis of near-term budgetary concerns or administrative convenience, there may be serious adverse consequences later on, including waiver of privilege and disqualification. Thus, foresight and early consideration of potential conflict and privilege issues are critical. ●

A Study In Merger Enforcement Transparency:
The FTC's Ocean Cruise Decision and the Presumption Governing High Concentration Mergers

Warren S. Grimes and John E. Kwoka

When a divided Federal Trade Commission (3–2) closed its investigation of two proposed acquisitions involving the three largest firms in the ocean cruise industry, it took the unusual step of issuing a statement explaining its decision. That statement, together with the dissenting statement of two Commissioners and subsequent analysis provided by the Directors of the Bureaus of Competition and Economics, offers unique and welcome insights into the bases for an important merger enforcement decision.[1] These comments explore both the implications of providing greater transparency to key enforcement decisions and also the reasoning and consequences of the Commission's decision not to pursue either of the two very large proposed mergers in an already concentrated ocean cruise industry.

Greater transparency is a necessary step toward achieving responsible and comprehensible agency merger enforcement. Transparency is needed because it contributes to greater understanding and predictability in the law and because it nurtures public debate about, and effective oversight of, agency merger enforcement policy. Part I of these comments describes the need for transparency. Part II describes the FTC's experiment in transparency in the cruise merger investigation. In the spirit of carrying forward public debate and discussion, Part III offers comments on the adequacy of the Commission's reasons for closing this investigation. Our major conclusions are twofold: (1) that further concrete steps are needed to foster transparency, particularly when a federal agency closes an important merger investigation; and (2) that the Commission's proffered explanation in this instance did not justify departure from the presumption in the Merger Guidelines that a large merger in an already concentrated industry is likely to have substantial anticompetitive effects.

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Fostering Transparency in Merger Enforcement

A full measure of transparency might require that an agency operate in a fish bowl, revealing every investigative step that is taken and opening itself to interference from parties with conflicting interests. This degree of openness might well paralyze law enforcement. The Commission chose a far

[1] Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd. /P&O Princess Cruises plc & Carnival Corporation/P&O Princess Cruises plc., FTC File No. 021 0041 (Oct. 4, 2002) (FTC Cruise Lines Statement), *available at* http://www.ftc.gov/os/2002/10/cruisestatement.htm; Joseph J. Simons, Director, Bureau of Competition, Merger Enforcement at the FTC, Remarks to the Tenth Annual Golden State Antitrust and Unfair Competition Institute (Oct. 24, 2002), *available at* http://www.ftc.gov/speeches/other/021024mergeenforcement.htm; Bureau of Economics, FTC, Cruise Investigation: Empirical Economic and Factual Analysis (Nov. 22, 2002), *available at* http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf.

more limited and rational sort of transparency when it issued a short but comprehensive statement explaining its decision to drop the investigation of the cruise mergers. Publishing a timely explanation of the outcome of an important merger investigation has much to commend it. For example, the mere knowledge that a decision will have to be explained in public can encourage disciplined inquiry and decision making at the agency. After publication, the decision can provide the bar with better understanding of the agency's interpretation of the law and can foster legitimate discussion and oversight of the agency's decision.[2]

Concern with transparency in antitrust enforcement is not new. Legislation, such as the Tunney Act, governs the Justice Department's settlement of litigated antitrust cases and is designed to promote, among other goals, transparency in agency enforcement decisions.[3] But different rules, or no rules, govern merger investigations that produce no litigation, and the same approaches are not applied at the DOJ and the FTC. There is, in short, no comprehensive and well-conceived approach to transparency for merger investigations.[4]

This is unfortunate given the importance of merger enforcement to a well-functioning economy. The agencies have the power to preserve a premerger industry structure that is conducive to competition, or at least more so than the structure that would be created by the unchallenged merger. No other area of enforcement offers the agencies a comparable opportunity for preventative structural medicine. Because of its importance, agencies should not be asked or allowed to conduct merger policy in secrecy. The agencies do, of course, offer guidance by publishing merger guidelines, but the process remains fact intensive and often highly complex. Without an adequate flow of information, it is difficult to understand and meaningfully critique merger enforcement policy. Attorneys advising clients also need information about agency decisions in order to advise clients accurately. Yet publicly available information on agency enforcement decisions is often inadequate.

Under current U.S. practice, when a federal agency challenges a merger, its reasoning can be announced through the proposed federal court complaint, explanatory documents required by statute or regulation, and a motion for a preliminary injunction that the agency files.[5] This information often falls short of what is required for needed transparency (or what is offered by the European Commission in a typical explanatory statement). However, if the agency chooses not to challenge an acquisition, or if the Department of Justice employs a "fix it first" approach that does not require the filing of a court complaint, there is no requirement that any explanation be made public, and a comprehensive disclosure is the exception. The Commission has offered explanations on occasion, as in the statements in 1997 when the agency decided not to pursue the Boeing/McDonnell Douglas acquisition.[6] Perhaps the Commission chose to issue statements in

[2] For a more comprehensive examination of the benefits and costs of transparency in the context of agency antitrust enforcement, see Warren S. Grimes, *Transparency in Federal Antitrust Enforcement* (Study to Be Presented at Annual Conference of the American Antitrust Institute (June 2003) and to be published in the BUFFALO L. REV.) (on file with the author).

[3] The Antitrust Procedures and Penalties Act, 15 U.S.C. §16(a).

[4] The applicable laws and regulations governing the Federal Trade Commission and the Antitrust Division of the Department of Justice, as well as procedures governing the FCC, FERC, and the European Union, are described in Grimes, *supra* note 2.

[5] These statutes and procedures are described in Grimes, *supra* note 2.

[6] Boeing Co., [1997–2001 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997). On other occasions the Commission has chosen to disclose far more than required, underscoring the discretion that it has and sometimes chooses to employ. *In re* General Motors Corp., No. C-3132, 1984 WL 565376 (FTC Apr. 11, 1984).

that matter because of the parallel EU investigation and the media attention to the issues. The Commission's cruise mergers statement (signed by three Commissioners) and the separate dissenting statement (two Commissioners) are a second example of such disclosure, perhaps not surprisingly in a case involving merger investigations by both the EU and the United Kingdom that were widely reported in the press.

The FTC statements in Boeing and cruise lines tend to undermine claims that such explanations are precluded by confidentiality rules or will unduly restrict the agency's flexibility. The FTC pointed out that its decision not to pursue either of the proposed cruise lines acquisitions was based on specific and complex circumstances of this particular industry and should not be read as indicating that large mergers in highly concentrated industries would be permitted in another case.[7]

Statements Explaining Agency Decisions for Important Merger Investigations. The need for public disclosure of the results of important U.S. merger enforcement decisions goes beyond responding to short term media pressures that may be generated by parallel (and more transparent) investigations outside the United States. Systematic transparency is needed if oversight and accountability are to be meaningful. The most obvious need for information occurs when an agency decides not to pursue an acquisition after conducting an in depth investigation. As FTC Bureau of Competition Director Joseph Simons has said: "it seems obvious that explaining why the Commission decides not to take action in a particular case may well provide at least as much useful information as an explanation of why the Commission decides to take action in other cases."[8] Obviously, the great bulk of merger transactions raise no genuine antitrust issues. But when an agency devotes substantial resources to investigating a proposed acquisition (the cruise mergers were investigated by the FTC for ten months), an explanation of the agency's decision should be provided, regardless of the final disposition. It would be an enormously helpful change in current practice for the agencies systematically to provide such disclosures.

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One way of achieving needed transparency would be for the Antitrust Division of the Justice Department and the FTC to issue statements explaining a decision to close a merger investigation whenever the agency requests additional information from one or more of the merging parties. The issuance of a second request is not an infallible measure of the importance of an agency investigation. Until a better measure is identified, however, the second request should be the trigger mechanism for requiring an agency explanation. The statement should identify the issues of concern and provide the agency's response to the major points in contention during the investigation. That should include information about the relevant market (often in dispute), the degree of overlap among participating firms, and at least the general range of concentration figures (if confidentiality prevents more precise disclosure).[9]

Legislative action to provide for transparency may be required, particularly if overreaching laws designed to protect business secrets unnecessarily undermine legitimate transparency goals. There would be advantages, however, if the agencies took the initiative. By doing so, the agencies could forestall legislation that might create an overly rigid or cumbersome mechanism. In the near term, a solution to the transparency problem might be for each agency to set its own standards,

[7] FTC Cruise Lines Statement, *supra* note 1.

[8] Simons, *supra* note 1.

[9] The Commission's cruise merger statement failed in several respects to meet this standard. For example, the Statement failed to address the strategic conduct issues raised by persons commenting on the proposed mergers. *See* discussion *infra* Part III.

or establish standards that are jointly agreed upon, based on the importance of the investigation and the amount of agency resources devoted to it, for determining when a public statement of explanation should be issued.

The Cruise Merger Case as a Case Study in Transparency

The unusual transparency in the FTC's cruise merger determination provides a model for transparency efforts. It also permits a more informed critique of the FTC's decision than could have been undertaken in the absence of disclosure. More informed oversight is a primary benefit of transparency.

Beginning in December 2001, the largest firm (Carnival Corp.) and the second largest firm (Royal Caribbean Cruises, Ltd.) in the ocean cruise industry battled one another to acquire the industry's third largest firm (P&O Princess Cruises plc). The FTC investigation of these dueling merger proposals gave rise to intense advocacy by the merging parties and to an active role by the American Antitrust Institute (AAI), which urged the Commission not to approve either transaction as proposed.[10]

From the outset of this matter, there was an unusually high degree of public visibility of these transactions because officials from each of the two would-be acquiring firms were anxious to tell their side of the story. In addition, the parallel investigations by competition authorities in the United Kingdom (investigating the proposed Royal Caribbean joint venture with Princess) and the European Union (investigating the proposed Carnival acquisition of Princess) generated additional information and interest in the proposed transactions. The FTC's investigation involved an unusually comprehensive collection of data, which was used by Commission staff to conduct various analyses.[11] The investigation moved through a number of phases. Early contacts between the would-be acquiring firms and the AAI suggested that the key issue was whether the market consisted only of North American cruise offerings, or whether all vacation opportunities should be included in the market. Later, after the European Union decided that a market definition limited to cruising was required, the parties focused their attention on various possible anticompetitive effects of an acquisition of Princess Lines by either of the suitors.

Before the Commission reached its decision, both the UK and the European Union had determined not to challenge these mergers and issued detailed statements explaining the grounds for their decisions.[12] For the North American cruise market, the FTC faced substantially different conditions that threatened greater anticompetitive effects. One obvious difference was the size and the maturity of the markets. In 2001, there had been only 1.9 million European cruise passengers (a penetration rate of 0.4% of the population) compared to 7 million North American cruise passengers (a penetration rate of 2.2%). U.S. passengers constituted 72% of worldwide demand.[13]

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[10] The AAI is a non-profit research and advocacy organization that occasionally takes positions involving proposed mergers or acquisitions. The AAI's goals and activities are described more fully at its Web site, http://www.antitrustinstitute.org.

[11] Simons, *supra* note 1 (reporting that the FTC received "enormous amounts of data" on capacity utilization, actual transaction prices, and financial data).

[12] Commission of the European Communities, Case No. COMP/M.2706 (Carnival Corporation/P&O Princess) C(2002)2851 (July 24, 2002), *available at* http://europa.eu.int/comm/competition/mergers/cases/ (57 pages); Competition Commission (UK), P&O Princess plc and Royal Caribbean Cruises Ltd: A Report on the Proposed Mergers (June 19, 2002), *available at* http://www.competition-commission.org.uk (115 pages not including the extensive appendices).

[13] *Carnival Corp.*, ¶ 15.

The growth rate for the industry was also higher in Europe than in the United States,[14] suggesting that entry into the U.S. market might be less attractive. Moreover, the concentration levels in the North American cruise market appeared to be substantially higher than figures for Western Europe.[15] For these reasons and others, the UK and EU decisions were not good predictors of the U.S. antitrust posture toward the mergers.

When its decision to close the investigation was announced, the Commission indicated that it was issuing an explanatory statement because of the high degree of press attention and the complexity of the issues. Whatever the motivation, the explanatory statements of the Commission and the dissenting Commissioners are an affirmative step toward needed transparency.[16]

On market definition, the Commission statement emphasized the complexity of the market and the relatively elastic demand for cruises by a significant percentage of customers, many of whom would be taking a cruise for the first time. Although some of these factors pointed toward an "all vacation" market, the Commission nonetheless accepted a narrower definition limited to cruise lines because a hypothetical monopolist in that market "could likely use yield management systems" to raise prices profitably.[17] Yield management is a technique by which sellers in low marginal cost industries, such as airlines and hotels, effect a price discrimination scheme: the firm seeks to charge higher prices to less price sensitive customers while still offering discounts to more price sensitive customers in order to operate at or near maximum capacity. Computerized yield management is used by cruise lines, which adjust prices upwards or downwards based on whether bookings for a particular cruise or types of accommodations for that cruise are above or below levels set by the firm for any phase of the booking cycle.

Both the Commission and the dissenting statements agreed that, in the words of the majority, "either transaction would significantly increase concentration in a market already highly concentrated." After either acquisition, the industry would have a lead firm with nearly 50 percent of the North American cruise market (the top two firms will control over 80 percent and the top three firms over 90 percent of the market). With post-merger Herfindahls in the 3700 range, the agency Merger Guidelines provide that the merger will be presumed "to create or enhance market power or facilitate its exercise."[18] Although the dissenting Commissioners stressed the importance of the presumption, the Commission statement did not mention it. Instead, the Commission stressed language from the Guidelines that market share and concentration data "provide only the starting point for analyzing the competitive impact of a merger." As discussed below, the Commission assessed and discarded as unlikely various theories of anticompetitive effects that might flow from either transaction.

Significantly, the Commission statement did not address possible strategic behavior by the post-merger firm that could disadvantage rivals or raise entry barriers. The dissenting Commissioners did address the issue, in particular indicating that a clear market leader might force key travel

[14] *Id.* ¶ 16.

[15] The European Communities statement reported that the market shares of a combined Carnival and Princess would be between 20–30% for Germany and between 25–35% for the UK, the countries for which the overlap raised the most significant competitive issues. *Id.* at ¶ 113.

[16] Warren S. Grimes et al., *The FTC's Cruise Lines Decisions: Three Cheers for Transparency*, FTC WATCH, No. 599, Nov. 18, 2002.

[17] FTC Cruise Lines Statement, *supra* note 1. The European Union had likewise considered and rejected, after considerable analysis, arguments for a broader market encompassing vacation alternatives to cruising. *Carnival Corp.*, ¶¶ 28–68.

[18] U.S. Dep't of Justice and Federal Trade Comm'n, Horizontal Merger Guidelines § 1.51(c) (1992 rev. 1997).

agents to accept exclusive contracts or pressure port authorities to deal with competitors on unfavorable terms.[19]

Overall, the statements document that the Commission and its staff addressed the issues underlying the cruise mergers with a thoroughness that is commendable. Its willingness to disclose aspects of that analysis is also commendable. We find troubling, however, the fact that the Commission did not offer a well-reasoned ground and factual basis for sidestepping the presumption that large mergers in highly concentrated markets are likely to generate anticompetitive effects.

Did the Commission Give Proper Weight to the Presumption of Anticompetitive Effects?

The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement.

The Presumption Governing Large Mergers in High Concentration Industries. The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement. One of these roots is Edward Chamberlin's insight that participants in a tightly oligopolistic market will recognize their interdependence and their mutual interest in a high price, and act accordingly.[20] Today's economic treatises amplify Chamberlin's point about oligopolistic industries: the higher the concentration, the greater the likelihood of anticompetitive effects through collusion or tacit parallel conduct.[21] In addition, higher concentration may facilitate anticompetitive unilateral action (for example, by combining firms in the same or closely related niche markets) and may increase the merged firm's opportunities for strategic conduct involving upstream or downstream markets (vertical effects).

These insights about coordinated interdependent action, unilateral action, and strategic behavior provide the basis for the modern version of the presumption that large mergers in a concentrated industry are likely to be anticompetitive. The Supreme Court first expressly applied the concentration presumption in *United States v. Philadelphia National Bank* in 1963[22] and it has been restated in all four editions of the Merger Guidelines.[23] While this presumption can be overturned in economics and in law by a number of offsetting factors, the presumption serves a very important procedural role. It shifts the burden of persuasion to proponents of a merger when the anticompetitive risks are highest.

In closing the cruise mergers investigation, the Commission majority chose not to honor the presumption. Rather, it conceded only that the rise in concentration is "interest-provoking." Even more notably, the reason that the Commission rejected the presumption was not because of such factors as entry conditions, but rather because it insisted upon, and did not find, "evidence to sup-

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[19] Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, Royal Caribbean/Princess and Carnival/Princess (Oct. 4, 2002), *available at* http://www.ftc.gov/os/2002/10/cruisedissent.htm.

[20] Edward Chamberlin, The Theory of Monopolistic Competition 46–48 (1933).

[21] F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance ch. 6 (3d ed. 1990).

[22] 374 U.S. 321, 363 (1963) ("[W]e think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.")

[23] The Guidelines were amended in 1997 without altering the presumption, which appears in Horizontal Merger Guidelines § 1.51(c).

[24] Although the Commission Statement does not directly address the presumption, in a subsequent speech, FTC Competition Director Joseph Simons acknowledged it and offered an explanation as to why the Commission majority chose not to follow it. Simons, *supra* note 1.

port one or more viable theories of antitrust violation."[24] It is indeed the case that the agency staffs are being challenged to offer increasingly specific theories of competitive harm, buttressed with whatever evidence can be marshalled.[25] While this is in principle unobjectionable, even desirable, it should be recognized that in practice competitive harms from mergers are almost always speculative, since mergers are consummated well before any empirical judgment on effects can be rendered. Demanding "proof" or even placing the "evidence bar" very high may seem like good policy, but it is tantamount to reversing the presumption of the Guidelines.

Of course, the Guidelines' presumption can be overcome by a proper showing.[26] In cases like the Boeing acquisition of McDonnell Douglas, the Commission has allowed mergers to very high levels of concentration.[27] The departure from the Guidelines in Boeing was explained because McDonnell Douglas, with only 5 percent of the world market for large civilian aircraft, was deemed unlikely to survive as an independent competitor and, although this was not emphasized in the Commission's statement, perhaps because of the large size necessary to maintain economies of scale and because any market power of the surviving firms could be mitigated by powerful, savvy buyers of the aircraft.

No such factors were cited in the Commission's cruise mergers statement. It cited several matters that could justify disregarding the presumption: (1) "changing market conditions," in particular the rapid growth and evolving service offerings in the industry; (2) the limited "degree of difference between services in this market and those outside" that will allow potential cruise customers to choose among various non-cruise vacation options; and (3) "particular circumstances here that would render either unilateral or coordinated [anticompetitive] effects unlikely." Although there is validity to many of these individual points, at the end of the day, the Commission's statement failed to define principled ground for disregarding the presumption.

Goldilocks Economics: The Commission's View of Cruise Mergers

There are, broadly speaking, three possible theories of anticompetitive effects from the cruise mergers. These are: (1) unilateral effects whereby a single firm takes advantage of its large size or its product niche to extract a price increase by itself; (2) coordinated interactions among the now-smaller number of firms resulting in higher prices for a substantial percentage of customers; and (3) strategic behavior that might increase entry barriers and/or disadvantage rivals, reducing overall competition in the industry. The Commission addressed the first two theories and found them lacking. The third concern was addressed only by the dissenting Commissioners. Under any of the three theories, a large merger in a highly concentrated industry would raise the risks of anticompetitive effects and, accordingly, should be subject to the Guidelines' presumption. Here we discuss each of these in some detail, focusing on the Commission's explanation for dismissing the concern and ignoring the presumption.

Unilateral Effects. Unilateral effects may arise in a number of circumstances. In an industry of differentiated products, company A enjoys some power to raise its prices without losing all its customers to company B or C. But if the price increase is substantial, A will lose too many customers to rivals to make that price increase profitable. A merger between companies A and B, however,

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[25] This is one reason for the increased emphasis on the unilateral effects theory, which has the trappings of specific and even quantifiable economic analysis—regardless of whether it is the most likely source of competitive harm from a merger.

[26] Horizontal Merger Guidelines § 1.51(c).

[27] *Boeing Co.*, *supra* note 5.

could recapture some of those losses, in the form of B's increased profits, thereby making the price increase profitable to the merged company. Since this is a decision made strictly by the parties to the merger, it is a "unilateral" effect, that is, not dependent on rivals' cooperation. Another scenario giving rise to unilateral effects involves capacity constraints. If C is constrained in its ability to increase output—whether due to production limitations, government regulation, or other causes—the merged firm (companies A and B) may be able to raise price unilaterally by reducing its output. Closely related to the latter is the case of a "dominant firm," whose output is sufficiently large as to be able to influence market price—again subject to the ability and interest of rivals to alter their production plans so as to undermine the increase.

. . . the Commission advances what might be termed "Goldilocks economics"— an effort to make two contradictory points by asserting there is just enough of one characteristic to sustain the first point but not so much as to undermine the second.

Since the introduction of this theory in the 1992 Merger Guidelines, much analytical work in economics and much (some argue, too much) attention in antitrust have been paid to unilateral effects from mergers. In its statement on the cruise mergers, the Commission dismissed concerns based upon this theory. It contended that no two of the companies are uniquely close competitors, but rather all have products that overlap extensively. That is, there is too much competition among all of them to allow unilateral action from a merger of any two to pay off. Moreover, it argued that rivals could and likely would "replace any lost competition" by such strategies as building new ships and reconfiguring existing ships. This ability to increase capacity, the Commission contended, would prevent any single firm from profiting by unilaterally reducing output or capacity.

These are relevant considerations, but the available evidence in this case is not convincing and the Commission's line of reasoning leaves much to be desired. While it certainly appears true that the cruise companies' offerings have many similarities, they are not identical in destinations, amenities, prestige, and other attributes that arguably matter to customers. Ironically, the Commission makes this very point in the next section where it discounts the risk of coordination because there is supposedly too much differentiation for agreement among the companies. As we shall see, this is not the only instance in which the Commission advances what might be termed "Goldilocks economics"—an effort to make two contradictory points by asserting there is just enough of one characteristic to sustain the first point but not so much as to undermine the second.

Also dismissed by the Commission majority is any concern that constraints on output expansion by rivals might confer unilateral pricing power on the merged company. But here the flaw in the Commission's argument is not a matter of speculation. The dissenting Commissioners noted apparently uncontroverted evidence regarding the Alaska cruise trade.[28] Rivals to a Carnival-Princess merger would face a company with an overwhelming share of the Alaska niche and with "certain advantages in terms of land facilities, port access, and park permits." Rivals, in short, would be hard pressed to expand output to defeat a unilateral price increase by the merged company, because while they might have cruise ships available, they would not have the necessary access to ground and water infrastructure to actually expand their offerings.

The Commission's opinion makes no direct mention of Alaska, but it does assert that rivals could, among other things, "build new ships [and] reconfigure ships" to defeat a unilateral price increase or capacity reduction. But reconfiguring entire ships, much less building new ones, is an expensive and time-consuming activity, and certainly not one to be undertaken without assurance that the relevant market will be a profitable market three or four years hence. Regulatory barriers in the Alaska market might, in any event, prevent a rival's use of ships in the Alaska market. The

[28] Dissenting FTC Cruise Lines Statement, *supra* note 19.

Guidelines are quite clear that delayed and speculative capacity expansion is not an antitrust remedy for output contraction.[29] The Commission's opinion elevates the uncertain prospect of capacity expansion to a status inconsistent with the Guideline's admonition.

Coordinated Effects. Most mergers historically have been evaluated in terms of their potential to improve firms' ability to coordinate their strategies with respect to price and other parameters of competition. A significant reduction of numbers and/or increase in concentration from a merger forms the basis for the longstanding presumption of competitive concerns that underlies the Guidelines. In its statement on its cruise merger analysis, by contrast, the Commission concedes no such presumption but only that its "interest" has been "provoked." This interest-provocation standard would appear to be quite different from the Guidelines' presumption, and indeed the majority immediately makes clear what is required to satisfy its interest: "A viable coordinated interaction theory must establish why either [merger] would likely reorient these powerful [competitive] incentives in a dramatically different direction."[30] As noted previously, this standard is tantamount to reversing the Guidelines' presumption by placing the burden of proof on complainants (staff or injured outside parties), rather than on the parties to a high concentration merger.

That this is the effect soon becomes clear in the Commission's statement. Based on this standard, the majority segues into an enumeration of factors that make coordination arguably more difficult and then, in a flourish, states that coordination theories are therefore not viable. Even before considering those factors, this reasoning is a non sequitur. The fact that some factors are unfavorable does not justify a conclusion that they outweigh those other factors that favor coordination.[31] After all, no real world industry possesses all possible features that facilitate coordination. Moreover, this line of reasoning fails altogether to address the question raised by the merger: Given these considerations, which now seemingly hinder coordination, might a reduction in the number of companies be sufficient to tip the balance and bring coordination about? The majority's discussion casts no light on this question.

The factors identified in the discussion of coordinated effects as apparently convincing to the Commission are the following: complex prices due to variety of products, inability to monitor rivals' prices, demand which is mostly very elastic, and the need for complex price discrimination in the industry.[32] This list is notable for what was previously termed "Goldilocks economics." Here we are told that cruising is much too complex and differentiated a product to permit price coordination, whereas previously the majority claimed that cruise offerings overlapped too much and were too similar to permit unilateral pricing action. Which is it? Apparently not too little, not too much, just the right amount of differentiation. This may be possible. But it also becomes increasingly unlikely as concentration levels rise and the risk of unilateral or coordinated anticompetitive effects increases: just enough differentiation to *discourage* coordinated effects may be more than enough to *encourage* unilateral effects.

Similarly, the Commission asserts that cruise firms lack reliable information about rivals' prices and thus cannot coordinate pricing. Yet in support of its earlier argument that cruising is an antitrust market, it asserted that cruise lines "expend significant effort to monitor (to the best of their

[29] Horizontal Merger Guidelines §§ 1.32, 3.2.

[30] FTC Cruise Lines Statement, *supra* note 1.

[31] The Commission's argument here would fail its own standard of proof, namely, providing evidence that "establishes" the stated conclusion.

