Ask the