[32] Two other factors are listed earlier as altering the meaning of concentration data: changing market conditions, and the degree of difference between services in this market and those outside. Oddly, neither of these is discussed again in this context.

ability) each other's prices." Apparently, price information also falls into the Goldilocks category—not too hot, not too cold, just right to somehow sustain both arguments. While full information is not available to us, it is noteworthy that the dissenting Commissioners allude to evidence that the cruise lines do in fact engage in actions and counteractions on price—that is, they are knowledgeable about and responsive to each others' prices.[33]

Coordination and Yield Management. The Commission statement goes on to discuss at some length the cruise lines' use of yield management systems as a tool for price discrimination, and also the evidence that it claims refutes the contention that yield management might aid coordination. The cruise industry, like other low-marginal cost industries, such as hotels or airlines, has a strong incentive to operate at full capacity. Indeed, the cruise lines' incentive to fill the ship lies not only in the low marginal costs of the industry, but also in the substantial additional revenue generated by passengers. According to one industry observer, cruise lines generate up to one fifth of their revenues from on-board charges.[34] To maximize fare revenues while still filling the ship, cruise firms use carefully orchestrated price discrimination that adjusts fares based on a variety of factors, including the relative price insensitivity of some customers. Sophisticated computerized yield management programs adjust fares based on the number of bookings at each phase of the booking cycle. When a popular cruise attracts a large number of early bookings, the yield management system raises fares, slowing demand but forcing less price sensitive customers to pay more. Yield management, then, is anything but a random system. For any cruise for which bookings are at or above the norms set by the firm at any stage of the booking cycle, prices will go up (and less price sensitive consumers who book at that particular stage will end up paying more). The percentage of total consumers who will pay higher prices because of this relative price insensitivity will vary with each cruise (or even with the berth accommodations for that cruise). What is clear, however, is that on average there are a substantial number of these customers—without them, the yield management system would not be worth the substantial cost that a cruise line invests in its development and operation.

Whether yield management aids or hinders coordination is an important policy question not only in this industry but also in others that might find sophisticated software useful in managing their pricing. There is no simple answer. Yield management more finely discriminates in price, making coordination more challenging, at the same time that it systematizes pricing strategies, making coordination more feasible. The Commission seeks nonetheless to give a simple answer in this case, and that answer is that, on the evidence, neither merger "would enable the putatively coordinating cruise lines to agree tacitly and successfully implement a price increase based on booking characteristics." And what exactly is that evidence? The majority opinion references "empirical analyses" of "actual transactions" that found (a) prices in some cases rose but in others it fell as the sail date approached, (b) there was "dramatic" variation in the degree of change, (c) the proportion of early bookings also varied "dramatically," (d) there is no consistent correlation among prices on directly competitive cruises, and (e) the prices of different categories of berths vary unsystematically.

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[33] The Carnival Statement of the European Communities also found that cruise lines were responsive to the pricing of rival cruise lines. *Carnival Corp.*, *supra* note 12, ¶ 59.

[34] Jane L. Levere, *Personal Business; Some Travel Bargains by Air, but Even More by Sea*, N.Y. TIMES, Apr. 6, 2003, at Sec. 3, p. 11 (quoting Credit Suisse First Boston analyst Scott Barry, who stated that because as much as 1/5 of cruise lines' revenue is generated from passengers on-board expenditures, "cruise lines always sail full.").

While the effort at empirical analysis is to be commended, it is not clear that the stated inferences deserve weight. Consider, for example, the first finding, that prices over the booking cycle sometimes rose and at other times fell. While the Commission takes this as evidence of the lack of anticompetitive coordination, this is what one would expect of a well-designed yield management system. Toward the end of the booking cycle, if berths remained unfilled, the cruise line should and—with yield management in its tool kit—would lower prices. If the cruise were nearly full, prices would rise. This uneven and unpredictable variation is yield management at work, without implications for coordination. It is surprising, as well as disappointing, that the Commission would be tempted by this implication when the cited fact simply does not distinguish between competing hypotheses. Similar observations might be made about the Commission's conclusions in other instances. The conclusions have meanings that are ambiguous, so that they could just as easily be cited by advocates of the opposing view, namely, that yield management enhances coordination.

This last point underscores another persistent problem in the Commission's analysis. At best, the cited empirical evidence concerns current industry practice, whereas the relevant policy question is whether the merger will increase the likelihood that yield management can be used in an anticompetitive manner when the number of significant companies is reduced from four to three. As before, the Commission's focus on pre-merger practices seeks to answer a factual question relevant to the past, whereas the real issue concerns conduct in the future.[35]

Other aspects of the Commission's discussion of yield management also raise concerns. There is no explicit recognition that while yield management may help in filling available berths (or airline seats, etc.), that does not imply that the price at which most customers secure berths are somehow more reasonable or closer to competitive levels. If yield management were to work perfectly, the only berth whose price would be at the competitive level—approaching marginal cost—is the last berth sold. Every other berth would be priced higher than the competitive level. Under less ideal (and more realistic) conditions, effective yield management will raise the average fare above the level that could be charged absent this sophisticated tool of price discrimination.

Moreover, any implication that yield management is benign in its impact on coordination is belied by experience in the industry for which sophisticated yield management was invented, namely, airlines. The airline industry has both used its sophisticated pricing software to aid coordination, and at other times readily found ways to circumvent its limitations.[36] While the airlines' experience is not an infallible guide to the effects of yield management in other industries—for example, pricing in the cruise industry may be less transparent than pricing in airlines—neither is there a basis for concluding that yield management generally obviates concern.

Coordination on Amenities and Capacity. Briefer comments on coordination with respect to amenities and capacity will suffice. With up to one fifth of a cruise line's revenue generated from on-board sales, amenities are a vital component in the financial performance of this industry. As noted earlier, the majority statement dismisses concern with coordination of quality ("amenities") by asserting that amenities are important, there are unilateral incentives to cheat, and so coordination would be undermined. Taken at face value, this line of reasoning is tantamount to a blanket denial that

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[35] Indeed, if the Commission found evidence that yield management aided price setting today, it might then argue that the merger raises no policy concern since it would not make matters worse.

[36] *See* Severin Borenstein, *Rapid Price Communication and Coordination: The Airline Tariff Publishing Case* (1994), *in* The Antitrust Revolution 310 (John Kwoka & Lawrence White eds., 3d ed. 1999).

coordination can ever occur when parties have differing self-interests—a proposition that is demonstrably false, and an altogether inadequate basis for dismissing the concern. This is particularly unfortunate since the coordination of non-price terms will be more easily accomplished in a more concentrated industry. For example, following the lead of the largest firm, the remaining firms in this highly oligopolistic industry could determine to change refund policy in a manner that increases costs to customers. Or they might tacitly follow the lead firm in setting the rules for which services are included in the fare and which services are subject to additional on-board charges. These examples are merely illustrative of the ways in which a concentrated industry might tacitly coordinate non-price terms.[37] Coordination of less transparent policies could have the effect of raising prices for price sensitive as well as price insensitive consumers. At the point of booking, a first time cruise passenger (who may be price sensitive) may be unaware of, or pay little attention to, policies governing refunds or on-board charges for amenities.

As for capacity coordination, the Commission's argument rests on two propositions: (a) the number of ships that would have to be withdrawn is very large, and (b) their redeployment would cause unacceptable profit declines elsewhere. The bases for these claims are not provided, but even if true they would not address the possibility that capacity might be reduced by such strategies as deferring new ship purchases, delaying some already contracted for, or reconfiguring ships under construction for more higher-price berths. In addition, the Commission here employs another variant of its Goldilocks reasoning: Previously we were told that the cruise lines could build and reconfigure ships easily enough to defeat any effort at a unilateral price increase, but the Commission now asserts there are contractual and other impediments sufficient to preclude capacity contraction. This redeployment "mattress" is, the Commission would have us believe, just right: soft enough to defeat unilateral action, but hard enough to counter coordinated effects. Unlike Goldilocks, who could do her own empirical testing of mattresses, the Commission must make its predictions based on ambiguous evidence that three Commissioners interpreted one way, and two Commissioners interpreted another way. This is hardly a reassuring basis for disregarding the presumption governing large mergers in high concentration industries.

Strategic Conduct. Strategic conduct has occupied the economics profession greatly in the past twenty years. Research has shown the possibility of new types of anticompetitive behavior and re-examined some traditional concerns that had been relegated to the dustbin. The result has been a much greater appreciation of the variety of methods by which an aggressive company can secure an advantage over its rivals, ultimately diminishing their competitive force and conferring greater market power on the company that initiated the conduct. While this is not the place to review this body of literature,[38] it is important that these issues be considered in antitrust analysis. The Commission has, for example, given weight to possible strategic behavior in imposing requirements on Time Warner's acquisition of Turner Broadcasting.[39] The Commission's cruise merger statement is, unfortunately, silent on these matters. Here we note two examples of potentially anticompetitive strategic conduct.

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[37] Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, and Rules*, 2000 WIS. L. REV. 941, 949–84 (2000) (describing and analyzing collusion by manipulation of the rules under which competition takes place).

[38] *See, e.g.*, JEFFREY CHURCH & ROGER WARE, INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH (2000); Tefft W. Smith & Hillard M. Sterling, *Challenging Competitors' Mergers: A Real Strategic Option*, 65 ANTITRUST L.J. 57 (1996).

[39] Time Warner, Inc., 61 Fed. Reg. 50,301 (1996). *See* Stanley M. Besen et al., *Vertical and Horizontal Ownership in Cable TV: Time Warner-Turner* (1996), *in* THE ANTITRUST REVOLUTION, *supra* note 36, at 452.

One important resource for consumers confronted with opaque pricing schemes is the expertise of the independent travel agent. But this resource too may be jeopardized by the tight oligopoly that will result from an acquisition that produces a single firm with 50 percent of the market. Any supplier can be expected to push its downstream resellers for loyalty and favored treatment. The independent travel agent is in a position to resist this pressure (and should have a substantial incentive to provide consumers with neutral advice) as long as booking options are dispersed among a sufficient number of cruise lines. In the post merger world, the leverage of the largest firm will now be substantial, perhaps sufficient to force travel agents to give it favored treatment under circumstances that will not be revealed to the consumer.

Some travel agents may be persuaded to book exclusively for the largest firm, raising the cost of rival firms to obtain bookings. The result must be a further undermining of competition. This means that rival cruise firms will no longer have access (or be denied access on equal terms) to a substantial body of travel agents, increasing their costs of doing business.

These are merely examples of how the post-merger form may exercise power strategically. Other credible theories of strategic abuses include the wielding of influence with regulators who may control access to ports or facilities that could raise costs for rivals. This was a concern of the dissenting Commissioners with respect to the Alaska niche market. Further confirmation of the potential for anticompetitive strategic conduct might be found in the history of such conduct in the airline industry, where large carriers have for many years employed computer reservation systems to gain advantages over rivals.

The Commission's Treatment of Rivals' Submissions. The Commission's statement contains language that may be construed as endorsing second-class treatment of merger-investigation submissions by rival firms. After noting that both the merging parties and competitors have a self-interest in presenting information to the Commission, the statement singles out competitor-supplied information for special comment. Opposition from competitors, the statement suggests, "often indicates that the transaction will increase—rather than decrease—competition." This is so, the statement continues, because higher prices from the anticompetitive effects of a merger would benefit rivals (and rivals would support the merger).[40]

The reasoning in the statement is vulnerable. First, it should be noted, few mergers turn out to have the efficiency benefits that merger parties tout.[41] Even if a merger is efficient, it may not promote competition, so this would not be an incentive for a rival to oppose it. Moreover, whether or not a merger is efficient, there are three ways in which it can be anticompetitive (unilateral effects, coordinated effects, or strategic conduct). Only one of these ways (coordinated effects) would benefit all rivals, and even then only if all rivals are similarly situated. Unilateral anticompetitive effects may benefit some rivals, but would not necessarily benefit others. There would be no benefit if the unilateral price increase occurs in a niche market where rivals play no significant role (e.g., Alaska cruising). Strategic effects, far from benefiting rivals, are usually designed to handicap rivals and can be severely threatening to them. Although it is possible that rivals may oppose a merger because they fear a more efficient post-merger firm, an equally likely explanation for a rival's opposition would be its fear of the strategic behavior of the more powerful merged entity. In the cruise mergers, for example, rivals of the merging firms could well fear the influence that the

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[40] FTC Cruise Lines Statement, *supra* note 1.

[41] F.M. Scherer, *Some Principles for Post Chicago Antitrust Analysis*, 52 Cas. W. Res. L. Rev. 5, 10–22 (2001).

merged firm will exercise over upstream suppliers, downstream travel agents, or even regulatory agencies that control access to vital routes, ports of call, or other land-based facilities.[42]

In the last analysis, enforcement agencies are routinely deluged with biased information and analysis from the merging parties. The information presented by rivals may also be biased but it may be the only expert and in-depth information that can provide a counterweight to the merging parties' submissions. There is every reason to treat this information with at least the same respect and seriousness accorded submissions from the merging parties themselves.

Conclusion

The Commission's issuance of the cruise merger statements is a welcome and highly constructive development. The statements are a concrete demonstration that a public explanation can be issued at the close of a major merger investigation. For all its strengths, the Commission majority's statement was inadequate because it failed to address important objections that had been raised to the acquisitions (such as the risk of anticompetitive strategic conduct) and because its reasoning was superficial or unsupported in addressing the risk of unilateral or coordinated post merger effects.

The most disquieting aspect of the Commission's decision was its bypassing, without an adequate basis, of the presumption governing large mergers in concentrated industries. By permitting the parties to go forward, the Commission is in fact running a market experiment with respect to the presumption. Whether the merged entity succeeds in unilaterally raising price on some routes, coordinating with its two remaining significant rivals, or extracting concessions that disadvantage those rivals will be issues that reveal themselves in the market, albeit intermingled with other causal influences. The upshot may well be further evidence regarding the policy premise underlying *Philadelphia National Bank* and four iterations of the Merger Guidelines that has long and well served U.S. antitrust policy.

The criticism of the Commission's substantive ruling offered here in no way diminishes the importance and value of this effort at transparency. Indeed, these comments could not be offered without that disclosure. It may be hoped that such feedback will aid in improving the precision of future disclosure and, perhaps, future analyses. More generally, transparency fosters not only oversight, informed public debate, and responsive and responsible government—it also aids counselors in their task of understanding and communicating merger policy to clients. Explanatory statements should be the rule, not the exception, when either federal agency closes a major merger investigation. ●

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[42] Evan Perez, *Carnival, Winning Princess Bid, Is Poised To Expand Dominance*, WALL ST. J. Oct. 28, 2002, at A 3.

Ethical and Practical Challenges Representing Trade Associations and Their Members

Christopher J. MacAvoy

Attorneys who represent trade associations in antitrust investigations or litigation may face a variety of ethical and practical challenges. Most counsel are alert to situations that raise obvious ethical issues—for example, where a member asks the association's counsel to take a position that is adverse to the interests of the association. But other issues present themselves more subtly and, in the worst cases, escape counsel's notice until they have blown up into waiver-of-privilege or disqualification problems. Sometimes even the most basic questions—e.g., who is my client?—may be hard to answer. Other questions that may be encountered include: whether an attorney may, in the same matter, represent the trade association and a member; whether the attorney may represent a member whose interests are adverse to those of other members; whether an attorney may represent a trade association in a matter adverse to a member; whether an attorney who has represented the trade association may represent a member in a matter that is or may become adverse to the association; and whether an attorney who represented the association may, in a subsequent matter, represent a non-member in a suit against members of the association.

The common interest or "joint defense" privilege brings additional complexities to the trade association lawyer's task. If counsel for a trade association briefs members on the status of an antitrust investigation or lawsuit, will the briefing be privileged? What happens if a member of the association tells the association's counsel something incriminating about the member's company, or about another member, or about association staff? Can the attorney disclose the information to other members or their counsel? If a trade association's lawyer receives confidential information from a member pursuant to a joint defense agreement, will this affect the lawyer's ability to accept a subsequent representation that is adverse to the member?

This article provides an overview of some of the major issues and general rules governing the attorney-client relationship between a lawyer representing a trade association and, potentially, the association's individual members. It is not, of course, a summary or survey of all states' applicable rules of professional ethics. Some of these issues were addressed by the Legal Ethics Committee of the District of Columbia Bar in Opinion 305, issued in January 2001. This article utilizes Opinion 305 as a reference.

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Trade Associations Present Special Challenges

Black's Law Dictionary defines a trade association as "an association of business organizations having similar problems and engaged in similar fields formed for mutual protection, interchange of ideas and statistics and for maintenance of standards within their industry." This straightforward definition suggests some of the reasons why trade associations are different from other clients. The similarities or common interests that cause firms or individuals to join trade associations in the first place suggest they will have common legal interests, but this is by no means inevitable. Especially if the members of a trade association are competitors, their legal interests may conflict in an antitrust matter.

Many trade associations have legal counsel on staff or retainer, and access to the association's counsel may be considered a significant benefit of membership. Frequently, the association's counsel has extensive experience with the legal and regulatory issues confronting a particular industry, and members view the association's counsel as a key source of guidance. The close and trusting relationship that often exists between an association's counsel and the members can, however, sow trouble in an antitrust investigation or litigation. To some degree, the issues that arise in this context are the same as those that arise between a corporation's lawyer and the corporation's employees. The trade association context, however, brings added complexities and cross-pressures, not the least of which are the financial incentives for an attorney to represent the association and one or more members, either simultaneously or seriatim.

The close and trusting relationship that often exists between an association's counsel and the members can, however, sow trouble in an antitrust investigation or litigation.

Who Is the Client?

A lawyer has an obligation to maintain the confidences of his or her client and to avoid conflicts of interest. But when a trade association is involved, who is the client? And once the client or clients are identified, what happens if the attorney wants to represent additional clients, either in the same matter or in a subsequent but related matter? These issues were comprehensively addressed in District of Columbia Ethics Opinion 305.

Important consequences may follow a determination that an attorney-client relationship exists between trade association counsel and a member. If the matter would require the lawyer to advance two adverse positions, the representation is prohibited.[1] If the lawyer would not be required to advance adverse positions in the same manner, the representation may nevertheless call into question his or her ability to represent each client wholeheartedly and zealously. The D.C. Rules of Professional Conduct, for example, prohibit a lawyer from representing, without disclosure and consent, a client with respect to a matter if:

1. that matter involves a specific party or parties and a position to be taken by that client in that matter is adverse to a position taken or to be taken by another client in the same matter even though that client is unrepresented or represented by a different lawyer;
2. such representation will be or is likely to be adversely affected by representation of another client;
3. representation of another client will be or is likely to be adversely affected by such representation; or
4. the lawyer's professional judgment on behalf of the client will be or reasonably may be adversely affected by the lawyer's responsibilities to or interests in a third party or the lawyer's own financial, business, property, or personal interests.[2]

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[1] D.C. R. of Prof'l Conduct 1.7(a).

[2] R. 1.7(b).

If a trade association's attorney also has an attorney-client relationship with a member, she may be required to withdraw from one or perhaps both representations if a conflict arises and consent is not obtained.[3]

General Rule: A Lawyer Who Represents an Association Does Not, Without More, Represent the Members. Ethics Opinion 305 reiterates the rule, stated in the District of Columbia Rule of Professional Conduct 1.13 and similar rules in other jurisdictions, that a lawyer who represents a trade association or other organization "represents the organization acting through its duly authorized constituents." Further, as stated in a comment to Rule 1.7, a lawyer who represents a trade association "is deemed to represent that specific entity, and not its . . . members or 'other constituents.'"

Several principles flow from the basic rule. Information that the trade association's attorney obtains from a member while the attorney is acting for the association is protected by the attorney-client privilege and the lawyer's duty to maintain her client's confidences. The privilege belongs to the trade association and not the member.[4] In addition, a lawyer for a trade association is not prohibited from representing the association in a matter adverse to a member.[5] In this circumstance, though, the association's lawyer should advise the member whose interest is adverse to that of the association of the conflict or potential conflict, that the lawyer cannot represent the member, and that the member may wish to obtain independent representation.[6]

Under What Circumstances Will an Attorney-Client Relationship Be Implied Between an Association's Attorney and a Member? Even though an attorney is deemed to represent the organization and not individual members of the organization, in some circumstances a trade association's lawyer will be found to represent a member of the association even though no retainer agreement has been executed and no invoices have been sent. If the circumstances surrounding the communications between the association's lawyer and the member are such that the member had a reasonable expectation of confidentiality and that the lawyer was acting on the member's behalf, an attorney-client relationship may be found by implication. In light of the potential consequences of being found to have an implied attorney-client relationship with a member, trade association counsel must guard against unwittingly stumbling into such situations.

In the leading case, *Westinghouse Electric Corp. v. Kerr-McGee Corp.*, 580 F.2d 1311 (7th Cir. 1978), a law firm for an association also represented a party in a law suit adverse to some of the association's members. The members had previously provided confidential information to the law firm in connection with the association's legislative efforts. Emphasizing that the members had an expectation of confidentiality as well as a reasonable belief the law firm was acting for both the association and the members, the court upheld the law firm's disqualification.

The *Westinghouse* approach has been followed by the Legal Ethics Committee of the District of Columbia, which has said that: "[w]hat is most important is whether the member of the trade association disclosed confidential information to the association's lawyer, and the surrounding circumstances and expectations."[7] Relevant factors in the analysis include:

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[3] D.C. R. of Prof'l Conduct 1.7, Comment [22].

[4] D.C. Bar Ethics Op. No. 305, at 2 n.3.

[5] *Id.* (citing Comment [13] to D.C. R. of Prof'l Conduct 1.7 and D.C. Bar Ethics Op. No. 216 (1991)).

[6] D.C. R. of Prof'l Conduct 1.13, Comment [8].

[7] D.C. Bar Ethics Op. No. 305, at 4.

- whether the lawyer affirmatively assumed a duty of representation to the member;
- whether the member had separate legal representation;
- whether the lawyer represented the member before he or she began representing the association;
- the nature of the disclosures that were made by the member to the attorney;
- the member's expectations of the attorney, and the reasonableness of those expectations;
- whether the member relied upon the attorney to represent its individual interests; and
- the size of the association (which may bear on the reasonableness of the member's expectation that the attorney was representing the member's individual interests).[8]

In *United States v. ASCAP*, 129 F. Supp. 2d 327 (S.D.N.Y. 2001), however, the court held that counsel for the American Society of Composers, Authors and Publishers did not have an attorney-client relationship with a member who was suing the association to recover royalties. The member argued that an attorney-client relationship existed because he had disclosed confidential information regarding his income and debts to ASCAP in order to receive advances against future royalties. In denying plaintiff's motion to disqualify ASCAP's counsel, the court pointed out that ASCAP's Articles of Association included a provision stating that ASCAP's counsel acts only on the association's behalf in all proceedings, including matters in which ASCAP and a member are adverse. *Id.* at 336.[9]

Are There Other Grounds on Which an Association's Lawyer Risks Disqualification? Even where an attorney-client relationship does not exist between the association's lawyer and a member, it may nevertheless be inappropriate for the lawyer to represent a client in a matter adverse to the member. An example of such a case is *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746 (2d Cir. 1981), in which the Second Circuit affirmed the disqualification of an attorney from representing a former executive of an association member in a breach of contract suit against the member company. The same law firm also represented the association in collective bargaining. Applying a "substantial relationship" test, the district court found that plaintiff's counsel likely gained access to confidential information about the member's employment policies and practices through his work for the association, and disqualified the lawyer. Affirming, the Second Circuit stated the test as follows:

> Disqualification will ordinarily be required whenever the subject matter of a suit is sufficiently related to the scope of the matters on which a firm represents an association as to create a realistic risk either that the plaintiff will not be represented with vigor or that unfair advantage will be taken of the defendant. *Id.* at 750.

The "substantial relationship" test is incorporated in the D.C. Rules of Professional Conduct, which provide that, absent consent, a representation that is adverse to a member is improper if:

a. the adverse matter is the same as, or substantially related to, the matter on which the lawyer represents the organization client[;]

b. during the course of representation of the organization client the lawyer has in fact acquired confidences or secrets . . . of the organization client or an affiliate or constituent that could be used to the disadvantage of any of the organization client or its affiliate or constituents, or

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[8] *Id.* at 5. *See also* United States v. ASCAP, 129 F. Supp. 2d 327 (S.D.N.Y. 2001).

[9] *See also* Ocean Club of Palm Beach Shores Condo. Ass'n v. Estate of Daly, 504 So.2d 1377 (Fla. App. 1987) (law firm for association could sue member of association); L'Association Des Proprietaires v. Redwine, 2002 WL 534137 (Cal. App. 2002) (former general counsel of homeowners' association could not represent former directors in suit against the association).

c. such representation seeks a result that is likely to have a material adverse effect on the financial condition of the organization client.[10]

As pointed out by D.C. Ethics Opinion 305, the D.C. Rules of Professional Conduct say that such situations raise "impairment of representation" concerns, without treating the member as an implied or "vicarious" client.[11]

How Does a Joint Defense Agreement Change the Picture?

Counsel representing trade associations or their members in antitrust investigations or litigation often enter joint defense agreements. A complete discussion of the issues surrounding such agreements and the joint defense privilege, as it is commonly known, is beyond the scope of this article.[12] There are several potential problem areas, however, that require highlighting.

What Is the Joint Defense Privilege? The joint defense privilege is an extension of the attorney-client privilege. As described by the Second Circuit, the joint defense privilege serves "to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel. Only those communications made in the course of an ongoing common enterprise and intended to further that enterprise are protected."[13] Similarly, the First Circuit has explained that "in order to establish the existence of the privilege, the party asserting the privilege must show that (1) the communications were made in the course of a joint defense effort, (2) the statements were designed to further the effort, and (3) the privilege has not been waived."[14]

The joint defense privilege belongs to each party to the joint defense effort.

The joint defense privilege belongs to each party to the joint defense effort.[15] Unless each party to the joint defense agreement consents to the privilege being waived, it can be waived only by subsequent litigation between the parties.[16] Thus, the joint defense privilege provides members of a trade association with a protection against disclosure they might otherwise lack, since the general rule, as discussed above, is that the association's lawyer represents only the entity.

Applications and Problems in the Trade Association Context.

• *Joint Defense Agreement as Basis for Antitrust Liability?* Counsel for trade association members sometimes react negatively when a joint defense agreement is proposed, out of concern that their company will incur antitrust exposure because it has signed a joint defense agreement and participated in a joint defense effort. Such concerns often are traceable to an early decision, *Jones Knitting Corp. v. Morgan*, 244 F. Supp. 235 (E.D. Pa. 1965), *aff'd in part and rev'd in part*, 361 F.2d 451 (3d Cir. 1966). The court held that restrictions contained in a joint defense agreement constituted a per se Sherman Act violation. The restrictions prevented signatories from entering settlement negotiations with a patent holder. The *Jones Knitting* decision has been criticized,[17] and

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[10] D.C. R. of Prof'l Conduct 1.7, Comment [14].

[11] D.C. Bar Ethics Op. No. 305, at 8 n.6.

[12] *See generally* ABA Section of Antitrust Law, Antitrust Evidence Handbook 92–95 (2d ed. 2002); ABA Section of Antitrust Law, Handbook on Antitrust Grand Jury Investigations ch. 9 (3d ed. 2002).

[13] United States v. Schwimmer, 892 F.2d 237, 243 (2d Cir. 1989) (citation omitted).

[14] United States v. Bay State Ambulance, 874 F.2d 20, 28 (1st Cir. 1989) (quoting *In re* Bevill, Bresler & Shulman Asset Mgmt. Corp., 805 F.2d 120, 126 (3d Cir. 1986)).

[15] *In re* Grand Jury Subpoenas, 902 F.2d 244, 248 (4th Cir. 1990).

[16] The Evidence Project, 171 F.R.D. 330, 525 (1997).

[17] Gould v. Control Laser Corp., 462 F. Supp. 685, 690–91 (M.D. Fla. 1978), *aff'd*, 650 F.2d 617 (5th Cir. 1981).

it appears inconsistent with current jurisprudence regarding the applicability of the per se rule to concerted refusals to deal. A more recent case, *Lemelson v. Bendix Corp.*, 621 F. Supp. 1122 (D. Del. 1985), involved a joint defense agreement to which a trade association and co-defendants in a patent infringement case were parties. The joint defense agreement required any party settling with the plaintiff to disclose the terms of the settlement to the other parties to the agreement. Rejecting the broad rule stated in *Jones Knitting*, the court held that the joint defense agreement did not support a claim of unlawful conspiracy under the Sherman Act.

• *Is Member Information Held by the Association Protected Against Disclosure?* As discussed above, the general rule is that the association alone, and not the individual association member, is the association lawyer's client. D.C. Bar Ethics Opinion 305 states that "[i]nformation obtained from a member while the lawyer is acting for the trade association is protected by the attorney-client privilege" and the lawyer's obligation to maintain her client's confidences.[18] The opinion further points out, however, that "it is the trade association that holds the privilege, not the member."[19] As previously discussed, in some circumstances, the member may have formed a reasonable belief that it was being represented individually by the attorney, in which case the attorney-client privilege and the lawyer's duty to maintain confidences apply to the member as well.[20] But in the absence of an implied representation, may the member's confidential communications be disclosed if the association decides to waive the attorney-client privilege? In this circumstance, the joint defense privilege is available to protect members against disclosure of their confidential information, provided appropriate steps have been taken to establish and preserve the privilege.

[C]ounsel representing trade associations or individual members must understand that a joint defense agreement may affect his or her ability to accept subsequent representations.

• *Will a Joint Defense Agreement Prevent the Association's Lawyer from Using Confidential Information in a Subsequent Engagement?* Joint defense agreements have obvious value, but counsel representing trade associations or individual members must understand that a joint defense agreement may affect his or her ability to accept subsequent representations. A 1995 formal ethics opinion of the ABA shows how a joint defense agreement may lead to ethical issues for an association's lawyer in subsequent matters.[21] Though the fact pattern addressed by the ABA opinion did not involve a trade association, the opinion would apply in that context. ABA Formal Opinion 95-395 addressed the following situation: a lawyer worked in a firm whose practice concentrated on insurance matters. The lawyer routinely represented Insurance Company in matters where it had common interests with other insurance companies, and frequently participated in a "joint defense consortium." The lawyer then left the firm and was approached by a client that wanted him to file suit against other members of the consortium, on a matter related to consortium matters the lawyer handled while at the firm. Insurance Company, however, would not be involved in the suit.

The ABA opinion analyzed this question in terms of a lawyer's duty to preserve confidences implied in the circumstances of a joint defense, separately addressing the lawyer's obligations to his former client, Insurance Company, and the other members of the consortium. With regard to the former client, the ABA observed that the lawyer had an obligation under Model Rule of Professional Conduct 1.6 not to reveal "information relating to representation of a client" without the client's consent. Information obtained by the lawyer through the joint defense consortium, pur-

[18] D.C. Bar Ethics Op. No. 305, at 2 n.3 (citing Comment [3] to D.C. R. of Prof'l Conduct 1.13 and D.C. Bar Ethics Op. No. 269).

[19] *Id.*

[20] *Id.*

[21] ABA Comm. on Ethics and Professional Responsibility, Formal Op. 95-395 (1995)].

suant to joint defense privilege, would fall within this definition "even though the information came not from Insurance Company but from another member of the consortium that was not represented by Lawyer." Thus, Insurance Company's consent would be required. "As a practical matter," though, the ABA thought it was unlikely Insurance Company would consent to the representation. Having signed a joint defense agreement, it "could not give such consent without exposing itself to liability to the members of the consortium whose confidences were involved."

ABA Formal Opinion 95-395 also addressed the lawyer's responsibilities to members of the joint defense consortium who had not been his clients. The ABA said that even though they were never the lawyer's clients, he had received information from them in confidence. While the lawyer did not owe an ethical obligation to the members of the consortium, he "would almost surely have a *fiduciary* obligation to the other members of the consortium, which might well lead to his disqualification." In light of this, the lawyer would "at a minimum" be obligated to warn his prospective new client of possible limitations on his representation, arising from his prior representation of Insurance Company. Further, the lawyer should consider whether his new representation would be "materially limited" by his responsibilities to Insurance Company or other members of the consortium, thus requiring him to decline the representation.

Similar issues have been addressed in court decisions. In *Wilson P. Abraham Construction Corp. v. Armco Steel Corp.*, 559 F.2d 250 (5th Cir. 1977) (per curiam), an attorney who had represented one of several parties involved in an antitrust grand jury investigation later sought to represent plaintiffs in a civil antitrust case against his former client's co-defendants. The court held that because there was a substantial relationship in the subject matters of the two representations, and confidential information was shared pursuant to joint defense privilege in the first matter, the attorney would breach a fiduciary duty if he later used the information to the detriment of the former client's co-defendants. More recently, in *National Medical Enterprises, Inc. v. Godbey*, 924 S.W.2d 123 (Tex. 1996), the Texas Supreme Court held that a lawyer was disqualified from representing plaintiffs in a lawsuit against a corporation because another lawyer in his firm previously had been retained by the corporation to represent an ex-employee in substantially related matters, and had received confidential information from the corporation pursuant to joint defense privilege. The court held that, even if the attorney could prosecute the suit without breaching the joint defense agreement, there would be a "strong appearance of impropriety." While not involving trade associations, these cases illustrate the potential pitfalls awaiting a lawyer for an association or a member who receives confidential information pursuant to a joint defense agreement, and attempts to undertake a subsequent representation that is adverse to one of the participants in the joint defense effort.

Conclusion

The ethical and practical issues that may arise in the context of an antitrust investigation or lawsuit involving a trade association and its members are complex, but manageable. If representation arrangements are established only on the basis of near-term budgetary concerns or administrative convenience, there may be serious adverse consequences later on, including waiver of privilege and disqualification. Thus, foresight and early consideration of potential conflict and privilege issues are critical. ●

A Study in Merger Enforcement Transparency:
The FTC's Ocean Cruise Decision and the Presumption Governing High Concentration Mergers

Warren S. Grimes and John E. Kwoka

When a divided Federal Trade Commission (3–2) closed its investigation of two proposed acquisitions involving the three largest firms in the ocean cruise industry, it took the unusual step of issuing a statement explaining its decision. That statement, together with the dissenting statement of two Commissioners and subsequent analysis provided by the Directors of the Bureaus of Competition and Economics, offers unique and welcome insights into the bases for an important merger enforcement decision.[1] These comments explore both the implications of providing greater transparency to key enforcement decisions and also the reasoning and consequences of the Commission's decision not to pursue either of the two very large proposed mergers in an already concentrated ocean cruise industry.

Greater transparency is a necessary step toward achieving responsible and comprehensible agency merger enforcement. Transparency is needed because it contributes to greater understanding and predictability in the law and because it nurtures public debate about, and effective oversight of, agency merger enforcement policy. Part I of these comments describes the need for transparency. Part II describes the FTC's experiment in transparency in the cruise merger investigation. In the spirit of carrying forward public debate and discussion, Part III offers comments on the adequacy of the Commission's reasons for closing this investigation. Our major conclusions are twofold: (1) that further concrete steps are needed to foster transparency, particularly when a federal agency closes an important merger investigation; and (2) that the Commission's proffered explanation in this instance did not justify departure from the presumption in the Merger Guidelines that a large merger in an already concentrated industry is likely to have substantial anticompetitive effects.

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Fostering Transparency in Merger Enforcement

A full measure of transparency might require that an agency operate in a fish bowl, revealing every investigative step that is taken and opening itself to interference from parties with conflicting interests. This degree of openness might well paralyze law enforcement. The Commission chose a far

[1] Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd. /P&O Princess Cruises plc & Carnival Corporation/P&O Princess Cruises plc., FTC File No. 021 0041 (Oct. 4, 2002) (FTC Cruise Lines Statement), *available at* http://www.ftc.gov/os/2002/10/cruisestatement.htm; Joseph J. Simons, Director, Bureau of Competition, Merger Enforcement at the FTC, Remarks to the Tenth Annual Golden State Antitrust and Unfair Competition Institute (Oct. 24, 2002), *available at* http://www.ftc.gov/speeches/other/021024mergeenforcement.htm; Bureau of Economics, FTC, Cruise Investigation: Empirical Economic and Factual Analysis (Nov. 22, 2002), *available at* http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf.

more limited and rational sort of transparency when it issued a short but comprehensive statement explaining its decision to drop the investigation of the cruise mergers. Publishing a timely explanation of the outcome of an important merger investigation has much to commend it. For example, the mere knowledge that a decision will have to be explained in public can encourage disciplined inquiry and decision making at the agency. After publication, the decision can provide the bar with better understanding of the agency's interpretation of the law and can foster legitimate discussion and oversight of the agency's decision.[2]

Concern with transparency in antitrust enforcement is not new. Legislation, such as the Tunney Act, governs the Justice Department's settlement of litigated antitrust cases and is designed to promote, among other goals, transparency in agency enforcement decisions.[3] But different rules, or no rules, govern merger investigations that produce no litigation, and the same approaches are not applied at the DOJ and the FTC. There is, in short, no comprehensive and well-conceived approach to transparency for merger investigations.[4]

This is unfortunate given the importance of merger enforcement to a well-functioning economy. The agencies have the power to preserve a premerger industry structure that is conducive to competition, or at least more so than the structure that would be created by the unchallenged merger. No other area of enforcement offers the agencies a comparable opportunity for preventative structural medicine. Because of its importance, agencies should not be asked or allowed to conduct merger policy in secrecy. The agencies do, of course, offer guidance by publishing merger guidelines, but the process remains fact intensive and often highly complex. Without an adequate flow of information, it is difficult to understand and meaningfully critique merger enforcement policy. Attorneys advising clients also need information about agency decisions in order to advise clients accurately. Yet publicly available information on agency enforcement decisions is often inadequate.

Under current U.S. practice, when a federal agency challenges a merger, its reasoning can be announced through the proposed federal court complaint, explanatory documents required by statute or regulation, and a motion for a preliminary injunction that the agency files.[5] This information often falls short of what is required for needed transparency (or what is offered by the European Commission in a typical explanatory statement). However, if the agency chooses not to challenge an acquisition, or if the Department of Justice employs a "fix it first" approach that does not require the filing of a court complaint, there is no requirement that any explanation be made public, and a comprehensive disclosure is the exception. The Commission has offered explanations on occasion, as in the statements in 1997 when the agency decided not to pursue the Boeing/McDonnell Douglas acquisition.[6] Perhaps the Commission chose to issue statements in

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[2] For a more comprehensive examination of the benefits and costs of transparency in the context of agency antitrust enforcement, see Warren S. Grimes, *Transparency in Federal Antitrust Enforcement* (Study to Be Presented at Annual Conference of the American Antitrust Institute (June 2003) and to be published in the BUFFALO L. REV.) (on file with the author).

[3] The Antitrust Procedures and Penalties Act, 15 U.S.C. §16(a).

[4] The applicable laws and regulations governing the Federal Trade Commission and the Antitrust Division of the Department of Justice, as well as procedures governing the FCC, FERC, and the European Union, are described in Grimes, *supra* note 2.

[5] These statutes and procedures are described in Grimes, *supra* note 2.

[6] Boeing Co., [1997–2001 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997). On other occasions the Commission has chosen to disclose far more than required, underscoring the discretion that it has and sometimes chooses to employ. *In re* General Motors Corp., No. C-3132, 1984 WL 565376 (FTC Apr. 11, 1984).

that matter because of the parallel EU investigation and the media attention to the issues. The Commission's cruise mergers statement (signed by three Commissioners) and the separate dissenting statement (two Commissioners) are a second example of such disclosure, perhaps not surprisingly in a case involving merger investigations by both the EU and the United Kingdom that were widely reported in the press.

The FTC statements in Boeing and cruise lines tend to undermine claims that such explanations are precluded by confidentiality rules or will unduly restrict the agency's flexibility. The FTC pointed out that its decision not to pursue either of the proposed cruise lines acquisitions was based on specific and complex circumstances of this particular industry and should not be read as indicating that large mergers in highly concentrated industries would be permitted in another case.[7]

Statements Explaining Agency Decisions for Important Merger Investigations. The need for public disclosure of the results of important U.S. merger enforcement decisions goes beyond responding to short term media pressures that may be generated by parallel (and more transparent) investigations outside the United States. Systematic transparency is needed if oversight and accountability are to be meaningful. The most obvious need for information occurs when an agency decides not to pursue an acquisition after conducting an in depth investigation. As FTC Bureau of Competition Director Joseph Simons has said: "it seems obvious that explaining why the Commission decides not to take action in a particular case may well provide at least as much useful information as an explanation of why the Commission decides to take action in other cases."[8] Obviously, the great bulk of merger transactions raise no genuine antitrust issues. But when an agency devotes substantial resources to investigating a proposed acquisition (the cruise mergers were investigated by the FTC for ten months), an explanation of the agency's decision should be provided, regardless of the final disposition. It would be an enormously helpful change in current practice for the agencies systematically to provide such disclosures.

The FTC statements in Boeing and cruise lines tend to undermine claims that such explanations are precluded by confidentiality rules or will unduly restrict the agency's flexibility.

One way of achieving needed transparency would be for the Antitrust Division of the Justice Department and the FTC to issue statements explaining a decision to close a merger investigation whenever the agency requests additional information from one or more of the merging parties. The issuance of a second request is not an infallible measure of the importance of an agency investigation. Until a better measure is identified, however, the second request should be the trigger mechanism for requiring an agency explanation. The statement should identify the issues of concern and provide the agency's response to the major points in contention during the investigation. That should include information about the relevant market (often in dispute), the degree of overlap among participating firms, and at least the general range of concentration figures (if confidentiality prevents more precise disclosure).[9]

Legislative action to provide for transparency may be required, particularly if overreaching laws designed to protect business secrets unnecessarily undermine legitimate transparency goals. There would be advantages, however, if the agencies took the initiative. By doing so, the agencies could forestall legislation that might create an overly rigid or cumbersome mechanism. In the near term, a solution to the transparency problem might be for each agency to set its own standards,

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[7] FTC Cruise Lines Statement, *supra* note 1.

[8] Simons, *supra* note 1.

[9] The Commission's cruise merger statement failed in several respects to meet this standard. For example, the Statement failed to address the strategic conduct issues raised by persons commenting on the proposed mergers. *See* discussion *infra* Part III.

or establish standards that are jointly agreed upon, based on the importance of the investigation and the amount of agency resources devoted to it, for determining when a public statement of explanation should be issued.

The Cruise Merger Case as a Case Study in Transparency

The unusual transparency in the FTC's cruise merger determination provides a model for transparency efforts. It also permits a more informed critique of the FTC's decision than could have been undertaken in the absence of disclosure. More informed oversight is a primary benefit of transparency.

Beginning in December 2001, the largest firm (Carnival Corp.) and the second largest firm (Royal Caribbean Cruises, Ltd.) in the ocean cruise industry battled one another to acquire the industry's third largest firm (P&O Princess Cruises plc). The FTC investigation of these dueling merger proposals gave rise to intense advocacy by the merging parties and to an active role by the American Antitrust Institute (AAI), which urged the Commission not to approve either transaction as proposed.[10]

From the outset of this matter, there was an unusually high degree of public visibility of these transactions because officials from each of the two would-be acquiring firms were anxious to tell their side of the story. In addition, the parallel investigations by competition authorities in the United Kingdom (investigating the proposed Royal Caribbean joint venture with Princess) and the European Union (investigating the proposed Carnival acquisition of Princess) generated additional information and interest in the proposed transactions. The FTC's investigation involved an unusually comprehensive collection of data, which was used by Commission staff to conduct various analyses.[11] The investigation moved through a number of phases. Early contacts between the would-be acquiring firms and the AAI suggested that the key issue was whether the market consisted only of North American cruise offerings, or whether all vacation opportunities should be included in the market. Later, after the European Union decided that a market definition limited to cruising was required, the parties focused their attention on various possible anticompetitive effects of an acquisition of Princess Lines by either of the suitors.

Before the Commission reached its decision, both the UK and the European Union had determined not to challenge these mergers and issued detailed statements explaining the grounds for their decisions.[12] For the North American cruise market, the FTC faced substantially different conditions that threatened greater anticompetitive effects. One obvious difference was the size and the maturity of the markets. In 2001, there had been only 1.9 million European cruise passengers (a penetration rate of 0.4% of the population) compared to 7 million North American cruise passengers (a penetration rate of 2.2%). U.S. passengers constituted 72% of worldwide demand.[13]

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[10] The AAI is a non-profit research and advocacy organization that occasionally takes positions involving proposed mergers or acquisitions. The AAI's goals and activities are described more fully at its Web site, http://www.antitrustinstitute.org.

[11] Simons, *supra* note 1 (reporting that the FTC received "enormous amounts of data" on capacity utilization, actual transaction prices, and financial data).

[12] Commission of the European Communities, Case No. COMP/M.2706 (Carnival Corporation/P&O Princess) C(2002)2851 (July 24, 2002), *available at* http://europa.eu.int/comm/competition/mergers/cases/ (57 pages); Competition Commission (UK), P&O Princess plc and Royal Caribbean Cruises Ltd: A Report on the Proposed Mergers (June 19, 2002), *available at* http://www.competition-commission.org.uk (115 pages not including the extensive appendices).

[13] *Carnival Corp.*, ¶ 15.

The growth rate for the industry was also higher in Europe than in the United States,[14] suggesting that entry into the U.S. market might be less attractive. Moreover, the concentration levels in the North American cruise market appeared to be substantially higher than figures for Western Europe.[15] For these reasons and others, the UK and EU decisions were not good predictors of the U.S. antitrust posture toward the mergers.

When its decision to close the investigation was announced, the Commission indicated that it was issuing an explanatory statement because of the high degree of press attention and the complexity of the issues. Whatever the motivation, the explanatory statements of the Commission and the dissenting Commissioners are an affirmative step toward needed transparency.[16]

On market definition, the Commission statement emphasized the complexity of the market and the relatively elastic demand for cruises by a significant percentage of customers, many of whom would be taking a cruise for the first time. Although some of these factors pointed toward an "all vacation" market, the Commission nonetheless accepted a narrower definition limited to cruise lines because a hypothetical monopolist in that market "could likely use yield management systems" to raise prices profitably.[17] Yield management is a technique by which sellers in low marginal cost industries, such as airlines and hotels, effect a price discrimination scheme: the firm seeks to charge higher prices to less price sensitive customers while still offering discounts to more price sensitive customers in order to operate at or near maximum capacity. Computerized yield management is used by cruise lines, which adjust prices upwards or downwards based on whether bookings for a particular cruise or types of accommodations for that cruise are above or below levels set by the firm for any phase of the booking cycle.

Both the Commission and the dissenting statements agreed that, in the words of the majority, "either transaction would significantly increase concentration in a market already highly concentrated." After either acquisition, the industry would have a lead firm with nearly 50 percent of the North American cruise market (the top two firms will control over 80 percent and the top three firms over 90 percent of the market). With post-merger Herfindahls in the 3700 range, the agency Merger Guidelines provide that the merger will be presumed "to create or enhance market power or facilitate its exercise."[18] Although the dissenting Commissioners stressed the importance of the presumption, the Commission statement did not mention it. Instead, the Commission stressed language from the Guidelines that market share and concentration data "provide only the starting point for analyzing the competitive impact of a merger." As discussed below, the Commission assessed and discarded as unlikely various theories of anticompetitive effects that might flow from either transaction.

Significantly, the Commission statement did not address possible strategic behavior by the post-merger firm that could disadvantage rivals or raise entry barriers. The dissenting Commissioners did address the issue, in particular indicating that a clear market leader might force key travel

[14] *Id.* ¶ 16.

[15] The European Communities statement reported that the market shares of a combined Carnival and Princess would be between 20–30% for Germany and between 25–35% for the UK, the countries for which the overlap raised the most significant competitive issues. *Id.* at ¶ 113.

[16] Warren S. Grimes et al., *The FTC's Cruise Lines Decisions: Three Cheers for Transparency*, FTC WATCH, No. 599, Nov. 18, 2002.

[17] FTC Cruise Lines Statement, *supra* note 1. The European Union had likewise considered and rejected, after considerable analysis, arguments for a broader market encompassing vacation alternatives to cruising. *Carnival Corp.*, ¶¶ 28–68.

[18] U.S. Dep't of Justice and Federal Trade Comm'n, Horizontal Merger Guidelines § 1.51(c) (1992 rev. 1997).

agents to accept exclusive contracts or pressure port authorities to deal with competitors on unfavorable terms.[19]

Overall, the statements document that the Commission and its staff addressed the issues underlying the cruise mergers with a thoroughness that is commendable. Its willingness to disclose aspects of that analysis is also commendable. We find troubling, however, the fact that the Commission did not offer a well-reasoned ground and factual basis for sidestepping the presumption that large mergers in highly concentrated markets are likely to generate anticompetitive effects.

Did the Commission Give Proper Weight to the Presumption of Anticompetitive Effects?

The Presumption Governing Large Mergers in High Concentration Industries. The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement. One of these roots is Edward Chamberlin's insight that participants in a tightly oligopolistic market will recognize their interdependence and their mutual interest in a high price, and act accordingly.[20] Today's economic treatises amplify Chamberlin's point about oligopolistic industries: the higher the concentration, the greater the likelihood of anticompetitive effects through collusion or tacit parallel conduct.[21] In addition, higher concentration may facilitate anticompetitive unilateral action (for example, by combining firms in the same or closely related niche markets) and may increase the merged firm's opportunities for strategic conduct involving upstream or downstream markets (vertical effects).

The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement.

These insights about coordinated interdependent action, unilateral action, and strategic behavior provide the basis for the modern version of the presumption that large mergers in a concentrated industry are likely to be anticompetitive. The Supreme Court first expressly applied the concentration presumption in *United States v. Philadelphia National Bank* in 1963[22] and it has been restated in all four editions of the Merger Guidelines.[23] While this presumption can be overturned in economics and in law by a number of offsetting factors, the presumption serves a very important procedural role. It shifts the burden of persuasion to proponents of a merger when the anticompetitive risks are highest.

In closing the cruise mergers investigation, the Commission majority chose not to honor the presumption. Rather, it conceded only that the rise in concentration is "interest-provoking." Even more notably, the reason that the Commission rejected the presumption was not because of such factors as entry conditions, but rather because it insisted upon, and did not find, "evidence to sup-

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[19] Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, Royal Caribbean/Princess and Carnival/Princess (Oct. 4, 2002), *available at* http://www.ftc.gov/os/2002/10/cruisedissent.htm.

[20] Edward Chamberlin, The Theory of Monopolistic Competition 46–48 (1933).

[21] F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance ch. 6 (3d ed. 1990).

[22] 374 U.S. 321, 363 (1963) ("[W]e think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.")

[23] The Guidelines were amended in 1997 without altering the presumption, which appears in Horizontal Merger Guidelines § 1.51(c).

[24] Although the Commission Statement does not directly address the presumption, in a subsequent speech, FTC Competition Director Joseph Simons acknowledged it and offered an explanation as to why the Commission majority chose not to follow it. Simons, *supra* note 1.

port one or more viable theories of antitrust violation."[24] It is indeed the case that the agency staffs are being challenged to offer increasingly specific theories of competitive harm, buttressed with whatever evidence can be marshalled.[25] While this is in principle unobjectionable, even desirable, it should be recognized that in practice competitive harms from mergers are almost always speculative, since mergers are consummated well before any empirical judgment on effects can be rendered. Demanding "proof" or even placing the "evidence bar" very high may seem like good policy, but it is tantamount to reversing the presumption of the Guidelines.

Of course, the Guidelines' presumption can be overcome by a proper showing.[26] In cases like the Boeing acquisition of McDonnell Douglas, the Commission has allowed mergers to very high levels of concentration.[27] The departure from the Guidelines in Boeing was explained because McDonnell Douglas, with only 5 percent of the world market for large civilian aircraft, was deemed unlikely to survive as an independent competitor and, although this was not emphasized in the Commission's statement, perhaps because of the large size necessary to maintain economies of scale and because any market power of the surviving firms could be mitigated by powerful, savvy buyers of the aircraft.

No such factors were cited in the Commission's cruise mergers statement. It cited several matters that could justify disregarding the presumption: (1) "changing market conditions," in particular the rapid growth and evolving service offerings in the industry; (2) the limited "degree of difference between services in this market and those outside" that will allow potential cruise customers to choose among various non-cruise vacation options; and (3) "particular circumstances here that would render either unilateral or coordinated [anticompetitive] effects unlikely." Although there is validity to many of these individual points, at the end of the day, the Commission's statement failed to define principled ground for disregarding the presumption.

Goldilocks Economics: The Commission's View of Cruise Mergers

There are, broadly speaking, three possible theories of anticompetitive effects from the cruise mergers. These are: (1) unilateral effects whereby a single firm takes advantage of its large size or its product niche to extract a price increase by itself; (2) coordinated interactions among the now-smaller number of firms resulting in higher prices for a substantial percentage of customers; and (3) strategic behavior that might increase entry barriers and/or disadvantage rivals, reducing overall competition in the industry. The Commission addressed the first two theories and found them lacking. The third concern was addressed only by the dissenting Commissioners. Under any of the three theories, a large merger in a highly concentrated industry would raise the risks of anticompetitive effects and, accordingly, should be subject to the Guidelines' presumption. Here we discuss each of these in some detail, focusing on the Commission's explanation for dismissing the concern and ignoring the presumption.

Unilateral Effects. Unilateral effects may arise in a number of circumstances. In an industry of differentiated products, company A enjoys some power to raise its prices without losing all its customers to company B or C. But if the price increase is substantial, A will lose too many customers to rivals to make that price increase profitable. A merger between companies A and B, however,

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[25] This is one reason for the increased emphasis on the unilateral effects theory, which has the trappings of specific and even quantifiable economic analysis—regardless of whether it is the most likely source of competitive harm from a merger.

[26] Horizontal Merger Guidelines § 1.51(c).

[27] *Boeing Co.*, *supra* note 5.

could recapture some of those losses, in the form of B's increased profits, thereby making the price increase profitable to the merged company. Since this is a decision made strictly by the parties to the merger, it is a "unilateral" effect, that is, not dependent on rivals' cooperation. Another scenario giving rise to unilateral effects involves capacity constraints. If C is constrained in its ability to increase output—whether due to production limitations, government regulation, or other causes—the merged firm (companies A and B) may be able to raise price unilaterally by reducing its output. Closely related to the latter is the case of a "dominant firm," whose output is sufficiently large as to be able to influence market price—again subject to the ability and interest of rivals to alter their production plans so as to undermine the increase.

Since the introduction of this theory in the 1992 Merger Guidelines, much analytical work in economics and much (some argue, too much) attention in antitrust have been paid to unilateral effects from mergers. In its statement on the cruise mergers, the Commission dismissed concerns based upon this theory. It contended that no two of the companies are uniquely close competitors, but rather all have products that overlap extensively. That is, there is too much competition among all of them to allow unilateral action from a merger of any two to pay off. Moreover, it argued that rivals could and likely would "replace any lost competition" by such strategies as building new ships and reconfiguring existing ships. This ability to increase capacity, the Commission contended, would prevent any single firm from profiting by unilaterally reducing output or capacity.

These are relevant considerations, but the available evidence in this case is not convincing and the Commission's line of reasoning leaves much to be desired. While it certainly appears true that the cruise companies' offerings have many similarities, they are not identical in destinations, amenities, prestige, and other attributes that arguably matter to customers. Ironically, the Commission makes this very point in the next section where it discounts the risk of coordination because there is supposedly too much differentiation for agreement among the companies. As we shall see, this is not the only instance in which the Commission advances what might be termed "Goldilocks economics"—an effort to make two contradictory points by asserting there is just enough of one characteristic to sustain the first point but not so much as to undermine the second.

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Also dismissed by the Commission majority is any concern that constraints on output expansion by rivals might confer unilateral pricing power on the merged company. But here the flaw in the Commission's argument is not a matter of speculation. The dissenting Commissioners noted apparently uncontroverted evidence regarding the Alaska cruise trade.[28] Rivals to a Carnival-Princess merger would face a company with an overwhelming share of the Alaska niche and with "certain advantages in terms of land facilities, port access, and park permits." Rivals, in short, would be hard pressed to expand output to defeat a unilateral price increase by the merged company, because while they might have cruise ships available, they would not have the necessary access to ground and water infrastructure to actually expand their offerings.

The Commission's opinion makes no direct mention of Alaska, but it does assert that rivals could, among other things, "build new ships [and] reconfigure ships" to defeat a unilateral price increase or capacity reduction. But reconfiguring entire ships, much less building new ones, is an expensive and time-consuming activity, and certainly not one to be undertaken without assurance that the relevant market will be a profitable market three or four years hence. Regulatory barriers in the Alaska market might, in any event, prevent a rival's use of ships in the Alaska market. The

[28] Dissenting FTC Cruise Lines Statement, *supra* note 19.

Guidelines are quite clear that delayed and speculative capacity expansion is not an antitrust remedy for output contraction.[29] The Commission's opinion elevates the uncertain prospect of capacity expansion to a status inconsistent with the Guideline's admonition.

Coordinated Effects. Most mergers historically have been evaluated in terms of their potential to improve firms' ability to coordinate their strategies with respect to price and other parameters of competition. A significant reduction of numbers and/or increase in concentration from a merger forms the basis for the longstanding presumption of competitive concerns that underlies the Guidelines. In its statement on its cruise merger analysis, by contrast, the Commission concedes no such presumption but only that its "interest" has been "provoked." This interest-provocation standard would appear to be quite different from the Guidelines' presumption, and indeed the majority immediately makes clear what is required to satisfy its interest: "A viable coordinated interaction theory must establish why either [merger] would likely reorient these powerful [competitive] incentives in a dramatically different direction."[30] As noted previously, this standard is tantamount to reversing the Guidelines' presumption by placing the burden of proof on complainants (staff or injured outside parties), rather than on the parties to a high concentration merger.

That this is the effect soon becomes clear in the Commission's statement. Based on this standard, the majority segues into an enumeration of factors that make coordination arguably more difficult and then, in a flourish, states that coordination theories are therefore not viable. Even before considering those factors, this reasoning is a non sequitur. The fact that some factors are unfavorable does not justify a conclusion that they outweigh those other factors that favor coordination.[31] After all, no real world industry possesses all possible features that facilitate coordination. Moreover, this line of reasoning fails altogether to address the question raised by the merger: Given these considerations, which now seemingly hinder coordination, might a reduction in the number of companies be sufficient to tip the balance and bring coordination about? The majority's discussion casts no light on this question.

The factors identified in the discussion of coordinated effects as apparently convincing to the Commission are the following: complex prices due to variety of products, inability to monitor rivals' prices, demand which is mostly very elastic, and the need for complex price discrimination in the industry.[32] This list is notable for what was previously termed "Goldilocks economics." Here we are told that cruising is much too complex and differentiated a product to permit price coordination, whereas previously the majority claimed that cruise offerings overlapped too much and were too similar to permit unilateral pricing action. Which is it? Apparently not too little, not too much, just the right amount of differentiation. This may be possible. But it also becomes increasingly unlikely as concentration levels rise and the risk of unilateral or coordinated anticompetitive effects increases: just enough differentiation to *discourage* coordinated effects may be more than enough to *encourage* unilateral effects.

Similarly, the Commission asserts that cruise firms lack reliable information about rivals' prices and thus cannot coordinate pricing. Yet in support of its earlier argument that cruising is an antitrust market, it asserted that cruise lines "expend significant effort to monitor (to the best of their

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[29] Horizontal Merger Guidelines §§ 1.32, 3.2.

[30] FTC Cruise Lines Statement, *supra* note 1.

[31] The Commission's argument here would fail its own standard of proof, namely, providing evidence that "establishes" the stated conclusion.

[32] Two other factors are listed earlier as altering the meaning of concentration data: changing market conditions, and the degree of difference between services in this market and those outside. Oddly, neither of these is discussed again in this context.

ability) each other's prices." Apparently, price information also falls into the Goldilocks category—not too hot, not too cold, just right to somehow sustain both arguments. While full information is not available to us, it is noteworthy that the dissenting Commissioners allude to evidence that the cruise lines do in fact engage in actions and counteractions on price—that is, they are knowledgeable about and responsive to each others' prices.[33]

Coordination and Yield Management. The Commission statement goes on to discuss at some length the cruise lines' use of yield management systems as a tool for price discrimination, and also the evidence that it claims refutes the contention that yield management might aid coordination. The cruise industry, like other low-marginal cost industries, such as hotels or airlines, has a strong incentive to operate at full capacity. Indeed, the cruise lines' incentive to fill the ship lies not only in the low marginal costs of the industry, but also in the substantial additional revenue generated by passengers. According to one industry observer, cruise lines generate up to one fifth of their revenues from on-board charges.[34] To maximize fare revenues while still filling the ship, cruise firms use carefully orchestrated price discrimination that adjusts fares based on a variety of factors, including the relative price insensitivity of some customers. Sophisticated computerized yield management programs adjust fares based on the number of bookings at each phase of the booking cycle. When a popular cruise attracts a large number of early bookings, the yield management system raises fares, slowing demand but forcing less price sensitive customers to pay more. Yield management, then, is anything but a random system. For any cruise for which bookings are at or above the norms set by the firm at any stage of the booking cycle, prices will go up (and less price sensitive consumers who book at that particular stage will end up paying more). The percentage of total consumers who will pay higher prices because of this relative price insensitivity will vary with each cruise (or even with the berth accommodations for that cruise). What is clear, however, is that on average there are a substantial number of these customers—without them, the yield management system would not be worth the substantial cost that a cruise line invests in its development and operation.

Whether yield management aids or hinders coordination is an important policy question not only in this industry but also in others that might find sophisticated software useful in managing their pricing. There is no simple answer. Yield management more finely discriminates in price, making coordination more challenging, at the same time that it systematizes pricing strategies, making coordination more feasible. The Commission seeks nonetheless to give a simple answer in this case, and that answer is that, on the evidence, neither merger "would enable the putatively coordinating cruise lines to agree tacitly and successfully implement a price increase based on booking characteristics." And what exactly is that evidence? The majority opinion references "empirical analyses" of "actual transactions" that found (a) prices in some cases rose but in others it fell as the sail date approached, (b) there was "dramatic" variation in the degree of change, (c) the proportion of early bookings also varied "dramatically," (d) there is no consistent correlation among prices on directly competitive cruises, and (e) the prices of different categories of berths vary unsystematically.

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[33] The Carnival Statement of the European Communities also found that cruise lines were responsive to the pricing of rival cruise lines. *Carnival Corp.*, *supra* note 12, ¶ 59.

[34] Jane L. Levere, *Personal Business; Some Travel Bargains by Air, but Even More by Sea*, N.Y. Times, Apr. 6, 2003, at Sec. 3, p. 11 (quoting Credit Suisse First Boston analyst Scott Barry, who stated that because as much as 1/5 of cruise lines' revenue is generated from passengers on-board expenditures, "cruise lines always sail full.").

While the effort at empirical analysis is to be commended, it is not clear that the stated inferences deserve weight. Consider, for example, the first finding, that prices over the booking cycle sometimes rose and at other times fell. While the Commission takes this as evidence of the lack of anticompetitive coordination, this is what one would expect of a well-designed yield management system. Toward the end of the booking cycle, if berths remained unfilled, the cruise line should and—with yield management in its tool kit—would lower prices. If the cruise were nearly full, prices would rise. This uneven and unpredictable variation is yield management at work, without implications for coordination. It is surprising, as well as disappointing, that the Commission would be tempted by this implication when the cited fact simply does not distinguish between competing hypotheses. Similar observations might be made about the Commission's conclusions in other instances. The conclusions have meanings that are ambiguous, so that they could just as easily be cited by advocates of the opposing view, namely, that yield management enhances coordination.

This last point underscores another persistent problem in the Commission's analysis. At best, the cited empirical evidence concerns current industry practice, whereas the relevant policy question is whether the merger will increase the likelihood that yield management can be used in an anticompetitive manner when the number of significant companies is reduced from four to three. As before, the Commission's focus on pre-merger practices seeks to answer a factual question relevant to the past, whereas the real issue concerns conduct in the future.[35]

Other aspects of the Commission's discussion of yield management also raise concerns. There is no explicit recognition that while yield management may help in filling available berths (or airline seats, etc.), that does not imply that the price at which most customers secure berths are somehow more reasonable or closer to competitive levels. If yield management were to work perfectly, the only berth whose price would be at the competitive level—approaching marginal cost—is the last berth sold. Every other berth would be priced higher than the competitive level. Under less ideal (and more realistic) conditions, effective yield management will raise the average fare above the level that could be charged absent this sophisticated tool of price discrimination.

Moreover, any implication that yield management is benign in its impact on coordination is belied by experience in the industry for which sophisticated yield management was invented, namely, airlines. The airline industry has both used its sophisticated pricing software to aid coordination, and at other times readily found ways to circumvent its limitations.[36] While the airlines' experience is not an infallible guide to the effects of yield management in other industries—for example, pricing in the cruise industry may be less transparent than pricing in airlines—neither is there a basis for concluding that yield management generally obviates concern.

Coordination on Amenities and Capacity. Briefer comments on coordination with respect to amenities and capacity will suffice. With up to one fifth of a cruise line's revenue generated from on-board sales, amenities are a vital component in the financial performance of this industry. As noted earlier, the majority statement dismisses concern with coordination of quality ("amenities") by asserting that amenities are important, there are unilateral incentives to cheat, and so coordination would be undermined. Taken at face value, this line of reasoning is tantamount to a blanket denial that

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[35] Indeed, if the Commission found evidence that yield management aided price setting today, it might then argue that the merger raises no policy concern since it would not make matters worse.

[36] *See* Severin Borenstein, *Rapid Price Communication and Coordination: The Airline Tariff Publishing Case* (1994), *in* THE ANTITRUST REVOLUTION 310 (John Kwoka & Lawrence White eds., 3d ed. 1999).

coordination can ever occur when parties have differing self-interests—a proposition that is demonstrably false, and an altogether inadequate basis for dismissing the concern. This is particularly unfortunate since the coordination of non-price terms will be more easily accomplished in a more concentrated industry. For example, following the lead of the largest firm, the remaining firms in this highly oligopolistic industry could determine to change refund policy in a manner that increases costs to customers. Or they might tacitly follow the lead firm in setting the rules for which services are included in the fare and which services are subject to additional on-board charges. These examples are merely illustrative of the ways in which a concentrated industry might tacitly coordinate non-price terms.[37] Coordination of less transparent policies could have the effect of raising prices for price sensitive as well as price insensitive consumers. At the point of booking, a first time cruise passenger (who may be price sensitive) may be unaware of, or pay little attention to, policies governing refunds or on-board charges for amenities.

As for capacity coordination, the Commission's argument rests on two propositions: (a) the number of ships that would have to be withdrawn is very large, and (b) their redeployment would cause unacceptable profit declines elsewhere. The bases for these claims are not provided, but even if true they would not address the possibility that capacity might be reduced by such strategies as deferring new ship purchases, delaying some already contracted for, or reconfiguring ships under construction for more higher-price berths. In addition, the Commission here employs another variant of its Goldilocks reasoning: Previously we were told that the cruise lines could build and reconfigure ships easily enough to defeat any effort at a unilateral price increase, but the Commission now asserts there are contractual and other impediments sufficient to preclude capacity contraction. This redeployment "mattress" is, the Commission would have us believe, just right: soft enough to defeat unilateral action, but hard enough to counter coordinated effects. Unlike Goldilocks, who could do her own empirical testing of mattresses, the Commission must make its predictions based on ambiguous evidence that three Commissioners interpreted one way, and two Commissioners interpreted another way. This is hardly a reassuring basis for disregarding the presumption governing large mergers in high concentration industries.

Strategic Conduct. Strategic conduct has occupied the economics profession greatly in the past twenty years. Research has shown the possibility of new types of anticompetitive behavior and re-examined some traditional concerns that had been relegated to the dustbin. The result has been a much greater appreciation of the variety of methods by which an aggressive company can secure an advantage over its rivals, ultimately diminishing their competitive force and conferring greater market power on the company that initiated the conduct. While this is not the place to review this body of literature,[38] it is important that these issues be considered in antitrust analysis. The Commission has, for example, given weight to possible strategic behavior in imposing requirements on Time Warner's acquisition of Turner Broadcasting.[39] The Commission's cruise merger statement is, unfortunately, silent on these matters. Here we note two examples of potentially anticompetitive strategic conduct.

[37] Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, and Rules*, 2000 WIS. L. REV. 941, 949–84 (2000) (describing and analyzing collusion by manipulation of the rules under which competition takes place).

[38] *See, e.g.*, JEFFREY CHURCH & ROGER WARE, INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH (2000); Tefft W. Smith & Hillard M. Sterling, *Challenging Competitors' Mergers: A Real Strategic Option*, 65 ANTITRUST L.J. 57 (1996).

[39] Time Warner, Inc., 61 Fed. Reg. 50,301 (1996). *See* Stanley M. Besen et al., *Vertical and Horizontal Ownership in Cable TV: Time Warner-Turner* (1996), *in* THE ANTITRUST REVOLUTION, *supra* note 36, at 452.

One important resource for consumers confronted with opaque pricing schemes is the expertise of the independent travel agent. But this resource too may be jeopardized by the tight oligopoly that will result from an acquisition that produces a single firm with 50 percent of the market. Any supplier can be expected to push its downstream resellers for loyalty and favored treatment. The independent travel agent is in a position to resist this pressure (and should have a substantial incentive to provide consumers with neutral advice) as long as booking options are dispersed among a sufficient number of cruise lines. In the post merger world, the leverage of the largest firm will now be substantial, perhaps sufficient to force travel agents to give it favored treatment under circumstances that will not be revealed to the consumer.

Some travel agents may be persuaded to book exclusively for the largest firm, raising the cost of rival firms to obtain bookings. The result must be a further undermining of competition. This means that rival cruise firms will no longer have access (or be denied access on equal terms) to a substantial body of travel agents, increasing their costs of doing business.

These are merely examples of how the post-merger form may exercise power strategically. Other credible theories of strategic abuses include the wielding of influence with regulators who may control access to ports or facilities that could raise costs for rivals. This was a concern of the dissenting Commissioners with respect to the Alaska niche market. Further confirmation of the potential for anticompetitive strategic conduct might be found in the history of such conduct in the airline industry, where large carriers have for many years employed computer reservation systems to gain advantages over rivals.

The Commission's Treatment of Rivals' Submissions. The Commission's statement contains language that may be construed as endorsing second-class treatment of merger-investigation submissions by rival firms. After noting that both the merging parties and competitors have a self-interest in presenting information to the Commission, the statement singles out competitor-supplied information for special comment. Opposition from competitors, the statement suggests, "often indicates that the transaction will increase—rather than decrease—competition." This is so, the statement continues, because higher prices from the anticompetitive effects of a merger would benefit rivals (and rivals would support the merger).[40]

The reasoning in the statement is vulnerable. First, it should be noted, few mergers turn out to have the efficiency benefits that merger parties tout.[41] Even if a merger is efficient, it may not promote competition, so this would not be an incentive for a rival to oppose it. Moreover, whether or not a merger is efficient, there are three ways in which it can be anticompetitive (unilateral effects, coordinated effects, or strategic conduct). Only one of these ways (coordinated effects) would benefit all rivals, and even then only if all rivals are similarly situated. Unilateral anticompetitive effects may benefit some rivals, but would not necessarily benefit others. There would be no benefit if the unilateral price increase occurs in a niche market where rivals play no significant role (e.g., Alaska cruising). Strategic effects, far from benefiting rivals, are usually designed to handicap rivals and can be severely threatening to them. Although it is possible that rivals may oppose a merger because they fear a more efficient post-merger firm, an equally likely explanation for a rival's opposition would be its fear of the strategic behavior of the more powerful merged entity. In the cruise mergers, for example, rivals of the merging firms could well fear the influence that the

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[40] FTC Cruise Lines Statement, *supra* note 1.

[41] F.M. Scherer, *Some Principles for Post Chicago Antitrust Analysis*, 52 CAS. W. RES. L. REV. 5, 10–22 (2001).

merged firm will exercise over upstream suppliers, downstream travel agents, or even regulatory agencies that control access to vital routes, ports of call, or other land-based facilities.[42]

In the last analysis, enforcement agencies are routinely deluged with biased information and analysis from the merging parties. The information presented by rivals may also be biased but it may be the only expert and in-depth information that can provide a counterweight to the merging parties' submissions. There is every reason to treat this information with at least the same respect and seriousness accorded submissions from the merging parties themselves.

Conclusion

The Commission's issuance of the cruise merger statements is a welcome and highly constructive development. The statements are a concrete demonstration that a public explanation can be issued at the close of a major merger investigation. For all its strengths, the Commission majority's statement was inadequate because it failed to address important objections that had been raised to the acquisitions (such as the risk of anticompetitive strategic conduct) and because its reasoning was superficial or unsupported in addressing the risk of unilateral or coordinated post merger effects.

The most disquieting aspect of the Commission's decision was its bypassing, without an adequate basis, of the presumption governing large mergers in concentrated industries. By permitting the parties to go forward, the Commission is in fact running a market experiment with respect to the presumption. Whether the merged entity succeeds in unilaterally raising price on some routes, coordinating with its two remaining significant rivals, or extracting concessions that disadvantage those rivals will be issues that reveal themselves in the market, albeit intermingled with other causal influences. The upshot may well be further evidence regarding the policy premise underlying *Philadelphia National Bank* and four iterations of the Merger Guidelines that has long and well served U.S. antitrust policy.

The criticism of the Commission's substantive ruling offered here in no way diminishes the importance and value of this effort at transparency. Indeed, these comments could not be offered without that disclosure. It may be hoped that such feedback will aid in improving the precision of future disclosure and, perhaps, future analyses. More generally, transparency fosters not only oversight, informed public debate, and responsive and responsible government—it also aids counselors in their task of understanding and communicating merger policy to clients. Explanatory statements should be the rule, not the exception, when either federal agency closes a major merger investigation. ●

[42] Evan Perez, *Carnival, Winning Princess Bid, Is Poised To Expand Dominance*, WALL ST. J. Oct. 28, 2002, at A 3.

Trinko: Will The Supreme Court Bring Clarity To Dealings Among Telecommunications Competitors?

Al Pfeiffer

The interplay between the antitrust laws and the Telecommunications Act (1996 Act) has become an area of increasing uncertainty to those in the telecommunications industry. The lower courts have disagreed about the antitrust significance of alleged failures to comply with the obligations imposed by the 1996 Act. District Courts have widely—though not unanimously—interpreted the Seventh Circuit's decision in *Goldwasser v. Ameritech Corp.* to mean an antitrust claim can never be based on allegations of conduct that also happens to violate the 1996 Act. The Second, Ninth, and Eleventh Circuits have recently disagreed. The Supreme Court's decision to grant review of the Second Circuit's decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, Docket No. 02-682, seems to present the Court with the opportunity to resolve a number of significant issues affecting dealings between local telephony incumbents and challengers. Verizon's petition for certiorari does not merely raise questions concerning how to interpret *Goldwasser* but also raises challenges to the Second Circuit's treatment of essential facilities and monopoly leveraging claims without regard to the 1996 Act—challenges sufficiently broad to have significance well beyond the regulated telecommunications industry. But it is not clear that *Trinko*, a class action by indirect customers of incumbent local telephone monopolists (ILECs) is the proper vehicle by which to address many of those issues, especially as they relate to the ILECs' direct customers, the competing local exchange carriers (CLECs).

Goldwasser and Its Progeny

The Seventh Circuit was the first court of appeals to consider the interplay of the 1996 Act and the antitrust laws, in *Goldwasser*, 222 F.3d 390 (7th Cir. 2000). A putative class of end users of local telephone services sued Ameritech, claiming that it had violated a number of its duties under the 1996 Act to provide to competitive local exchange carriers reasonable, nondiscriminatory access to its network. As the Seventh Circuit put it, the *Goldwasser* plaintiffs somewhat simplistically argued that "Ameritech is a monopolist; Ameritech is engaging in conduct designed to maintain its monopoly power, through a variety of exclusionary practices; and plaintiffs as consumers are harmed," where the only exclusionary practices alleged were violations of the 1996 Act. *Id.* at 396. The court emphatically rejected any suggestion of such a syllogism. It found the duties imposed by the 1996 Act are not "coterminous with the duty of a monopolist to refrain from exclusionary practices." *Id.* at 399. The court went on to observe that "it would be undesirable here to assume that a violation of a 1996 Act requirement automatically counts as exclusionary behavior for purposes of Sherman Act § 2." *Id.* at 400.

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. . . Goldwasser became controversial because, at least as interpreted by a number of lower courts, it announced a per se rule that any conduct which implicated the 1996 Act could never be the basis for antitrust liability.

Those points are hardly controversial; few would argue that every violation of a 1996 Act duty, no matter how minor or technical, would *automatically* suffice as sufficient exclusionary conduct to impose antitrust liability. But *Goldwasser* became controversial because, at least as interpreted by a number of lower courts, it announced a per se rule that any conduct which implicated the 1996 Act could never be the basis for antitrust liability. It disclaimed any finding of express or implied immunity, *id.* at 401, but went on to hold that "the 1996 Act imposes duties on the ILECs that are not found in the antitrust laws. Those duties do not conflict with the antitrust laws, either; they are simply more specific and far-reaching obligations . . . ." *Id.* The Seventh Circuit concluded that

> [a]t some appropriate point down the road, the FCC will undoubtedly find that local markets have also become sufficiently competitive that the transitional regulatory regime can be dismantled and the background antitrust laws can move to the fore. Our holding here is simply that this is not what Congress has mandated at this time for the ILEC duties that are the subject of the Goldwasser complaint.

Id. at 401–02.

A number of ILECs responded to the Seventh Circuit's ruling by asserting *Goldwasser* defenses to a variety of consumer and competitor antitrust claims around the country. While several courts rejected the defense,[1] the majority of district courts to consider the issue followed—or even expanded—*Goldwasser*.[2]

Trinko, *Covad*, and *MetroNet* All Disagree with *Goldwasser*

The Second, Ninth and Eleventh Circuits, the only courts of appeal to have considered the issue since *Goldwasser*, have refused to follow an interpretation of *Goldwasser* that precludes antitrust liability based on conduct violative of the 1996 Act. All three circuit courts reversed district court rulings that dismissed antitrust claims, but each arose in a distinct procedural setting.

Trinko. The Second Circuit's ruling arose in *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp. (Trinko)*, 305 F.3d 89 (2d Cir. 2002), which, like *Goldwasser*, was a class action on behalf of end-user consumers. Following the entry of a consent decree in which Verizon agreed to pay over $10 million to the FCC and AT&T concerning access disputes, a putative class of CLEC customers sued Verizon. The end-users claimed that they received poor local service from CLECs because Verizon did not provide the CLECs access to its network equal in quality to what it provided itself. Had Verizon met its obligations, the plaintiffs theorized, those competing carriers would have been able to provide better service as a competitive alternative to Verizon. Verizon moved to dismissed, claiming (1) the end user plaintiffs lacked standing to pursue their claims and (2) no

[1] *See, e.g.*, Ohio Bell Tel. Co. v. CoreComm Newco Inc., 214 F. Supp. 2d 810 (N.D. Ohio 2002) (permitting § 2 claim based on 1996 Act violations); Davis v. Pac. Bell, 204 F. Supp. 2d 1236 (N.D. Cal. 2002) (same); Stein v. Pac. Bell, 173 F. Supp. 2d 975 (N.D. Cal. 2001) (same); Sprint-Florida, Inc. v. Electronet Intermedia Consulting, Inc., No. 4:00-CV-176-RH (N.D. Fla. Sept. 20, 2000) (same); MGC Communications. Corp. v. Sprint Corp., No. CV-S-00-948-PMP (D. Nev. Dec. 12, 2000) (same); Bell Atl. Network Servs., Inc. v. Ntegrity Telecontent Servs., Inc., Civ. No. 99-5366-AET (D.N.J. Oct. 31, 2000) (same).

[2] *See, e.g.*, Covad Communications Co. v. Bell Atl. Corp., 201 F. Supp. 2d 123 (D.D.C. 2002) (dismissing based on Goldwasser); Cavalier Tel., LLC v. Verizon Va. Inc., 208 F. Supp. 2d 608 (E.D. Va. 2002) (same); MGC Communications, Inc. v. BellSouth Telecomms., Inc., 146 F. Supp. 2d 1344 (S.D. Fla. 2001) (same); Intermedia Communications Inc. v. BellSouth Telecomms., Inc., No. 8:00-CIV-1410-T-24(C) (M.D. Fla. Dec. 15, 2000) (R2-7-A200) (same); Telecomms. & Info. Sys., Inc. v. BellSouth Telecomms., Inc., No. 99-1706-SEITZ (S.D. Fla. June 6, 2001) (same); Building Communications, Inc. v. Ameritech Servs., Inc., No. 97-CV-76336 (E.D. Mich. June 21, 2001) (same).

antitrust claim was possible in any event, under *Goldwasser*. The district court found the plaintiff had standing, but dismissed the antitrust claims, expressly following *Goldwasser*.

The Second Circuit reversed. First, the court agreed that the end-user plaintiffs had standing. Relying on *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982), the court concluded that a "customer of a competitor can suffer a direct injury from an anticompetitive scheme aimed principally at the competitor." 305 F.3d at 106. Next, the Second Circuit expressly disagreed with the district court's application of *Goldwasser*. It found that "The allegations in the amended complaint describe conduct that may support an antitrust claim under a number of theories. While some of this conduct might also violate section 251, these are not merely allegations that section 251 has been violated." *Id.* at 108. While the class plaintiffs' allegations were somewhat conclusory, the court found the plaintiffs had properly stated Section 2 claims on both monopoly leveraging (applying the Second Circuit's lower threshold standard as expressed in *Berkey Photo*)[3] and essential facilities theories, finding that many of Verizon's arguments were simply inappropriate for resolution at the Rule 12 stage. 305 F.3d at 108.

Covad. Unlike *Trinko* and *Goldwasser*, the Eleventh Circuit was not faced with indirect claims by a class action of would-be end-user customers of local service resellers. Instead, the court in *Covad Communications Co. v. BellSouth Corp.*, 299 F.3d 1272 (11th Cir. 2002), faced claims brought by a facilities-based CLEC, Covad Communications Company. Covad, a provider of DSL service, needed access to BellSouth's local telephone network in order to provide its own services. Covad claimed it was excluded from the relevant Internet access markets in which it competed with BellSouth when it was denied proper access to BellSouth's local network. *Id.* at 1276–77. BellSouth moved to dismiss, relying heavily on *Goldwasser*. The district court, quoting liberally from *Goldwasser*, dismissed Covad's claims.

The Eleventh Circuit reversed. First, it rejected *Goldwasser* "to the extent that it is read to say that a Sherman Act antitrust claim cannot be brought as a matter of law on the basis of an allegation of anti-competitive conduct that happens to be 'intertwined' with obligations established by the 1996 Act." *Id.* at 1282. The Eleventh Circuit then went on to review Covad's allegations on their merits, and found they sufficed to state a Section 2 claim under theories of essential facilities, refusal to deal, and price squeeze, finding each to be merely a subspecies of monopoly leveraging. *Id.* at 1284. The Eleventh Circuit subsequently denied BellSouth's petition for rehearing en banc, with three judges dissenting.[4]

MetroNet. The Ninth Circuit also recently confronted a *Goldwasser* defense in a CLEC case, *MetroNet Services Corp. v. U.S. West Communications*, 325 F.3d 1086 (9th Cir. 2003). The plaintiff, MetroNet, buys Centrex service from Qwest in bulk at a volume discount and passes along the discount to small customers who would otherwise not qualify for it. Qwest changed its volume discount pricing rules in 1997. As the court put it "Qwest's new pricing scheme rendered MetroNet's customers ineligible for the volume discount," *id.* at 1091, causing a 400 percent increase in their cost of service. *Id.* at 1093. Qwest moved for summary judgment, claiming, among other things, that the highly regulated nature of the telecommunications industry precluded any claim of market power or exclusionary conduct. The district court granted Qwest's motion for summary judgment.

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[3] Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 253, 275 (2d Cir. 1979).

[4] The denial of the petition for rehearing, and the dissenting opinion from that denial, are reported at 314 F.3d 1282 (11th Cir. 2002).

The Ninth Circuit, finding the matter to be "a close question," reversed. *Id.* at 1091. The court first rejected Qwest's Goldwasser defense:

> Even absent the explicit language of the savings clauses, Qwest would not be entitled to implied immunity for its imposition of per location pricing. . . . Where the conduct challenged under the antitrust laws "is the product of the regulated business" independent initiative and choice, [that conduct] is properly subject to antitrust scrutiny.

Id. at 1101. The Ninth Circuit went on to review MetroNet's claims on the merits and found that triable issues existed concerning Qwest's market power, the anticompetitive effects of its conduct, and antitrust injury. The court also expressly found a triable issue on MetroNet's essential facilities claim. *Id.* at 1111–12.

Certiorari in *Trinko*

Verizon petitioned for certiorari in *Trinko*,[5] at which point the case took some interesting turns.

First, the Solicitor General filed an amicus brief on behalf of the DOJ Antitrust Division and the FTC, supporting review by the Supreme Court.[6] The government's position appears to have migrated substantially from the views espoused in 2001 when the government first addressed *Goldwasser* in an amicus brief filed in the Eleventh Circuit on behalf of the plaintiff in *Intermedia Communications Inc. v. BellSouth Telecommunications, Inc.*[7] In *Intermedia*, the government had argued that while "Intermedia's lengthy complaint could have been clearer with respect to its antitrust claims," its allegations of exclusionary conduct grounded in the 1996 Act included "all of the factual allegations required to state a claim under Section 2." *Intermedia* Amicus Brief at 24. But in *Trinko*, the government (the FTC being notably absent) argued that, while the plaintiff may have alleged necessary elements, such as exclusionary conduct, its allegations were "inherently implausible when measured against the regulatory scheme the complaint itself mentions." *Trinko* Amicus Brief at 14. The government also criticized the Second Circuit's application of the lower threshold *Berkey Photo* monopoly-leveraging standard and asked the Supreme Court to clarify that monopoly leveraging is only actionable when it results in a monopoly, or a dangerous probability of achieving one, in the downstream market. *Id.* at 16. As to both monopoly leveraging and essential facilities, the government argued that it is an antitrust plaintiff's burden, in establishing exclusionary conduct, to prove the defendant acted in an economically irrational manner, but rather for the effect of excluding competition: "essential facilities claims must at a minimum include some showing of 'exclusionary' or 'predatory' conduct, *i.e.,* that the refusal to share the facility would not make economic sense unless it tended to reduce or eliminate competition." *Id.* at 13. The government noted that, while the *Trinko* plaintiffs had pleaded that Verizon's conduct lacked any legitimate business justification, its allegation should be disregarded—even at the Rule 12 stage—as "inherently implausible." *Id.* at 14.

The government's position appears to have migrated substantially from the views espoused in 2001 [in* Intermedia*].

The Supreme Court obviously wrestled with whether and how to deal with Verizon's petition. The Court put the matter on its conference schedule four times before finally granting review. And when it did take the case, the Court declined to review either of the issues raised by Verizon (which

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[5] Petition for a Writ of Certiorari, No. 02-682 (*Trinko* Pet.).

[6] Brief for the United States and the Federal Trade Commission as Amici Curiae, S. Ct. No. 02-682 (filed Dec. 2002) (*Trinko* Amicus Brief).

[7] Brief for the United States and Federal Communications Commission as Amici Curiae in Support of Appellants, 11th Cir., No. 01-10224-JJ (filed Mar. 28, 2001) (*Intermedia* Amicus Brief).

focused on consumer standing and the interplay of the 1996 and Sherman Acts), or the alternative question proposed by the government (which focused on the standards for assessing exclusionary conduct). Instead, it stated that review was "limited" to the question "[d]id the Court of Appeals err in reversing the District Court's dismissal of respondent's antitrust claims?"[8] Thus, the Court's intended scope is unclear. Ultimately, *Trinko* could range from a narrowly focused examination of antitrust claims in the shadow of the 1996 Act, to a broad review of antitrust standing and/or parties' burdens in showing exclusionary conduct under Section 2.

The Potential For Dramatic Changes

The telecommunications industry has been slow to achieve the goal of increased competition in all markets, which Congress mandated when it passed the landmark Telecommunications Act of 1996.[9] A number of CLECs have alleged that ILECs, such as Verizon and BellSouth, have manipulated the regulatory and competitive landscapes in order to protect their long-sanctioned, ratepayer-funded monopolies over local telephone service. ILECs responding to those antitrust cases have relied on *Goldwasser* to assert that the 1996 Act absolutely precluded any claim that they had violated the antitrust laws in their interactions with competitors. The district courts were split in their treatment of that defense, though a majority followed *Goldwasser* and dismissed competitor's claims.[10]

The Second Circuit's decision in *Trinko* addresses such allegations of ILEC abuse, albeit in the context of the end-user customers of those companies that compete with Verizon by reselling its local service offerings. The Supreme Court found those issues to be serious enough to merit its review. CLECs have also alleged (including in *Covad*) that the ILECs have simultaneously been engaged in conduct that has more far-reaching, and ultimately more seriously anticompetitive effects, than merely retaining their historic, local telephone monopolies. The CLECs allege that the ILECs have extended their traditional local service monopolies so as to dominate new, innovative markets, markets that depend on access to the local telephone network in order to provide competing services in downstream markets. That type of monopoly extension behavior is not squarely presented in *Trinko* (though it is the very core of Covad's claims against BellSouth, as recently analyzed and approved by the Eleventh Circuit), so it is unclear whether the Supreme Court can or should properly reach those issues based on the *Trinko* complaint.

But at least some parties are seeking to turn *Trinko* into much more than a battle over the interplay of the Sherman Act and the 1996 Act. *Trinko* potentially presents a number of issues of interest well beyond the telecommunications industry.

Predatory Conduct. If the Supreme Court reviews *Trinko* in the manner suggested by the government, it could have significant effects on Section 2 claims in general, not just in the regulated telecommunications context. The government's amicus brief could be read as an attempt to use *Trinko* as a vehicle to reformulate the Section 2 pleading rules as they relate to "exclusionary" or "predatory" conduct.

The government argues that, in order to plead any type of Section 2 claim, a plaintiff must make an affirmative showing that the defendant's conduct is without any legitimate business justifica-

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[8] Order Granting Petition For Writ of Certiorari, Verizon Communications v. Law Offices of Curtis V. Trinko, 123 S. Ct. 1480 (2003) (No. 02-682).

[9] 47 U.S.C. §§ 151 *et seq.*

[10] *See supra* notes 1 & 2.

tion—in the government's words, that the conduct makes no economic sense but for the purpose to exclude competition. *Trinko* Amicus Brief at 11. Specifically, the government criticizes the *Trinko* complaint for failing to allege that Verizon's conduct "involves a sacrifice of profits or business advantage and makes economic sense only because it softens or injures competition." *Id.* Indeed, at least in the context of Trinko's claims, the government asserts that it is appropriate on a Rule 12 motion to weigh the credibility of such allegations, even if the plaintiff makes them. *Id.* at 13–14 (criticizing plaintiffs' allegations of lack of business justification as "inherently implausible"). The government's position, read most broadly, would appear to be (1) a significant shift in the traditional allocation of Section 2 burdens of pleading and proof and (2) wherever those burdens fall, a significant narrowing of what has traditionally been viewed as exclusionary conduct.

[T]he government criticizes the Trinko *complaint for failing to allege that Verizon's conduct "involves a sacrifice of profits or business advantage and makes economic sense only because it softens or injures competition."*

It is well-settled that a monopolist does not enjoy an unfettered right to refuse to deal, even with competitors. That right "exists only if there are legitimate competitive reasons for the refusal."[11] As a number of circuits have recently reaffirmed, including most recently the Third Circuit in *LePage's*, the defendant bears the burden of showing such reasons motivated its conduct.[12] The government's position on exclusionary conduct in *Trinko* could be interpreted to shift that burden to the plaintiff, to prove as part of its affirmative case that the defendant's challenged conduct makes no business sense except for its adverse effects on competition. It is unclear what justifies this shift.

Regardless of who ultimately bears the burden of proof on the issue, the government's position could also be stretched to assert a relatively narrow view of the type of conduct that would fail to meet the "legitimate justification" standard. Any efforts to turn the government's position into an absolute would appear to be unsound, as well as a significant shift in position by the government, even within the telecommunications industry. The government considered similar issues in the *Intermedia* case in the Eleventh Circuit in 2001, and opined that allegations of "failure to provide reasonable interconnection" by BellSouth against a CLEC sufficiently "allege[d] exclusionary conduct by a firm with monopoly power that lacks business justification and that harms competition."[13] It is true that in *Trinko* the government argued that exclusionary conduct "normally involves the sacrifice of short-term profits or goodwill in order to maintain or obtain long-term monopoly power." *Trinko* Amicus Brief at 10. But "normally" is an important modifier of that sentence. While conduct that directly sacrifices short-term profits in order to harm competition is certainly an instance in which conduct has been found exclusionary, it is by no means the only such instance. For example, price squeezes have commonly been found unlawful without any requirement that the monopolist engage in predatory pricing at either end of the squeeze.[14] And more generally, a narrow reading of the government's position on exclusionary conduct would seem to do away with recognized theories of anticompetitive conduct, such as raising rivals' costs, which need not

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[11] Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 483 n.32 (1992) (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 602–05 (1985)); *accord* United States v. Colgate & Co., 250 U.S. 300, 307 (1919) (refusals to deal acceptable only "[i]n the absence of any purpose to create or maintain a monopoly").

[12] LePage's, Inc. v. 3M, 324 F.3d 141, 164 (3d Cir. 2003); *accord* Nat'l Communications Ass'n Inc. v. AT&T Corp., 238 F.3d 124, 131 (2d Cir. 2001); United States v. Microsoft Corp., 253 F.3d 34, 59 (D.C. Cir.) (*en banc*), *cert. denied*, 534 U.S. 952 (2001).

[13] Brief for the United States and Federal Communications Commission as Amici Curiae in Support of Appellants, Intermedia Communications, Inc. v. BellSouth Telecomms., Inc., No. 01-10224-JJ (filed Mar. 28, 2001) at 25–26.

[14] *See, e.g.*, City of Batavia v. FERC, 672 F.2d 64, 90 (D.C. Cir. 1982); Ray v. Indiana & Mich. Elec. Co., 606 F. Supp. 757, 776 (N.D. Ind. 1984), *aff'd*, 758 F.2d 1148 (7th Cir. 1985).

involve predation in the sense of forgone short-term profits.[15] Courts have held that allegations of raising rivals' cost "qualify as anticompetitive conduct" unless there is a "legitimate business justification for it."[16]

Essential Facilities. Verizon devotes much of its petition for certiorari to an open attack on the essential facilities doctrine. It cites a number of academic criticisms of the doctrine, points out that the Supreme Court has never expressly endorsed the theory (despite its roots in the Supreme Court's decision in *United States v. Terminal Railroad Ass'n*),[17] and urges the Supreme Court to reject the doctrine outright. *Trinko* Pet. at 15–17. But as a fallback, Verizon also argues for significant limitation on the doctrine: it asserts that the doctrine should only be applicable to concerted, not unilateral conduct, *id.* at 16 n.10, and should only be applied in the context of absolute denials of access—not constructive denials based on unreasonable terms and conditions of access. *Id.* at 13–14.

Adoption of either of these fallback suggestions would effect a significant change in essential facilities jurisprudence. A number of circuit court decisions have found viable essential facilities claims despite the lack of an outright denial of access,[18] and that would appear to be the logical result. Otherwise, a monopolist with control over an essential bottleneck could simply throttle competition by "permitting" access, but only on terms that would not allow any real competition. That would seem at odds with the purpose of having the essential facilities doctrine in the first place. Similarly, every circuit court has recognized the viability of the doctrine, all recognizing the same four essential elements (none of which includes concerted action), and most have done so in the context of Section 2, not Section 1.[19] Verizon has not stated any logical reason why an essential facilities claim should depend on concerted action.

Monopoly Leveraging. Verizon and the government have also asked the Supreme Court to review the Second Circuit's monopoly leveraging analysis. Both attack the Second Circuit's reduced, *Berkey Photo* threshold: the Second Circuit monopoly leveraging test requires only a showing that a monopolist has attempted to utilize its monopoly power in one market to gain a "competitive advantage" in another. *Trinko*, 305 F.3d at 108. Verizon and the government assert that, to the extent leveraging is recognized as an offense at all, it requires a showing that the monopolist used its monopoly power in one market to obtain or maintain a monopoly in another market (or, for an attempt claim, that there is a dangerous probability that it will do so). *Trinko* Pet. at 21–22; *Trinko* Amicus Brief at 16. While the "competitive advantage" language originated with

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[15] *See* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209, 235–62 (1986); *see also* Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 Colum. Bus. L. Rev. 257, 318–23 (2001) (discussing economic logic behind raising rivals' cost theory).

[16] *See, e.g.*, Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal and Prof'l Publ'ns, Inc., 63 F.3d 1540, 1553 n.12 (10th Cir. 1995).

[17] 224 U.S. 383 (1912).

[18] *See Covad*, 299 F.3d at 1286–87 (citing cases from other circuits holding that "Section 2 prohibits denial of access to essential facilities *on reasonable terms*").

[19] *See, e.g.*, Hecht v. Pro-Football, Inc., 570 F.2d 982, 992–93 (D.C. Cir. 1977); Interface Group, Inc. v. Mass. Port Auth., 816 F.2d 9, 12 (1st Cir. 1987); Del. & Hudson Ry. Co. v. Consol. Rail Corp., 902 F.2d 174, 179 (2d Cir. 1990); Ideal Dairy Farms, Inc. v. John Labatt, Ltd., 90 F.3d 737, 748 (3d Cir. 1996); Advanced Health-Care Servs. v. Radford Cmty. Hosp., 910 F.2d 139, 150 (4th Cir. 1990); Mid-Texas Communications Sys., Inc. v. AT&T Co., 615 F.2d 1372, 1387 n.12 (5th Cir. 1980); Directory Sales Mgt. Corp. v. Ohio Bell Tel. Co., 833 F.2d 606, 612 (6th Cir. 1987); MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132–33 (7th Cir. 1983); City of Malden v. Union Elec. Co., 887 F.2d 157, 160 (8th Cir. 1989); City of Vernon v. S. Cal. Edison Co., 955 F.2d 1361, 1366–67 (9th Cir. 1992); Aspen Highlands Skiing Corp. v. Aspen Skiing Co., 738 F.2d 1509, 1520 (10th Cir. 1984), *aff'd on other grounds*, 472 U.S. 585 (1985); Covad Communications Co. v. BellSouth Corp., 299 F.3d 1272, 1285–88 (11th Cir. 2002); Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1356–57 (Fed. Cir. 1999).

the Supreme Court's decision in *United States v. Griffith*,[20] the circuits have split on whether that is a correct interpretation, and even the Second Circuit has, in the past,[21] questioned whether the *Berkey Photo* approach is still valid in light of the Supreme Court's ruling in *Spectrum Sports*, which establishes that Section 2 "makes the conduct of a single firm unlawful only when it actually monopolizes or dangerously threatens to do so."[22] While the complaint in *Trinko* is far from clear, the Second Circuit certainly interpreted it as asserting a monopoly leveraging claim, and the Supreme Court may do likewise. Assuming the Court reaches the monopoly leveraging issue, it could still determine that the *Trinko* allegations, as pleaded, state a monopoly leveraging claim under the monopoly-to-monopoly standard and, thus, might choose not to reach the *Berkey Photo* issue.

[T]hat standing challenge creates a substantial risk that the Supreme Court could resolve* Trinko *without resolving the antitrust merits.

Or an Isolated Case?

But there are also procedural aspects of *Trinko* that may prevent the Supreme Court from providing the clear guidance the telecommunications industry needs concerning ILECs' antitrust rights and duties, much less the sweeping changes the government seeks.

Standing Issues. The status of the plaintiffs is a key issue that may limit the scope of the Supreme Court's ruling in *Trinko*. The putative class in *Trinko* consists entirely of indirect customers of the incumbent monopolist, Verizon—that is, customers who succeeded in obtaining local telephone service from one of Verizon's competitors.[23] The plaintiffs' claimed injury is that because Verizon did not "provide equal access" to its local telephony reseller competitors, the plaintiffs "received poor local phone service." *Id.* at 95. As a result, Verizon has argued and continues to argue before that the plaintiff class members have suffered at most "indirect" harm and so lack standing to pursue antitrust claims against Verizon. *Trinko* Pet. at 24.[24]

The existence of that standing challenge creates a substantial risk that the Supreme Court could resolve *Trinko* without resolving the antitrust merits. If the Court determined the *Trinko* class plaintiffs lacked standing, it would have no reason to proceed further and reach the important issues framed by both Verizon and BellSouth in their respective petitions.[25] The indirect nature of the *Trinko* plaintiffs' claims may be compounded by the fact that the agreement between Verizon and the directly injured party, AT&T, contained a mandatory dispute resolution procedure that did not allow for a suit of the type Trinko brought. 305 F.3d at 94.

Facilities-Based vs. Reseller Claims. Even if the plaintiff in *Trinko* were AT&T, the competitive local carrier which dealt directly with Verizon, rather than a group of AT&T's customers, it is not clear that *Trinko* would squarely frame the issues Verizon and the United States seek to have the Supreme Court address. AT&T is essentially a local service reseller, using access to Verizon's local telephone network to provide the same service as Verizon. It is unclear whether that market

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[20] 334 U.S. 100, 107 (1948).

[21] *See* Virgin Atl. Airways v. British Airways, 257 F.3d 256, 272 (2d Cir. 2001).

[22] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993).

[23] The court dewcribed the class as "consisting of customers who received local phone service in the region served by Bell Atlantic from company other than Bell Atlantic," 305 F.3d at 92.

[24] "[T]he alleged injury here should have been barred as indirect, deriving from harm to the direct customer." *Trinko* Pet. at 24.

[25] *See, e.g.*, Steel Co. v. Citizens For A Better Environment, 523 U.S. 83, 110 (1998) (declining to review merits having found no standing: "However desirable prompt resolution of the merits EPCRA question may be, it is not as important as observing the constitutional limits set upon courts in our system of separated powers").

position truly presents Section 2 monopoly leveraging or essential facilities issues. The district court concluded in *Covad* that claims by local telephone resellers' customers do not involve "a secondary market" so as to implicate leveraging theory at all.[26] The government took a similar position concerning the essential facilities doctrine in *Trinko*. The United States described the principle behind "the leading case," the Seventh Circuit's decision in *MCI Communications Corp. v. AT&T*,[27] as follows: "a monopolist may be required to assist rivals by sharing a facility if the monopolist can 'extend monopoly power from one stage of production to another.'" *Trinko* Amicus Brief at 12. Certainly Verizon agrees with that analysis. Verizon cites MCI's rejection of a demand that AT&T share access to its long distance network,[28] and interprets that rejection as having been based on MCI's desire to use elements of the long distance network in order to provide long distance service (as opposed to the Section 2 claim upheld *MCI*, in which MCI sought to use elements of the local telephone network in order to compete in the long distance market). Verizon, relying on that interpretation of *MCI*, argues that AT&T (from whose interactions with Verizon the plaintiff's claims arise) only participates at one level of one market, the same local service market in which Verizon competes, and asserts that there can be no essential facilities claim when the competitor merely provides the same service as the incumbent whose facilities it seeks to share. *Trinko* Pet. at 12 n.6 (referring to "the *rejected* (same-level, same-market) claim in *MCI*").

It is not clear that interpretation is correct: *MCI* first found that the long distance elements could not be essential facilities because MCI had shown the ability to duplicate them;[29] since they were not essential to competition, it was no stretch to conclude AT&T did not have to share them in order to foster competition in the same market. But were the Supreme Court to accept Verizon's reasoning, the Court could resolve the essential facilities claim on very narrow grounds applicable only to local service reseller competitors (those who participate, in Verizon's words, at the "same-market, same-level"). If it concluded AT&T simply did not participate in two markets, but only one, it could conclude that the *Trinko* plaintiffs simply did not plead an essential facilities or monopoly leveraging theory, without ever reaching the issues raised by Verizon and the government. The Supreme Court has declined prior opportunities to resolve these issues. *Trinko*'s procedural posture gives the Court the opening to do so again.

Even if the Supreme Court tackles the essential facilities and monopoly leveraging issues, it is not clear what the scope of its analysis would be. Facilities-based CLECs who compete in downstream markets present a different set of essential facilities and monopoly leveraging issues than resellers. As in *Alcoa*,[30] the seminal Section 2 "price squeeze" case, facilities-based downstream CLECs like Covad buy essential inputs from a monopolist in an upstream market and use those inputs to compete with that vertically integrated monopolist in a separate, downstream market. In this example, the upstream market is the local telephone network, controlled by the ILEC. The CLEC is not seeking simply to take that network and resell it. Instead, just as the competitors in Alcoa bought aluminum ingot in order to produce and sell aluminum sheet, the CLEC leases elements of an ILEC's network, combines them with its own facilities, and produces a new service (for exam-

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[26] See Petition for a Writ of Certiorari, *Covad*, Pet. App. at 55a.

[27] 708 F.2d 1081, 1132–33 (7th Cir. 1983).

[28] *Id.* at 1149.

[29] *Id.* at 1148.

[30] United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).

ple, DSL) which competes with ILECs in another, downstream market. If the Supreme Court views the claims in *Trinko* as involving only one market, as Verizon itself argues, it is not clear whether *Trinko* could provide meaningful guidance for Section 2 claims by non-reseller competitors.

Conclusion

Trinko is an intriguing case. It clearly presents the classic *Goldwasser* issue of whether the ILECs are absolved of antitrust liability for conduct also covered by the 1996 Act. And at first glance, it also appears to capture issues, such as monopoly leveraging and essential facilities, that have been the subject of extensive debate in the broader antitrust community but which have never received direct Supreme Court guidance. But on closer examination, it is unclear whether an indirect purchaser class action, being reviewed on a Rule 12 motion to dismiss, is the proper vehicle to address such weighty issues. The industry may be better served if the Supreme Court waits for a case with a more fully developed factual record, and a more widely applicable fact pattern, before it tackles those broader issues. ●

Interview with Joseph Simons, Director, FTC Bureau of Competition


Joseph J. Simons

Editor's Note: *As many observers have noted, the Federal Trade Commission and its Bureau of Competition have been exceptionally active over the last two years, in spite of the change in administrations and a declining number of reportable mergers. In this interview, the Director of the Bureau of Competition, Joseph J. Simons, discusses a broad range of issues, including the effort to reinvigorate the FTC's administrative litigation process; the reasons behind the FTC's recent focus on abuse of the* Noerr-Pennington *and State Action doctrines; and the possibility that the FTC will advocate a less stringent standard than that established by the Supreme Court in* Professional Real Estate Investors. *He also asserts that the FTC's competition philosophy is not at odds with the philosophies of either the Department of Justice or the European Commission, and reveals how the FTC's new statement on negotiating merger remedies can be of most utility to parties.*

Simons has served as Director of the Bureau of Competition since 2001. No stranger to the FTC, he previously served as the Bureau of Competition's Associate Director for Mergers in 1989 and also oversaw analysis of the Bureau's non-merger matters in his position as Assistant Director of Evaluation. Immediately prior to serving as Director of the Bureau of Competition, Simons was a partner at Clifford Chance Rogers & Wells LLP. Along with Barry Harris, a former DOJ chief economist, Simons is responsible for the development of "critical loss analysis," a technique for applying the market definition test of the DOJ/FTC Horizontal Merger Guidelines, which is used widely by both the DOJ Antitrust Division and the FTC. (See Paper Trail*, this issue.)*

The Antitrust Source *conducted this interview on May 2, 2003.*

ANTITRUST SOURCE: Let's start off with some policy questions. Specifically, let me ask you about the FTC's use of administrative litigation, which seems to have increased recently. Is that true, and if so, why has it happened?

JOSEPH SIMONS: You are right about the increased use of Part 3, and in my mind it is certainly assuming much greater importance. Today we have five antitrust cases in Part 3. [*Polygram Holding, Inc.*, Docket No. 9298 (June 28, 2002) (Initial Decision); *Schering Plough Corp.*, Docket No. 9297 (July 2, 2002) (Initial Decision), *Chicago Bridge & Iron Co.*, Docket No. 9300 (October 25, 2001) (complaint), *Rambus Inc.*, Docket No. 9302 (June 18, 2002) (complaint), *Union Oil Co. of California*, Docket No. 9305 (Mar. 4, 2003) (complaint).]

The increase is partly intentional and partly due to external factors. One external factor is the change in the HSR thresholds. Although the change has reduced the number of filings for us to review, we're still looking at the smaller mergers—just not in the HSR context. We don't find a need to challenge many of these smaller transactions, but when we do, the big difference is that we typically can't prevent the transaction from taking place. So instead of going to federal court for an injunction, our only realistic option is to go the administrative route. After many years of no

Part 3 merger cases, the Commission issued two Part 3 merger complaints last year. One, *MSC Software*, settled [*MSC.Software Corp.*, Docket No. 9299 (Oct. 29, 2002) (consent order)] and the other, *Chicago Bridge*, is still in litigation.

The other external factor is the decline in merger activity in the current economy. The resulting easing of our merger workload has allowed the Agency to spend more of its resources on non-merger cases. In addition to these considerations, we are emphasizing Part 3 for several policy reasons.

First, we have a fairly extensive positive agenda involving non-merger enforcement. The agency is now able to commit more of its resources to this agenda, given the decline in M&A. Another reason that we are very enthusiastic about administrative litigation is the improvements that have occurred over the last several years in that process. If you go back to the mid-1980s, there was a case in the federal district court here in Washington involving Occidental Petroleum where the federal district court judge referred to the glacial pace of the FTC's administrative proceedings as one reason for denying a preliminary injunction motion by the Commission.[1] The judge cited the average time from issuance of the complaint to the administrative law judge's initial decision as 35 months. Today, with reforms that were introduced in the 1990s,[2] that time is cut by about a third. The Commission's rules now generally provide that an ALJ's decision should come within a year of the issuance of the complaint.[3] That's a lot faster then you would expect to see in the overwhelming majority of federal district courts.

Another reason why we are so interested in Part 3 cases is the substantial public policy benefit that results when the Commission itself gets to write an opinion. The carefully-written opinions that accompany final litigated orders increase the transparency of the Commission's decision-making process and can provide considerable guidance to the Bar and the business community.

. . . perhaps most important, we view administrative litigation as a means to create sound antitrust jurisprudence.

And finally, and perhaps most important, we view administrative litigation as a means to create sound antitrust jurisprudence. For example, the *AMA* case [*American Medical Association*, 94 F.T.C. 701 (1979), *aff'd as modified*, 638 F.2d 443 (2d Cir. 1980), *aff'd by an equally divided Court*, 455 U.S. 676 (1982);] helped open up the door for alternative forms of health care delivery, and *Indiana Federation of Dentists* [*Indiana Fed'n of Dentists v. FTC*, 745 F.2d 1124 (7th Cir. 1984), *rev'd*, 476 U.S. 447 (1986)] established the principle that direct evidence of anticompetitive effects minimizes the need for a rigid showing of market definition and market power. So we think there are lots of good reasons to reinvigorate the administrative litigation process of the Commission.

ANTITRUST SOURCE: Do you think that the outcomes of administrative litigation are given as much deference as the outcomes of proceedings in federal district courts?

SIMONS: I think that the outcomes in the FTC administrative cases probably receive more deference than those of a federal district court because federal district court judges typically are generalists and ordinarily have not had an opportunity to develop an expertise in antitrust law. By and large,

[1] FTC v. Occidental Petroleum Corp., 1986 U.S. Dist. LEXIS 26138; 1986-1 Trade Cas. (CCH) ¶ 67,071 (1986).

[2] *See* 61 Fed. Reg. 50,639 (Sept.26, 1996) and 63 Fed. Reg. 7525 (Feb. 13, 1998).

[3] *Id.*, 16 C.F.R. § 3.51(a) (2003).

when you look at the Commission's opinions, you will find that they generally are much better reasoned than an opinion that a typical federal district court judge would likely issue in an antitrust case.

ANTITRUST SOURCE: You don't think that the "home court advantage" enjoyed by the Commission in administrative proceedings might lead people to give less weight to the results in terms of precedential value?

SIMONS: I guess the question you're asking revolves around findings of fact in a particular case. Someone might wonder if the Commission would be inclined to find facts sufficient to support a violation under the applicable legal standard. I don't think so, but in any case, the so-called "home court advantage" wouldn't be an issue in terms of development of the law. That's where we see the most benefit—not so much on the fact finding as in the development of the law. The Commission can articulate or refine a legal standard just as easily in an opinion supporting a dismissal of a complaint as it can in an opinion supporting a remedial order, so I don't see the "home court" as meaningful in terms of the weight given Commission decisions.

ANTITRUST SOURCE: Can you describe what the Bureau of Competition's current non-merger enforcement priorities are and explain the reasons for them?

SIMONS: The first thing that we try to do is focus on the sectors in the economy that have the biggest impact on consumers. These would include health care and oil and gas, in particular, in terms of what we deal with here.

Health care is tremendously important to the economy, both locally and nationally. Health care products and services account for about 15 percent of the gross domestic product, and that's up fairly sharply in the last ten years. In the past year we've settled a bunch of cases with physicians' groups that were engaged in price-fixing activities. Some of these groups were quite large and so our cases had a very substantial impact. We have quite a few more cases of this type in the pipeline. Prescription drugs are very costly for consumers, government, employers, and others. We've been very active here. We're bringing three types of cases. One type involves agreements between branded manufacturers and generics to keep the generics out of markets that otherwise would open up after a patent expires. The second category involves unilateral conduct by branded drug manufacturers to delay generic entry, either by improperly listing patents in the FDA's "Orange Book"[4] or by, in one case, an illegal patent acquisition. The third area involves agreements among generic manufacturers to divide markets.

In the area of oil and gas, anyone who reads the newspapers or listens to the radio knows about the significant public concern about prices in that sector. Most of the Commission's previous energy-related activities have focused on mergers, but the Commission recently issued a very important complaint charging that Unocal defrauded the California Air Resources Board in the context of a standard setting rulemaking. Unocal's action could subject California consumers to an additional five cents a gallon in the price of gasoline, according to the complaint.

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[4] When a drug manufacturer submits a New Drug Application to the FDA, the holder of a patent may list its patent in the FDA's "Orange Book" if the patent may claim the drug product described in the application. The FDA does not assess the validity of these listings. Under current law, an Orange Book listing triggers an automatic 30-month stay of FDA approval of any generic competitor to the branded product.

In addition to focusing on these key sectors of the economy, we are looking at two other really important areas in our non-merger agenda: the *Noerr-Pennington* and State Action doctrines. We've seen an enormous proliferation of regulatory and licensing activity at every level of government over the past decade or two. This increase in the role of government provides very large opportunities for abuse and potentially subjects consumers to great harm. So, we're focusing on cases and initiatives that would circumscribe the application of *Noerr-Pennington* and the State Action Doctrines.

ANTITRUST SOURCE: Any thought being given to making Section 2-type cases a priority?

SIMONS: I would say actually that Section 2-type cases are already a priority. We've brought quite a few of them. For example, we've had a very significant consent order in Bristol-Myers-Squibb. That case involves various means of monopolization, one being a reverse payment in the context of a patent settlement to keep the generic out, and also repeatedly using improper Orange Book listings to delay generic entry. Two of our cases in administrative litigation, *Rambus* and *Unocal*, involve monopolization involving standard-setting activities. We also had a case [*Biovail Corp.*, Docket No. C-4060 (Oct. 2, 2002) (consent order)] involving Biovail's acquisition of a patent that it then used to keep a generic out of the market by listing the patent in the Orange Book and then suing for patent infringement. That case included both Section 7 and monopoly maintenance claims.

. . . I don't think there's any difference in antitrust enforcement philosophy between the Antitrust Division and the Federal Trade Commission.

ANTITRUST SOURCE: Are there differences in philosophy between the Antitrust Division and the FTC, in your opinion? And do you think it serves the interests of justice to have a dual federal antitrust enforcement system?

SIMONS: As a general matter, no, I don't think there's any difference in antitrust enforcement philosophy between the Antitrust Division and the Federal Trade Commission. I do think it's a pretty good idea to have the dual enforcement system. Each agency has its own special powers, such as the DOJ's jurisdiction over criminal matters, and areas of expertise. As an example of the latter, the Commission has particular expertise in retail-related matters and that's to some degree related to the fact that we also do consumer protection here. I think any time you do have dual enforcement, obviously there are potential pitfalls, but I think we've largely dealt with those. As I said, I think we do have doctrinal coherence. I think that is secured by our working closely with the folks at the Department of Justice, and examples of that include the fact that any guidelines we develop we generally issue jointly. Administratively, we have a clearance process which works well and prevents duplication of efforts on particular cases.

ANTITRUST SOURCE: One area that has been very active in both the FTC and the DOJ is the relationship between intellectual property and antitrust as it relates to unilateral refusals to license intellectual property. The DOJ has specifically supported the Federal Circuit opinion in the *CSU v. Xerox* case, in spite of the fact that there has been criticism of that opinion by some in the antitrust community; for example, from former FTC Chairman Pitofsky. What is the FTC's view on an IP holder's ability to refuse to license intellectual property, and does the FTC agree with or disagree with the *CSU v. Xerox* case?

SIMONS: As a general proposition, the intellectual property laws are not different from real property laws in terms of how antitrust applies. The antitrust laws do not impose a general unilateral duty to deal on owners of real property, even for monopolists. Only in those cases where the refusal to deal can be characterized as exclusionary behavior to maintain a monopoly have the courts imposed a duty to deal. Patent holders likewise enjoy protection from a general duty to deal, even when they have a monopoly. But they are still subject to the antitrust laws if the refusal constitutes exclusionary behavior to obtain or to maintain a monopoly in violation of Section 2 of the Sherman Act. In other words, the nature of the property, whether real or intellectual, makes no difference. The *CSU* brief basically says that exemptions from the antitrust laws are disfavored and that a holding exempting refusals to license patents from the antitrust laws would be inappropriate. The brief adds, however, that the Federal Circuit's *CSU* decision need not be read as adopting such a holding. I myself don't think *CSU* purports to state a blanket antitrust immunity under all circumstances for patentees who refuse to license.

I myself don't think CSU *purports to state a blanket antitrust immunity under all circumstances for patentees who refuse to license.*

ANTITRUST SOURCE: Would you characterize yours and the DOJ's positions on this case to be the same?

SIMONS: I think I would.

ANTITRUST SOURCE: Do you think that antitrust law ought to encourage subjective inquiry into the intellectual property holder's motivations in refusing to deal?

SIMONS: I think that subjective intent is relevant to the extent it illuminates the assessment of the conduct. Knowing the exact intent underlying some conduct informs the inquiry because the person who was actually involved is in the best situation to determine what objectively was going on. Now, having said that, you don't want to just take loaded words or statements relating to a desire to crush a competitor as having much meaning. What I'm talking about is something that's more specific than a broad generalization about a desire to dominate or crush a competitor.

ANTITRUST SOURCE: In your view, should liability ever turn on the subjective intent of the holder of the intellectual property right?

SIMONS: Yes, at least sometimes. I'll give you an example. In cases involving the listing of a patent in the Orange Book, I think we would take the position that the party's good faith, reasonable belief—both subjectively and objectively—that the law required the listing should preclude liability. On the other hand, if the party didn't ever bother to find out whether a filing was appropriate or not, and made it really clear that it didn't care, we would have serious concerns. I'd take the position that the listing could violate Section 2, providing all the other requirements of Section 2 were met.

ANTITRUST SOURCE: You mentioned earlier that one of the enforcement priorities of the Bureau of Competition was the area in which federal regulations or government processes were abused. Can you explain why it is that this has become such a focus for the FTC and the Bureau?

SIMONS: One of the things I'm fond of saying is that, in terms of our enforcement agenda under Chairman Muris, the past is prologue. The kinds of cases brought when Tim was the Bureau Director in the 1980s foreshadow what we are doing today. So if you went back and looked at the cases from that period, you would see that abuse of government process was a very high priority. It remains a priority today, for reasons that are quite well established. Predatory conduct can often be very expensive to implement. It often requires the alleged predator to experience very high costs. For example, predatory pricing, which involves taking a loss on every sale, is rarely a viable strategy. In contrast, monopolization that uses abuse of governmental processes can be extremely cost-effective. An extreme version of that is the situation involving improper Orange Book listings. It costs almost nothing to list a patent in the Orange Book, and then within forty-five days after that, to file a lawsuit, the effect of which, under FDA law and procedures, is an automatic delay in the FDA's grant of regulatory authority to the generic drug-maker. So that strategy is very cheap to implement, and the effects are very strong—the generic is lawfully prohibited from selling a product without FDA approval. So when you have a situation where the cost of anticompetitive conduct is very low, and the impact of that conduct on consumers is very high, then it is definitely going to be a priority for us.

ANTITRUST SOURCE: In your view, are courts too willing to apply *Noerr-Pennington* immunity?

SIMONS: Let me say it this way. There is concern here that at least some courts have found *Noerr-Pennington* immunity in instances in which it's inappropriate. So one of the reasons that we created a *Noerr-Pennington* task force is to try to identify cases and enforcement actions that will develop the law and limit the overly broad application of *Noerr*.

ANTITRUST SOURCE: What is the task force doing specifically to accomplish that goal?

SIMONS: It is engaged in a study and will be producing a report shortly, and the Bureau has had the benefit of that research.

ANTITRUST SOURCE: One of the recent speeches given by Chairman Muris lists several issues in this area that merit special attention, citing immunized petitioning and private settlements, such as the *Bristol-Myers* case, the *Walker Process* doctrine, and independent misrepresentation, such as in the *Unocal* case. Are there any other initiatives or types of cases the Bureau expects to bring as a result of the work of the *Noerr* Task Force?

SIMONS: Pattern cases are an example, where we would argue that the requirements of *PREI* [*Professional Real Estate Investors, Inc. v. Columbia Pictures Industries*, 508 U.S. 49 (1993)] would not apply and that the requirements would be less stringent. By pattern case, I mean a pattern of anticompetitive behavior. An example of that would be the conduct laid out in the complaint against Bristol-Myers.

ANTITRUST SOURCE: Are you saying that if there were a pattern of ill-founded litigation, the case wouldn't have to meet the Supreme Court's standard in *Professional Real Estate Investors*?

SIMONS: Correct. So, in other words, even if the conduct was not objectively baseless, if the alleged predator was filing lawsuits or taking other actions without regard to the merits, then that conduct could be sufficient to void *Noerr* protection, even if any one of the lawsuits, standing alone, would not.

ANTITRUST SOURCE: Should the qualification for being part of a pattern mean that the actor had nefarious intent?

SIMONS: Well, nefarious intent in the sense that the party didn't care whether the claims were meritorious or not.

ANTITRUST SOURCE: Is nefarious intent necessary but not sufficient? Or is it sufficient?

SIMONS: Well, it would be sufficient to avoid *Noerr*, but the elements of Section 2 would have to be met as well.

ANTITRUST SOURCE: Let's talk about mergers, specifically the new statement of the Federal Trade Commission's Bureau of Competition on negotiating merger remedies. What do you think the most immediate effects of that will be, and what do you think its long-term impact is going to be?

SIMONS: The point of that statement was just to set out in one place what the Bureau does in negotiating and evaluating remedies. It's really another example of our efforts relating to transparency.

The remedy negotiation is often a critical, sometimes the most critical, part of getting a transaction through the Commission.

One of the specific benefits that we hope to achieve from issuing the statement them is to give parties a better idea of what the Bureau and the Commission are looking for in discussing remedies, and to point out that parties actually can exercise a huge amount of control over the process and that they should take advantage of it. The remedy negotiation is often a critical, sometimes the most critical, part of getting a transaction through the Commission. So this process should be considered with great care by the parties as part of their overall strategy for completing a merger.

For example, for most transactions the parties have in their mind a time frame in which they want to complete the transaction. So it would help the parties substantially, I think, to develop an approach to potential consent negotiations in light of their overall timetable. A divestiture of an ongoing independent business can be negotiated very quickly and would not have to be done up front. So, if the business strategy of the companies (in particular, the acquirer) is consistent with that type of a potential remedy, they might embrace that approach as one that could dramatically shorten the process. If, on the other hand, that type of remedy would not fit the circumstances, then an alternative approach could involve an asset package that clearly would be very attractive to potential buyers and for which the agency would have a lot of confidence that the divestiture could be very successful. In circumstances like that, we probably wouldn't require an up-front buyer, either. An example of that was the divestiture of the Malibu brand in the *Seagrams-Diageo* [*Diageo PLC and Vivendi Universal S.A.*, Docket No. C-4032 (Feb. 4, 2002) (consent order)] transaction.

If, on the other hand, those circumstances aren't present and what the parties would seek to divest would be something that is much more limited, then they'd have to recognize that the Commission likely would require an up-front buyer and then they'd have to make a judgment about the negotiating strategy. Do they want to start with something that's very minimal, and inch by inch build it up to a point where the Commission would find it acceptable? Or do they want to propose something that is much more substantial at the outset? So, in this way, with these types of considerations, the parties really can exercise a lot of control over the timing of their transaction. One of the objectives of this statement was to clarify that.

ANTITRUST SOURCE: In a similar vein, the FTC's Statement Regarding Guidelines for Merger Investigations gave guidelines for electronic production, and some of the advice in it was contingent upon the FTC obtaining additional experience in electronic productions. What steps has the Bureau taken towards gaining that additional experience? And what direction do you see electronic production taking so that practitioners can take advantage of it?

SIMONS: We are doing extensive amounts of our own research in terms of the best way to do electronic productions, and we are talking extensively to IT specialists who have expertise in this area. We've had one very successful electronic production and one that was less successful, and we're trying to learn from those experiences. As we go forward, we are very committed to sharing what we've learned with the private bar and the business community. We are certainly prepared to do that in discussions with recipients of our second requests who have pending document productions. We hope to be able to talk about it on a broader basis as well in the near future. But, as much as we are interested in electronic production, it is still very new, so it will take some time before we can say exactly how we'd like to see it work.

ANTITRUST SOURCE: Is the goal of it to streamline and make more efficient the production and review process, or alternatively, to ensure that you get all of the responsive documents?

SIMONS: It's a little bit of both. We certainly want to minimize the burden on the parties and ourselves at the same time that we are getting all of the documents and information that we need to evaluate the transaction effectively. So it's really balancing both of those concerns.

ANTITRUST SOURCE: You alluded to the Commission's interest in the increasing transparency of its decision-making processes. A prominent example of that is the Cruise Line merger investigation in which the Commission issued a statement explaining its decision not to challenge. Do you anticipate more of the same kind of thing in the future?

SIMONS: Yes, I absolutely do. I don't expect the Commission to issue a statement every time it decides not to vote out enforcement action, but I do expect that the Commission will continue to issue statements to clarify its position in situations involving significant policy issues. For example, we recently looked at a grocery merger involving the same market (Las Vegas) involved in another grocery merger in 1999. The Commission obtained a consent agreement in the earlier case, but chose not to take enforcement action in the recent matter. Because of concern that the bar might wrongly infer a change in policy, the Commission wanted to make very clear the reasons for its decision. For this reason, the Commission issued a statement explaining that the prior order had been predicated on a belief that grocery entry was difficult in Las Vegas, but subsequently concluded otherwise.[5] As the statement explained, during the intervening period, very significant entry had occurred in the market, disproving the assumption that entry was difficult. That's an example of the Commission wanting to make clear the basis for its decision to prevent the substantial ambiguity that otherwise likely would have resulted.

ANTITRUST SOURCE: What's the process that the Commission or the Bureau goes through in deciding whether or not to issue a statement explaining the reason for not pursuing an action? Is it a systematic process, or is it ad hoc?

SIMONS: Ultimately, the Commission makes that decision. I guess we think about it with respect to every action that we take. So in that sense, it's systematic. And it just depends. Routine decisions—

[5] FTC Press Release, Investigation of Kroger/Raley's Supermarkets Transaction Closed (Nov. 13, 2002), *available at* http://www.ftc.gov/opa/2002/11/krogerraley.htm.

those that fit well within our public policy statements or an established pattern—are not likely to be misinterpreted, so they typically would not require a statement or explanation. But when we come across a situation that's new or somewhat different, then the Commission would consider whether a public statement would be beneficial.

ANTITRUST SOURCE: Earlier in this interview, you referred to the change in the HSR thresholds and the fact that that had freed up additional resources for non-merger enforcement activity. Overall, what do you think has been the result of the higher notification thresholds for both merger and non-merger cases?

We have in fact found some transactions that did not involve a filing but nevertheless caused us concern. As a result, we are pursuing more merger cases involving consummated mergers.

SIMONS: Well, obviously the immediate result is that there are fewer filings. And on average, of course, that's better because the overwhelming majority of filings are not problematic, and I understand that the Commission's experience was that the smallest transactions were even less likely to raise concerns. But the probability of antitrust concerns for the smaller transactions, however small, is still more than zero, so we have had to develop a process of monitoring those transactions that are no longer subject to the filing requirement. We have in fact found some transactions that did not involve a filing but nevertheless caused us concern. As a result, we are pursuing more merger cases involving consummated mergers. So, in sum, that's the primary impact of the higher filing thresholds. We have fewer filings, are doing a little more monitoring, and will have some cases involving consummated mergers that previously would most likely have been handled in a pre-merger context.

ANTITRUST SOURCE: Talking still about mergers, David Scheffman, the FTC's Chief Economist, has said that the usual economic presumption is that if a competitor is complaining about a merger, it's because it's going to be procompetitive. Does that presumption apply when the rival is also a customer of one or both of the merging parties?

SIMONS: With any complaint, whether the source is a competitor or a customer or a competitor/customer, we carefully evaluate the substance of the complaint and consider any potential biases that the complainant might have. You can have complaints from customers that really don't get much weight because they're not really complaining about an antitrust type of injury. Sometimes one participant in the marketplace will provide a service in a manner that the particular customer is especially attracted to. If that participant is being acquired, and the customer, for whatever reason, doesn't have a good relationship with the acquiring company, the customer may well complain, but the basis for the complaint may have no relation whatsoever to potential anticompetitive effects. So even for a customer complaint, we carefully evaluate the substance of it for any bias. The competitor complaints are, as Dave Scheffman said, perhaps more likely to be biased (and in particular, biased against a procompetitive merger) and so we always pay especially careful attention to potential bias on the part of any competitors.

ANTITRUST SOURCE: What kind of evidence must a company give in order for the Bureau to find a valid efficiency defense? And even if you can't specify the entities, have there been any mergers cleared that, but for the efficiencies, would have been blocked?

SIMONS: Efficiencies come into play in two ways. One is by providing a motivation for doing the transaction. So in looking at two transactions, one that has identifiable efficiencies associated with it and one that does not, we would feel more comfortable in predicting an anticompetitive effect in the transaction lacking an apparent efficiency motivation. In other words, in a close case where there is limited evidence of a potential anticompetitive effect, evidence of substantial efficiencies would make us feel more comfortable with a decision not to challenge. That is because the transaction is likely motivated by something other than a desire for increased market power. Under these facts, there isn't what I would refer to as a technical efficiency defense, but evaluating the efficiencies would still be highly valuable to us.

The second way that the efficiencies are relevant is what is commonly understood to be the efficiencies defense. This involves a showing that the merger will produce efficiencies that will prevent any anticompetitive effects, i.e., they will prevent a price increase or other loss of consumer welfare. I don't think the burden of proof here is particularly high, but the parties must be able to provide a credible, coherent explanation of anticipated efficiencies, and support that explanation with facts. The problem we often see is that companies have only a very vague idea about what efficiencies they expect to achieve from the merger and they haven't had an opportunity to do any kind of detailed studies. And so it becomes very difficult at that point to provide credible evidence to support an efficiency claim. The best evidence often comes from companies that have completed similar transactions in the past and are able to demonstrate actual efficiencies in similar circumstances. This sort of evidence is quite compelling, but obviously not everyone can provide it. We are certainly open to other types of support for an efficiency argument, but do not limit our consideration of efficiencies to those situations are limited to that type of circumstance by any means. In response to your question about whether efficiencies have been the deciding factor in any merger investigations, I don't believe there has been such a case during my tenure as Bureau Director, but we certainly have looked very closely at efficiencies in a number of investigations.

The problem we often see is that companies have only a very vague idea about what efficiencies they expect to achieve from the merger and they haven't had an opportunity to do any kind of detailed studies.

ANTITRUST SOURCE: Let's talk about health care. What have been the major accomplishments of the hospital merger enforcement program under the new merger litigation task force?

SIMONS: Let's go back a few years. It is no secret that the government has gone zero for its last seven attempts to block a hospital merger. Assuming that record resulted from something other than coincidence, blithely continuing along the same path made no sense. That left us with two choices: either give up and abandon hospital merger enforcement completely, or try to figure out the source of the problem and develop a different approach. We choose the latter, deciding to go back and evaluate the outcomes of a number of hospital merger cases. We created the merger task force at least in part to carry out this work. The task force has been very busy for nearly a year now, looking at consummated hospital mergers, evaluating whether there have been anticompetitive effects or efficiencies, whether we could successfully bring a Section 7 case against an anticompetitive hospital merger, and, if we succeeded, whether we could craft a effective remedy to restore competition. I expect that the fruits of all these efforts will begin to emerge within the next few months. So, let me just stop there.

ANTITRUST SOURCE: In the United States' work with the International Competition Network, what in your view is the more important goal, substantive analytical convergence or procedural convergence?

SIMONS: Both are very important and they go hand in hand. Perhaps the most important way in which we are working toward substantive convergence is from the bottom up. What I am referring to is the day-to-day interaction and work on cases jointly between, for example, our staff and the staff of the European Commission or any of its member states. That's how we can make real progress toward substantive convergence—people working through real problems in detail and talking extensively with each other and getting an understanding for how each other thinks about specific, concrete problems. And in order to have that kind of cooperation, procedural convergence is important, because that type of close interaction and cooperation is more likely and works better when both agencies are working on the same problems at the same time with the same information.

I think the biggest challenge going forward for us has to do with the expanding Part 3 administrative litigation and the need to develop a stronger litigation capability in the Bureau. I think that's going to be a real key to our success in the future.

ANTITRUST SOURCE: How well do you think that process is working?

SIMONS: I think it's working extremely well. Folks point to *GE/Honeywell* and conclude that the U.S. and the European Commission are badly split because there seemed to be a big blow-up and a big division between us and the Europeans on that transaction. But if you look back, particularly at the eighteen months since Chairman Muris arrived, you'll find virtually no disagreement on the handling of similar cases. And, the disagreements that have occurred are not dissimilar to the sorts of disagreements we have among ourselves. Although the Commission in the last eighteen months or so has been virtually unanimous on competition enforcement matters, it hasn't always been that way. The Commission has often been split in its votes in the past. So if the members of the FTC don't always agree, it shouldn't be a big surprise when the European Commission or some of the member states might view a transaction somewhat differently compared to the U.S.

ANTITRUST SOURCE: During your two years as the head of the Bureau of Competition, what would you cite as the Bureau's biggest accomplishments and what, in your opinion, are the biggest challenges you face in the years ahead?

SIMONS: I think the biggest accomplishment is that we are making excellent progress in fulfilling the Chairman's positive agenda, which he laid out right at the outset of his term. It is a very ambitious program and it requires us to be extremely active and efficient. And I think we are fulfilling those requirements. If you look at the enforcement statistics and the number of investigations that we have initiated, the record so far is one of which we are justifiably quite proud. And we are not done yet, by any means. The pipeline has been quite full, and more and more of what we have been working on will be emerging in the next few months. I think the biggest challenge going forward for us has to do with the expanding Part 3 administrative litigation and the need to develop a stronger litigation capability in the Bureau. I think that's going to be a real key to our success in the future. ●

Trinko: Will the Supreme Court Bring Clarity to Dealings Among Telecommunications Competitors?

Al Pfeiffer

The interplay between the antitrust laws and the Telecommunications Act (1996 Act) has become an area of increasing uncertainty to those in the telecommunications industry. The lower courts have disagreed about the antitrust significance of alleged failures to comply with the obligations imposed by the 1996 Act. District Courts have widely—though not unanimously—interpreted the Seventh Circuit's decision in *Goldwasser v. Ameritech Corp.* to mean an antitrust claim can never be based on allegations of conduct that also happens to violate the 1996 Act. The Second, Ninth, and Eleventh Circuits have recently disagreed. The Supreme Court's decision to grant review of the Second Circuit's decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, Docket No. 02-682, seems to present the Court with the opportunity to resolve a number of significant issues affecting dealings between local telephony incumbents and challengers. Verizon's petition for certiorari does not merely raise questions concerning how to interpret *Goldwasser* but also raises challenges to the Second Circuit's treatment of essential facilities and monopoly leveraging claims without regard to the 1996 Act—challenges sufficiently broad to have significance well beyond the regulated telecommunications industry. But it is not clear that *Trinko*, a class action by indirect customers of incumbent local telephone monopolists (ILECs) is the proper vehicle by which to address many of those issues, especially as they relate to the ILECs' direct customers, the competing local exchange carriers (CLECs).

Goldwasser and Its Progeny

The Seventh Circuit was the first court of appeals to consider the interplay of the 1996 Act and the antitrust laws, in *Goldwasser*, 222 F.3d 390 (7th Cir. 2000). A putative class of end users of local telephone services sued Ameritech, claiming that it had violated a number of its duties under the 1996 Act to provide to competitive local exchange carriers reasonable, nondiscriminatory access to its network. As the Seventh Circuit put it, the *Goldwasser* plaintiffs somewhat simplistically argued that "Ameritech is a monopolist; Ameritech is engaging in conduct designed to maintain its monopoly power, through a variety of exclusionary practices; and plaintiffs as consumers are harmed," where the only exclusionary practices alleged were violations of the 1996 Act. *Id.* at 396. The court emphatically rejected any suggestion of such a syllogism. It found the duties imposed by the 1996 Act are not "coterminous with the duty of a monopolist to refrain from exclusionary practices." *Id.* at 399. The court went on to observe that "it would be undesirable here to assume that a violation of a 1996 Act requirement automatically counts as exclusionary behavior for purposes of Sherman Act § 2." *Id.* at 400.

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Those points are hardly controversial; few would argue that every violation of a 1996 Act duty, no matter how minor or technical, would *automatically* suffice as sufficient exclusionary conduct to impose antitrust liability. But *Goldwasser* became controversial because, at least as interpreted by a number of lower courts, it announced a per se rule that any conduct which implicated the 1996 Act could never be the basis for antitrust liability. It disclaimed any finding of express or implied immunity, *id.* at 401, but went on to hold that "the 1996 Act imposes duties on the ILECs that are not found in the antitrust laws. Those duties do not conflict with the antitrust laws, either; they are simply more specific and far-reaching obligations . . . ." *Id.* The Seventh Circuit concluded that

> [a]t some appropriate point down the road, the FCC will undoubtedly find that local markets have also become sufficiently competitive that the transitional regulatory regime can be dismantled and the background antitrust laws can move to the fore. Our holding here is simply that this is not what Congress has mandated at this time for the ILEC duties that are the subject of the Goldwasser complaint.

Id. at 401–02.

. . . Goldwasser became controversial because, at least as interpreted by a number of lower courts, it announced a per se rule that any conduct which implicated the 1996 Act could never be the basis for antitrust liability.

A number of ILECs responded to the Seventh Circuit's ruling by asserting *Goldwasser* defenses to a variety of consumer and competitor antitrust claims around the country. While several courts rejected the defense,[1] the majority of district courts to consider the issue followed—or even expanded—*Goldwasser*.[2]

Trinko, *Covad*, and *MetroNet* All Disagree with *Goldwasser*

The Second, Ninth and Eleventh Circuits, the only courts of appeal to have considered the issue since *Goldwasser*, have refused to follow an interpretation of *Goldwasser* that precludes antitrust liability based on conduct violative of the 1996 Act. All three circuit courts reversed district court rulings that dismissed antitrust claims, but each arose in a distinct procedural setting.

Trinko. The Second Circuit's ruling arose in *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp. (Trinko)*, 305 F.3d 89 (2d Cir. 2002), which, like *Goldwasser*, was a class action on behalf of end-user consumers. Following the entry of a consent decree in which Verizon agreed to pay over $10 million to the FCC and AT&T concerning access disputes, a putative class of CLEC customers sued Verizon. The end-users claimed that they received poor local service from CLECs because Verizon did not provide the CLECs access to its network equal in quality to what it provided itself. Had Verizon met its obligations, the plaintiffs theorized, those competing carriers would have been able to provide better service as a competitive alternative to Verizon. Verizon moved to dismissed, claiming (1) the end user plaintiffs lacked standing to pursue their claims and (2) no

[1] *See, e.g.*, Ohio Bell Tel. Co. v. CoreComm Newco Inc., 214 F. Supp. 2d 810 (N.D. Ohio 2002) (permitting § 2 claim based on 1996 Act violations); Davis v. Pac. Bell, 204 F. Supp. 2d 1236 (N.D. Cal. 2002) (same); Stein v. Pac. Bell, 173 F. Supp. 2d 975 (N.D. Cal. 2001) (same); Sprint-Florida, Inc. v. Electronet Intermedia Consulting, Inc., No. 4:00-CV-176-RH (N.D. Fla. Sept. 20, 2000) (same); MGC Communications. Corp. v. Sprint Corp., No. CV-S-00-948-PMP (D. Nev. Dec. 12, 2000) (same); Bell Atl. Network Servs., Inc. v. Ntegrity Telecontent Servs., Inc., Civ. No. 99-5366-AET (D.N.J. Oct. 31, 2000) (same).

[2] *See, e.g.*, Covad Communications Co. v. Bell Atl. Corp., 201 F. Supp. 2d 123 (D.D.C. 2002) (dismissing based on Goldwasser); Cavalier Tel., LLC v. Verizon Va. Inc., 208 F. Supp. 2d 608 (E.D. Va. 2002) (same); MGC Communications, Inc. v. BellSouth Telecomms., Inc., 146 F. Supp. 2d 1344 (S.D. Fla. 2001) (same); Intermedia Communications Inc. v. BellSouth Telecomms., Inc., No. 8:00-CIV-1410-T-24(C) (M.D. Fla. Dec. 15, 2000) (R2-7-A200) (same); Telecomms. & Info. Sys., Inc. v. BellSouth Telecomms., Inc., No. 99-1706-SEITZ (S.D. Fla. June 6, 2001) (same); Building Communications, Inc. v. Ameritech Servs., Inc., No. 97-CV-76336 (E.D. Mich. June 21, 2001) (same).

antitrust claim was possible in any event, under *Goldwasser*. The district court found the plaintiff had standing, but dismissed the antitrust claims, expressly following *Goldwasser*.

The Second Circuit reversed. First, the court agreed that the end-user plaintiffs had standing. Relying on *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982), the court concluded that a "customer of a competitor can suffer a direct injury from an anticompetitive scheme aimed principally at the competitor." 305 F.3d at 106. Next, the Second Circuit expressly disagreed with the district court's application of *Goldwasser*. It found that "The allegations in the amended complaint describe conduct that may support an antitrust claim under a number of theories. While some of this conduct might also violate section 251, these are not merely allegations that section 251 has been violated." *Id.* at 108. While the class plaintiffs' allegations were somewhat conclusory, the court found the plaintiffs had properly stated Section 2 claims on both monopoly leveraging (applying the Second Circuit's lower threshold standard as expressed in *Berkey Photo*)[3] and essential facilities theories, finding that many of Verizon's arguments were simply inappropriate for resolution at the Rule 12 stage. 305 F.3d at 108.

Covad. Unlike *Trinko* and *Goldwasser*, the Eleventh Circuit was not faced with indirect claims by a class action of would-be end-user customers of local service resellers. Instead, the court in *Covad Communications Co. v. BellSouth Corp.*, 299 F.3d 1272 (11th Cir. 2002), faced claims brought by a facilities-based CLEC, Covad Communications Company. Covad, a provider of DSL service, needed access to BellSouth's local telephone network in order to provide its own services. Covad claimed it was excluded from the relevant Internet access markets in which it competed with BellSouth when it was denied proper access to BellSouth's local network. *Id.* at 1276–77. BellSouth moved to dismiss, relying heavily on *Goldwasser*. The district court, quoting liberally from *Goldwasser*, dismissed Covad's claims.

The Eleventh Circuit reversed. First, it rejected *Goldwasser* "to the extent that it is read to say that a Sherman Act antitrust claim cannot be brought as a matter of law on the basis of an allegation of anti-competitive conduct that happens to be 'intertwined' with obligations established by the 1996 Act." *Id.* at 1282. The Eleventh Circuit then went on to review Covad's allegations on their merits, and found they sufficed to state a Section 2 claim under theories of essential facilities, refusal to deal, and price squeeze, finding each to be merely a subspecies of monopoly leveraging. *Id.* at 1284. The Eleventh Circuit subsequently denied BellSouth's petition for rehearing en banc, with three judges dissenting.[4]

MetroNet. The Ninth Circuit also recently confronted a *Goldwasser* defense in a CLEC case, *MetroNet Services Corp. v. U.S. West Communications*, 325 F.3d 1086 (9th Cir. 2003). The plaintiff, MetroNet, buys Centrex service from Qwest in bulk at a volume discount and passes along the discount to small customers who would otherwise not qualify for it. Qwest changed its volume discount pricing rules in 1997. As the court put it "Qwest's new pricing scheme rendered MetroNet's customers ineligible for the volume discount," *id.* at 1091, causing a 400 percent increase in their cost of service. *Id.* at 1093. Qwest moved for summary judgment, claiming, among other things, that the highly regulated nature of the telecommunications industry precluded any claim of market power or exclusionary conduct. The district court granted Qwest's motion for summary judgment.

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[3] Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 253, 275 (2d Cir. 1979).

[4] The denial of the petition for rehearing, and the dissenting opinion from that denial, are reported at 314 F.3d 1282 (11th Cir. 2002).

The Ninth Circuit, finding the matter to be "a close question," reversed. *Id.* at 1091. The court first rejected Qwest's Goldwasser defense:

> Even absent the explicit language of the savings clauses, Qwest would not be entitled to implied immunity for its imposition of per location pricing. . . . Where the conduct challenged under the antitrust laws "is the product of the regulated business" independent initiative and choice, [that conduct] is properly subject to antitrust scrutiny.

Id. at 1101. The Ninth Circuit went on to review MetroNet's claims on the merits and found that triable issues existed concerning Qwest's market power, the anticompetitive effects of its conduct, and antitrust injury. The court also expressly found a triable issue on MetroNet's essential facilities claim. *Id.* at 1111–12.

Certiorari in *Trinko*

Verizon petitioned for certiorari in *Trinko*,[5] at which point the case took some interesting turns.

First, the Solicitor General filed an amicus brief on behalf of the DOJ Antitrust Division and the FTC, supporting review by the Supreme Court.[6] The government's position appears to have migrated substantially from the views espoused in 2001 when the government first addressed *Goldwasser* in an amicus brief filed in the Eleventh Circuit on behalf of the plaintiff in *Intermedia Communications Inc. v. BellSouth Telecommunications, Inc.*[7] In *Intermedia*, the government had argued that while "Intermedia's lengthy complaint could have been clearer with respect to its antitrust claims," its allegations of exclusionary conduct grounded in the 1996 Act included "all of the factual allegations required to state a claim under Section 2." *Intermedia* Amicus Brief at 24. But in *Trinko*, the government (the FTC being notably absent) argued that, while the plaintiff may have alleged necessary elements, such as exclusionary conduct, its allegations were "inherently implausible when measured against the regulatory scheme the complaint itself mentions." *Trinko* Amicus Brief at 14. The government also criticized the Second Circuit's application of the lower threshold *Berkey Photo* monopoly-leveraging standard and asked the Supreme Court to clarify that monopoly leveraging is only actionable when it results in a monopoly, or a dangerous probability of achieving one, in the downstream market. *Id.* at 16. As to both monopoly leveraging and essential facilities, the government argued that it is an antitrust plaintiff's burden, in establishing exclusionary conduct, to prove the defendant acted in an economically irrational manner, but rather for the effect of excluding competition: "essential facilities claims must at a minimum include some showing of 'exclusionary' or 'predatory' conduct, *i.e.,* that the refusal to share the facility would not make economic sense unless it tended to reduce or eliminate competition." *Id.* at 13. The government noted that, while the *Trinko* plaintiffs had pleaded that Verizon's conduct lacked any legitimate business justification, its allegation should be disregarded—even at the Rule 12 stage—as "inherently implausible." *Id.* at 14.

The government's position appears to have migrated substantially from the views espoused in 2001 [in Intermedia*].*

The Supreme Court obviously wrestled with whether and how to deal with Verizon's petition. The Court put the matter on its conference schedule four times before finally granting review. And when it did take the case, the Court declined to review either of the issues raised by Verizon (which

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[5] Petition for a Writ of Certiorari, No. 02-682 (*Trinko* Pet.).

[6] Brief for the United States and the Federal Trade Commission as Amici Curiae, S. Ct. No. 02-682 (filed Dec. 2002) (*Trinko* Amicus Brief).

[7] Brief for the United States and Federal Communications Commission as Amici Curiae in Support of Appellants, 11th Cir., No. 01-10224-JJ (filed Mar. 28, 2001) (*Intermedia* Amicus Brief).

focused on consumer standing and the interplay of the 1996 and Sherman Acts), or the alternative question proposed by the government (which focused on the standards for assessing exclusionary conduct). Instead, it stated that review was "limited" to the question "[d]id the Court of Appeals err in reversing the District Court's dismissal of respondent's antitrust claims?" [8] Thus, the Court's intended scope is unclear. Ultimately, *Trinko* could range from a narrowly focused examination of antitrust claims in the shadow of the 1996 Act, to a broad review of antitrust standing and/or parties' burdens in showing exclusionary conduct under Section 2.

The Potential For Dramatic Changes

The telecommunications industry has been slow to achieve the goal of increased competition in all markets, which Congress mandated when it passed the landmark Telecommunications Act of 1996.[9] A number of CLECs have alleged that ILECs, such as Verizon and BellSouth, have manipulated the regulatory and competitive landscapes in order to protect their long-sanctioned, ratepayer-funded monopolies over local telephone service. ILECs responding to those antitrust cases have relied on *Goldwasser* to assert that the 1996 Act absolutely precluded any claim that they had violated the antitrust laws in their interactions with competitors. The district courts were split in their treatment of that defense, though a majority followed *Goldwasser* and dismissed competitor's claims.[10]

The Second Circuit's decision in *Trinko* addresses such allegations of ILEC abuse, albeit in the context of the end-user customers of those companies that compete with Verizon by reselling its local service offerings. The Supreme Court found those issues to be serious enough to merit its review. CLECs have also alleged (including in *Covad*) that the ILECs have simultaneously been engaged in conduct that has more far-reaching, and ultimately more seriously anticompetitive effects, than merely retaining their historic, local telephone monopolies. The CLECs allege that the ILECs have extended their traditional local service monopolies so as to dominate new, innovative markets, markets that depend on access to the local telephone network in order to provide competing services in downstream markets. That type of monopoly extension behavior is not squarely presented in *Trinko* (though it is the very core of Covad's claims against BellSouth, as recently analyzed and approved by the Eleventh Circuit), so it is unclear whether the Supreme Court can or should properly reach those issues based on the *Trinko* complaint.

But at least some parties are seeking to turn *Trinko* into much more than a battle over the interplay of the Sherman Act and the 1996 Act. *Trinko* potentially presents a number of issues of interest well beyond the telecommunications industry.

Predatory Conduct. If the Supreme Court reviews *Trinko* in the manner suggested by the government, it could have significant effects on Section 2 claims in general, not just in the regulated telecommunications context. The government's amicus brief could be read as an attempt to use *Trinko* as a vehicle to reformulate the Section 2 pleading rules as they relate to "exclusionary" or "predatory" conduct.

The government argues that, in order to plead any type of Section 2 claim, a plaintiff must make an affirmative showing that the defendant's conduct is without any legitimate business justifica-

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[8] Order Granting Petition For Writ of Certiorari, Verizon Communications v. Law Offices of Curtis V. Trinko, 123 S. Ct. 1480 (2003) (No. 02-682).

[9] 47 U.S.C. §§ 151 *et seq.*

[10] *See supra* notes 1 & 2.

tion—in the government's words, that the conduct makes no economic sense but for the purpose to exclude competition. *Trinko* Amicus Brief at 11. Specifically, the government criticizes the *Trinko* complaint for failing to allege that Verizon's conduct "involves a sacrifice of profits or business advantage and makes economic sense only because it softens or injures competition." *Id.* Indeed, at least in the context of Trinko's claims, the government asserts that it is appropriate on a Rule 12 motion to weigh the credibility of such allegations, even if the plaintiff makes them. *Id.* at 13–14 (criticizing plaintiffs' allegations of lack of business justification as "inherently implausible"). The government's position, read most broadly, would appear to be (1) a significant shift in the traditional allocation of Section 2 burdens of pleading and proof and (2) wherever those burdens fall, a significant narrowing of what has traditionally been viewed as exclusionary conduct.

[T]he government criticizes the Trinko *complaint for failing to allege that Verizon's conduct "involves a sacrifice of profits or business advantage and makes economic sense only because it softens or injures competition."*

It is well-settled that a monopolist does not enjoy an unfettered right to refuse to deal, even with competitors. That right "exists only if there are legitimate competitive reasons for the refusal."[11] As a number of circuits have recently reaffirmed, including most recently the Third Circuit in *LePage's*, the defendant bears the burden of showing such reasons motivated its conduct.[12] The government's position on exclusionary conduct in *Trinko* could be interpreted to shift that burden to the plaintiff, to prove as part of its affirmative case that the defendant's challenged conduct makes no business sense except for its adverse effects on competition. It is unclear what justifies this shift.

Regardless of who ultimately bears the burden of proof on the issue, the government's position could also be stretched to assert a relatively narrow view of the type of conduct that would fail to meet the "legitimate justification" standard. Any efforts to turn the government's position into an absolute would appear to be unsound, as well as a significant shift in position by the government, even within the telecommunications industry. The government considered similar issues in the *Intermedia* case in the Eleventh Circuit in 2001, and opined that allegations of "failure to provide reasonable interconnection" by BellSouth against a CLEC sufficiently "allege[d] exclusionary conduct by a firm with monopoly power that lacks business justification and that harms competition."[13] It is true that in *Trinko* the government argued that exclusionary conduct "normally involves the sacrifice of short-term profits or goodwill in order to maintain or obtain long-term monopoly power." *Trinko* Amicus Brief at 10. But "normally" is an important modifier of that sentence. While conduct that directly sacrifices short-term profits in order to harm competition is certainly an instance in which conduct has been found exclusionary, it is by no means the only such instance. For example, price squeezes have commonly been found unlawful without any requirement that the monopolist engage in predatory pricing at either end of the squeeze.[14] And more generally, a narrow reading of the government's position on exclusionary conduct would seem to do away with recognized theories of anticompetitive conduct, such as raising rivals' costs, which need not

[11] Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 483 n.32 (1992) (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 602–05 (1985)); *accord* United States v. Colgate & Co., 250 U.S. 300, 307 (1919) (refusals to deal acceptable only "[i]n the absence of any purpose to create or maintain a monopoly").

[12] LePage's, Inc. v. 3M, 324 F.3d 141, 164 (3d Cir. 2003); *accord* Nat'l Communications Ass'n Inc. v. AT&T Corp., 238 F.3d 124, 131 (2d Cir. 2001); United States v. Microsoft Corp., 253 F.3d 34, 59 (D.C. Cir.) (*en banc*), *cert. denied*, 534 U.S. 952 (2001).

[13] Brief for the United States and Federal Communications Commission as Amici Curiae in Support of Appellants, Intermedia Communications, Inc. v. BellSouth Telecomms., Inc., No. 01-10224-JJ (filed Mar. 28, 2001) at 25–26.

[14] *See, e.g.*, City of Batavia v. FERC, 672 F.2d 64, 90 (D.C. Cir. 1982); Ray v. Indiana & Mich. Elec. Co., 606 F. Supp. 757, 776 (N.D. Ind. 1984), *aff'd*, 758 F.2d 1148 (7th Cir. 1985).

involve predation in the sense of forgone short-term profits.[15] Courts have held that allegations of raising rivals' cost "qualify as anticompetitive conduct" unless there is a "legitimate business justification for it."[16]

Essential Facilities. Verizon devotes much of its petition for certiorari to an open attack on the essential facilities doctrine. It cites a number of academic criticisms of the doctrine, points out that the Supreme Court has never expressly endorsed the theory (despite its roots in the Supreme Court's decision in *United States v. Terminal Railroad Ass'n*),[17] and urges the Supreme Court to reject the doctrine outright. *Trinko* Pet. at 15–17. But as a fallback, Verizon also argues for significant limitation on the doctrine: it asserts that the doctrine should only be applicable to concerted, not unilateral conduct, *id.* at 16 n.10, and should only be applied in the context of absolute denials of access—not constructive denials based on unreasonable terms and conditions of access. *Id.* at 13–14.

Adoption of either of these fallback suggestions would effect a significant change in essential facilities jurisprudence. A number of circuit court decisions have found viable essential facilities claims despite the lack of an outright denial of access,[18] and that would appear to be the logical result. Otherwise, a monopolist with control over an essential bottleneck could simply throttle competition by "permitting" access, but only on terms that would not allow any real competition. That would seem at odds with the purpose of having the essential facilities doctrine in the first place. Similarly, every circuit court has recognized the viability of the doctrine, all recognizing the same four essential elements (none of which includes concerted action), and most have done so in the context of Section 2, not Section 1.[19] Verizon has not stated any logical reason why an essential facilities claim should depend on concerted action.

Monopoly Leveraging. Verizon and the government have also asked the Supreme Court to review the Second Circuit's monopoly leveraging analysis. Both attack the Second Circuit's reduced, *Berkey Photo* threshold: the Second Circuit monopoly leveraging test requires only a showing that a monopolist has attempted to utilize its monopoly power in one market to gain a "competitive advantage" in another. *Trinko*, 305 F.3d at 108. Verizon and the government assert that, to the extent leveraging is recognized as an offense at all, it requires a showing that the monopolist used its monopoly power in one market to obtain or maintain a monopoly in another market (or, for an attempt claim, that there is a dangerous probability that it will do so). *Trinko* Pet. at 21–22; *Trinko* Amicus Brief at 16. While the "competitive advantage" language originated with

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15 *See* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209, 235–62 (1986); *see also* Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 Colum. Bus. L. Rev. 257, 318–23 (2001) (discussing economic logic behind raising rivals' cost theory).

16 *See, e.g.*, Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal and Prof'l Publ'ns, Inc., 63 F.3d 1540, 1553 n.12 (10th Cir. 1995).

17 224 U.S. 383 (1912).

18 *See Covad*, 299 F.3d at 1286–87 (citing cases from other circuits holding that "Section 2 prohibits denial of access to essential facilities *on reasonable terms*").

19 *See, e.g.*, Hecht v. Pro-Football, Inc., 570 F.2d 982, 992–93 (D.C. Cir. 1977); Interface Group, Inc. v. Mass. Port Auth., 816 F.2d 9, 12 (1st Cir. 1987); Del. & Hudson Ry. Co. v. Consol. Rail Corp., 902 F.2d 174, 179 (2d Cir. 1990); Ideal Dairy Farms, Inc. v. John Labatt, Ltd., 90 F.3d 737, 748 (3d Cir. 1996); Advanced Health-Care Servs. v. Radford Cmty. Hosp., 910 F.2d 139, 150 (4th Cir. 1990); Mid-Texas Communications Sys., Inc. v. AT&T Co., 615 F.2d 1372, 1387 n.12 (5th Cir. 1980); Directory Sales Mgt. Corp. v. Ohio Bell Tel. Co., 833 F.2d 606, 612 (6th Cir. 1987); MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132–33 (7th Cir. 1983); City of Malden v. Union Elec. Co., 887 F.2d 157, 160 (8th Cir. 1989); City of Vernon v. S. Cal. Edison Co., 955 F.2d 1361, 1366–67 (9th Cir. 1992); Aspen Highlands Skiing Corp. v. Aspen Skiing Co., 738 F.2d 1509, 1520 (10th Cir. 1984), *aff'd on other grounds*, 472 U.S. 585 (1985); Covad Communications Co. v. BellSouth Corp., 299 F.3d 1272, 1285–88 (11th Cir. 2002); Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1356–57 (Fed. Cir. 1999).

the Supreme Court's decision in *United States v. Griffith*,[20] the circuits have split on whether that is a correct interpretation, and even the Second Circuit has, in the past,[21] questioned whether the *Berkey Photo* approach is still valid in light of the Supreme Court's ruling in *Spectrum Sports*, which establishes that Section 2 "makes the conduct of a single firm unlawful only when it actually monopolizes or dangerously threatens to do so."[22] While the complaint in *Trinko* is far from clear, the Second Circuit certainly interpreted it as asserting a monopoly leveraging claim, and the Supreme Court may do likewise. Assuming the Court reaches the monopoly leveraging issue, it could still determine that the *Trinko* allegations, as pleaded, state a monopoly leveraging claim under the monopoly-to-monopoly standard and, thus, might choose not to reach the *Berkey Photo* issue.

[T]hat standing challenge creates a substantial risk that the Supreme Court could resolve Trinko *without resolving the antitrust merits.*

Or an Isolated Case?

But there are also procedural aspects of *Trinko* that may prevent the Supreme Court from providing the clear guidance the telecommunications industry needs concerning ILECs' antitrust rights and duties, much less the sweeping changes the government seeks.

Standing Issues. The status of the plaintiffs is a key issue that may limit the scope of the Supreme Court's ruling in *Trinko*. The putative class in *Trinko* consists entirely of indirect customers of the incumbent monopolist, Verizon—that is, customers who succeeded in obtaining local telephone service from one of Verizon's competitors.[23] The plaintiffs' claimed injury is that because Verizon did not "provide equal access" to its local telephony reseller competitors, the plaintiffs "received poor local phone service." *Id.* at 95. As a result, Verizon has argued and continues to argue before that the plaintiff class members have suffered at most "indirect" harm and so lack standing to pursue antitrust claims against Verizon. *Trinko* Pet. at 24.[24]

The existence of that standing challenge creates a substantial risk that the Supreme Court could resolve *Trinko* without resolving the antitrust merits. If the Court determined the *Trinko* class plaintiffs lacked standing, it would have no reason to proceed further and reach the important issues framed by both Verizon and BellSouth in their respective petitions.[25] The indirect nature of the *Trinko* plaintiffs' claims may be compounded by the fact that the agreement between Verizon and the directly injured party, AT&T, contained a mandatory dispute resolution procedure that did not allow for a suit of the type Trinko brought. 305 F.3d at 94.

Facilities-Based vs. Reseller Claims. Even if the plaintiff in *Trinko* were AT&T, the competitive local carrier which dealt directly with Verizon, rather than a group of AT&T's customers, it is not clear that *Trinko* would squarely frame the issues Verizon and the United States seek to have the Supreme Court address. AT&T is essentially a local service reseller, using access to Verizon's local telephone network to provide the same service as Verizon. It is unclear whether that market

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[20] 334 U.S. 100, 107 (1948).

[21] *See* Virgin Atl. Airways v. British Airways, 257 F.3d 256, 272 (2d Cir. 2001).

[22] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993).

[23] The court dewcribed the class as "consisting of customers who received local phone service in the region served by Bell Atlantic from company other than Bell Atlantic," 305 F.3d at 92.

[24] "[T]he alleged injury here should have been barred as indirect, deriving from harm to the direct customer." *Trinko* Pet. at 24.

[25] *See, e.g.*, Steel Co. v. Citizens For A Better Environment, 523 U.S. 83, 110 (1998) (declining to review merits having found no standing: "However desirable prompt resolution of the merits EPCRA question may be, it is not as important as observing the constitutional limits set upon courts in our system of separated powers").

position truly presents Section 2 monopoly leveraging or essential facilities issues. The district court concluded in *Covad* that claims by local telephone resellers' customers do not involve "a secondary market" so as to implicate leveraging theory at all.[26] The government took a similar position concerning the essential facilities doctrine in *Trinko*. The United States described the principle behind "the leading case," the Seventh Circuit's decision in *MCI Communications Corp. v. AT&T*,[27] as follows: "a monopolist may be required to assist rivals by sharing a facility if the monopolist can 'extend monopoly power from one stage of production to another.'" *Trinko* Amicus Brief at 12. Certainly Verizon agrees with that analysis. Verizon cites MCI's rejection of a demand that AT&T share access to its long distance network,[28] and interprets that rejection as having been based on MCI's desire to use elements of the long distance network in order to provide long distance service (as opposed to the Section 2 claim upheld *MCI*, in which MCI sought to use elements of the local telephone network in order to compete in the long distance market). Verizon, relying on that interpretation of *MCI*, argues that AT&T (from whose interactions with Verizon the plaintiff's claims arise) only participates at one level of one market, the same local service market in which Verizon competes, and asserts that there can be no essential facilities claim when the competitor merely provides the same service as the incumbent whose facilities it seeks to share. *Trinko* Pet. at 12 n.6 (referring to "the *rejected* (same-level, same-market) claim in *MCI*").

It is not clear that interpretation is correct: *MCI* first found that the long distance elements could not be essential facilities because MCI had shown the ability to duplicate them;[29] since they were not essential to competition, it was no stretch to conclude AT&T did not have to share them in order to foster competition in the same market. But were the Supreme Court to accept Verizon's reasoning, the Court could resolve the essential facilities claim on very narrow grounds applicable only to local service reseller competitors (those who participate, in Verizon's words, at the "same-market, same-level"). If it concluded AT&T simply did not participate in two markets, but only one, it could conclude that the *Trinko* plaintiffs simply did not plead an essential facilities or monopoly leveraging theory, without ever reaching the issues raised by Verizon and the government. The Supreme Court has declined prior opportunities to resolve these issues. *Trinko*'s procedural posture gives the Court the opening to do so again.

Even if the Supreme Court tackles the essential facilities and monopoly leveraging issues, it is not clear what the scope of its analysis would be. Facilities-based CLECs who compete in downstream markets present a different set of essential facilities and monopoly leveraging issues than resellers. As in *Alcoa*,[30] the seminal Section 2 "price squeeze" case, facilities-based downstream CLECs like Covad buy essential inputs from a monopolist in an upstream market and use those inputs to compete with that vertically integrated monopolist in a separate, downstream market. In this example, the upstream market is the local telephone network, controlled by the ILEC. The CLEC is not seeking simply to take that network and resell it. Instead, just as the competitors in Alcoa bought aluminum ingot in order to produce and sell aluminum sheet, the CLEC leases elements of an ILEC's network, combines them with its own facilities, and produces a new service (for exam-

[26] See Petition for a Writ of Certiorari, *Covad*, Pet. App. at 55a.

[27] 708 F.2d 1081, 1132–33 (7th Cir. 1983).

[28] *Id.* at 1149.

[29] *Id.* at 1148.

[30] United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).

ple, DSL) which competes with ILECs in another, downstream market. If the Supreme Court views the claims in *Trinko* as involving only one market, as Verizon itself argues, it is not clear whether *Trinko* could provide meaningful guidance for Section 2 claims by non-reseller competitors.

Conclusion

Trinko is an intriguing case. It clearly presents the classic *Goldwasser* issue of whether the ILECs are absolved of antitrust liability for conduct also covered by the 1996 Act. And at first glance, it also appears to capture issues, such as monopoly leveraging and essential facilities, that have been the subject of extensive debate in the broader antitrust community but which have never received direct Supreme Court guidance. But on closer examination, it is unclear whether an indirect purchaser class action, being reviewed on a Rule 12 motion to dismiss, is the proper vehicle to address such weighty issues. The industry may be better served if the Supreme Court waits for a case with a more fully developed factual record, and a more widely applicable fact pattern, before it tackles those broader issues. ●

Paper Trail: Working Papers and Recent Scholarship

Editors' Note: *Occasionally, an intensive intellectual probing of specific antitrust concepts will occur as a result of some court or agency opinion. While some of these issues may be discussed in other ABA Antitrust Section publications,* The Antitrust Source *will take the opportunity to summarize the probing for our readers and highlight the papers of interest in an Editor's Note. In this inaugural note, we review the recent buzz on critical loss. This issue also contains a brief Book Note reviewing a collection of essays on post-Chicago developments in antitrust. Send comments or suggestions for books, papers, or issues to review to William Page (page@law.ufl.edu), or John Woodbury (jrw@crai.com).*

—John R. Woodbury/William H. Page

WRITINGS ON CRITICAL LOSS

A Stylized Sketch of Market Definition History

Once upon a time, the approach of antitrust practitioners towards market definition seemed to flow from some simple, albeit idealized, concepts. In the "ideal" market, all goods were perfect substitutes, like wheat or widgets. The prices of each perfectly-homogeneous product produced by different firms would be identical—any price differences would be immediately and instantaneously eliminated either by suppliers arbitraging the market or by consumers engaging in "self-arbitrage." To be sure, reality diverged from the ideal, but not enough for any (at the time) to believe that thinking of the markets in terms of the ideal was in any way misplaced. To define a market, one only had to find products that were "reasonably interchangeable" in supply and demand. Blue widgets seemed to be "reasonably" good substitutes for red widgets (and vice-versa, although it may have seemed odd to conduct the two-way analysis—after all, how could one product be a good substitute for another without the reverse also being true?)

But lawyers and economists began to view the "reasonably interchangeable" paradigm as one with its own implementation baggage. Practitioners had trouble distinguishing where one market ended and another began. Blue widgets seemed to be reasonable substitutes for red widgets, but square widgets and round widgets seemed to be used for somewhat different products. Where should practitioners say that the chain of substitution ended, thus defining a "market"? Becoming uncomfortable with seemingly broad markets that arose via the reasonable interchangeability standard, we began defining submarkets as well as markets, a concept that has been (until recently) scoffed at by purists, including or perhaps especially by economists. Either it's a market or it's not.

The SSNIP and Market Definition

And then came the 1982 Guidelines with the paradigm of the SSNIP-ing hypothetical monopolist as their basis for market definition: a market was now conceived of as a grouping of products over which a hypothetical monopolist of those products could profitably make a "small but significant and non-transitory increase in price" over current levels. That approach captured the essence of what it meant to be a market for antitrust purposes: Was this a product whose price could be successfully raised by a firm with market power? The focus dramatically shifted from product interchangeability—or demand and supply cross-elasticities—to own-price demand elasticities. The thought experiment had become far more transparent.

Still, the question of how to operationalize the new paradigm seemed as difficult as the interchangeability paradigm. Yes, there were those whose papers explored residual demand analysis as a way of implementing the new market-definition test by directly focusing on own-price elasticities (e.g., Jonathan Baker and Tim Bresnahan, and David Scheffman and Pablo Spiller). This approach, however, was sufficiently data-intensive that for most mergers, it was impractical. What do you do if you can't directly measure product elasticities?

Finally, Critical Loss

Barry Harris and Joseph Simons answered in 1989 with critical loss analysis: "Simply" calculate how much the hypothetical monopolist of the product would have to lose in order to render a 5 or 10 percent price increase unprofitable and then ask whether such a loss—which depends upon the own-price demand elasticity—was more or less likely to result. The only data required was that on current production and the price-variable cost margin. Critical loss soon became part of the practitioner's lexicon and made its way into the courts. Although determining whether the actual loss would exceed the critical loss still required difficult-to-obtain and sometimes difficult-to-evaluate data, the approach nonetheless provided practitioners with a much more focused goal.

Critical loss soon became part of the practitioner's lexicon and made its way into the courts.

The *SunGard* decision and the FTC's *Cruise Line* opinion have recently thrust critical loss analysis into the spotlight. Critical loss analysis played a key role in both. Most recently, our sibling "old media" publication, *Antitrust* magazine, provided readers with a critique of that analysis by two former chief economists of the Antitrust Division, Michael Katz and Carl Shapiro. And another sibling publication, the *Antitrust Law Journal*, is set to publish a critical loss paper by Daniel O'Brien and Abraham Wickelgren. In addition, the ABA Antitrust Section recently sponsored a critical-loss Bown Bag program with Harris, Simons (the FTC's Competition Bureau Director), and Shapiro, and rumor has it that Scheffman, Director of the FTC's Bureau of Economics, has mandated critical loss analysis for all staff merger evaluations. (The edited transcript of the ABA Brown Bag will appear in a later issue of *The Antitrust Source*.)

The two sibling papers make very similar points. First, the papers make the point that the critical loss test has been widely misused. A critical component of the critical loss calculation is the current price-cost margin, and a high current margin generates a low critical loss. Only a relatively small actual loss of sales at such a high margin would make the SSNIP unprofitable. Many practitioners then proceed to "demonstrate" that the actual loss would be greater than the critical loss, a conclusion that justifies broadening the market.

But the current margin itself is related to the firm's own-price demand elasticity as indicated by the Lerner Index—the percentage price-cost margin is equal to the inverse of the firm's demand elasticity (expressed as a positive number). Thus, embedded within the critical loss is an estimate of the own-price demand elasticity (as can be inferred from the price-cost margin). And a relatively high margin is a result of a relatively low own-price elasticity of demand. So, with a relatively inelastic demand, any SSNIP will result in a small actual loss as well as a small critical loss. Given this conundrum, Katz and Shapiro suggest that when the margin is large, the presumption should be that the market is narrow.[1]

While the two papers indicated that such a presumption could be rebutted by, e.g., evidence that demand is much more elastic when price increases than when it decreases or by evidence that tacit or overt coordination is already occurring (not the best argument in defense of a merger), it's apparent that the burden on the merging parties would be substantial.

Given the infirmities of the conventional critical loss calculation, Katz and Shapiro suggest an alternative approach that is also discussed in O'Brien and Wickelgren. Suppose among a number of products being considered as part of the relevant market and under the control of the hypothetical monopolist, there is a SSNIP for one product. Suppose as well that the fraction of the lost sales that is captured by the other candidate products under the control of the hypothetical monopolist—what Katz and Shapiro refer to as the "aggregate diversion ratio"—exceeds the critical loss (expressed as a percentage of total production) for a SSNIP. Then the two papers demonstrate that the actual loss to the hypothetical monopolist will be less than the critical loss and the SSNIP will be profitable. With respect to diversion, Katz and Shapiro note that with a 60 percent pre-merger margin, a SSNIP of 10 percent would be profitable if the aggregate diversion ratio is only 25 percent. Put differently, if the hypothetical monopolist raises price by a SSNIP and 75 percent of the resulting lost output is diverted to products outside the postulated market, then the products under the control of a monopolist still constitute a relevant antitrust market.

Because of the analytical shortcomings of the critical loss methodology, O'Brien and Wickelgren come very close to recommending that critical loss calculations be jettisoned as a tool for market definition. Katz and Shapiro recommend implementation of their aggregate diversion analysis for market definition but do not provide us with any guidance as to how to empirically implement that approach. And both papers underscore the point that the rebuttable inference from high margins or from modest aggregate diversion is that the markets drawn are likely to be narrow in merger cases.

Editor's Perspective—Whither Market Definition?

By necessity, this note has glossed over many of the subtle points these (and other) papers raise. Before providing a list of papers on critical loss that might be of interest, a few closing observations are warranted, if only by editorial prerogative. Readers are invited to offer their own responses to the observations and questions posed below.

First, the conclusion that antitrust markets tend to be narrow because firm margins tend to be high in many if not most industries (particularly product differentiated industries) depends critically on the more mundane, less glamorous calculation of the margin itself. Both papers make the same

[1] Note that this correct elasticity interpretation of the firm's margin and the resulting inference about the actual loss is seemingly at odds with the *Cruise Line* matter that has given heightened prominence to critical loss analysis. In that matter, the FTC concluded that the high margin of the cruise lines implied a small critical loss. Because the estimated aggregate demand elasticity was about 2 in absolute value, the FTC further concluded the actual loss would be greater than the critical loss and therefore that the market was broader than cruise lines. However, as discussed in the text above, a high margin implies a low price elasticity for the firm. And as the pair of recent papers reminds us, the market elasticity of demand will be smaller than the firm's elasticity of demand. The single firm's own-price elasticity is determined in part by output lost to other firms, including those in the same antitrust market, when the firm raises its price. Those are not losses to the hypothetical monopolist controlling those other firms and so the market demand elasticity will generally tend to be lower than the firm-level elasticity. For any given price increase for one firm (holding all other prices constant), the hypothetical monopolist, controlling multiple firms, loses fewer unit sales than does any single firm under the monopolist's control. Thus, the aggregate demand elasticity estimate of 2 was inconsistent with firm-level demand elasticities considerably smaller than 2. Either one or both was estimated incorrectly.

observation in footnotes that the margin calculation is assumed to be correct, but offer no guidance as to the appropriate calculation. The usual approach is to use the gross margin, where the cost components are typically limited to those that are most variable, which sometimes even excludes labor costs. The presumption here is that the only costs that count are those that we consider relevant for the two-year time horizon that plays such a prominent role in the Guidelines.

But if firms think that price increases and output reductions in the short run adversely affect their competitive position in the longer run, then those opportunity costs should be accounted for. For example, these costs might include any reduction in the inability to innovate to the extent that innovation incentives depend on the level of output or on market share. Inclusion of such opportunity costs would lower the margin and by implication increase the firm's own-price elasticity, suggesting broader rather than narrower markets.

[T]hese papers raise the question of what is the purpose of market definition in the numerous markets that are characterized by some degree of product differentiation.

Second, and more fundamentally, these papers raise the question of what is the purpose of market definition in the numerous markets that are characterized by some degree of product differentiation. The language of diversion used in both papers is exactly what is used in the analysis of differentiated products. Of course, the practitioner can mechanically combine multiple differentiated products into a single antitrust market. In preparing to defend the merger to the agencies, the practitioner may conclude that the pre-merger shares of parties are not worrisome within that market. Then the practitioner goes on to assess whether within that market, the products of the two merging firms are the closest substitutes (the resurrection of the submarket). If this last question is relevant, what was the purpose of defining a market in the first place, given that the degree of substitution varies enough across products to ask the closest-substitute question?

The market definition exercise certainly is still likely to be a useful aid—whether using the thought experiment of the original Harris-Simons paper or the diversion approach developed in the two most recent papers—in identifying those products that are more rather than less substitutable for those of the merging parties. But the use of that exercise plays a far different role than the one used in the conventional approach to market definition: how high is the HHI and the delta? And there may well be other approaches and data (e.g., consumer surveys) that are as helpful in identifying closest substitutes as is the market definition exercise.

It is clear that once those substitute products have been identified, the next step is not an HHI analysis. Rather, it's something like a unilateral differentiated Bertrand analysis and an evaluation of the likelihood of coordinated effects among firms producing differentiated products. But wouldn't this conclusion suggest that all of the effort in defining a relevant market is largely if not completely irrelevant? For those who believe that the heart of antitrust analysis is competitive effects, not market definition, the response would be "tell us something we don't know."

In the case of the Bertrand simulations, any diversion between the products of the merging parties will lead to an increase in prices, absent efficiencies. This inevitable outcome is nowhere clearer than in the final footnote of the Katz and Shapiro paper, notwithstanding their use of "aggregate diversion." If price exceeds marginal/variable cost and the diversion is non-zero for at least one of the merging parties, prices are predicted to increase. And then the question is: what is a significant price increase? What benchmark should be used? And while it's customary to say that such a price increase can be defeated by repositioning and new entry, isn't that possibility already accounted for when the firm sets its pre-merger price, so that the resulting margin has embedded within it the repositioning/entry responses at "slightly" higher prices?

Like all good papers, these on critical loss raise at least as many questions as they answer.

—JRW

Selected Critical Loss Literature

Some of the relevant critical loss literature includes the following:

Barry Harris and Joseph Simons, *Focusing Market Definition: How Much Substitution Is Necessary?*, 12 Research in Law and Economics 207 ((Richard O. Zerbe, Jr., ed., 1989) .

Michael G. Baumann and Paul E. Godek, *Could and Would Understood: Critical Elasticities and the Merger Guidelines,* 40 Antitrust Bulletin 885 (1995).

Gregory Werden, *Demand Elasticities in Antitrust Analysis*, 66 Antitrust Law Journal 363 (1998).

Kenneth L. Danger and H.E Frech III, *Critical Thinking about "Critical Loss" in Antitrust*, 46 Antitrust Bulletin 339 (2001).

James Langenfeld and Wenqing Li, *Critical Loss Analysis in Evaluating Mergers*, 46 Antitrust Bulletin 299 (2001).

Reid B. Horowitz, *The Use of Critical Loss in and Beyond Merger Analysis*, ABA Section of Antitrust Law, Clayton Act Newsletter No. 2, at 3 (2002).

David Scheffman, *"Critical Loss" Analyses*, Presentation to the EU Merger Task Force (January 2003), http://www.ftc.gov/speeches/other/criticalloss.pdf.

Michael Katz and Carl Shapiro, *Critical Loss: Let's Tell the Whole Story*, Antitrust, Spring 2003, at 49.

Daniel P. O'Brien and Abraham L. Wickelgren, *A Critical Analysis of Critical Loss Analysis*, Antitrust Law Journal (forthcoming 2003).

BOOK NOTE

Post-Chicago Developments in Antitrust Law (Antonio Cucinotta et al., eds., Edward Elgar Pub. Co., Cheltenham, UK and Northampton, Massachusetts 2002)

This collection of fourteen essays is part of Elgar's series, *New Horizons in Law and Economics*. It collects many of the papers presented at a conference on Post-Chicago antitrust held in Taormina, Sicily, in 2000. (As someone who was there, I have to say it was the best location for a conference I can recall.) The list of authors includes many names associated with American Post-Chicago scholarship: Herb Hovenkamp, Jon Baker, Eleanor Fox, Rudy Peritz, Mike Jacobs, Bob Lande, and Peter Carstensen. Some of their papers, not surprisingly, advocate or offer a Post-Chicago approach to antitrust issues—for example, Baker's identification of promising new theories of anticompetitive effect; Peritz's discussion of dynamic competition; and Fox's essay on global antitrust. And there are Post-Chicago contributions from European scholars, such as Francesco Denozza's essay on raising consumers' costs as an antitrust problem, and Patrick Van Cayseele's game-theoretic approach to cartel analysis. Nevertheless, this volume is by no means a Post-Chicago love fest. First of all, Hovenkamp's opening survey of Post-Chicago theories is remarkably critical; it finds only a few useful Post-Chicago innovations (some theories of raising rivals' costs, and unilateral effects theories of horizontal mergers) and strongly condemns *Kodak v. Image Technical* and the litigation that followed it. In addition, Roger Van den Bergh's essay provides a Chicagoesque critique of European Community antitrust decisions. John Lopatka and I contribute a paper that tries to explain the pattern of Chicago's victories and defeats in its confrontations with Post-Chicago theories in the Supreme Court. ●

—WHP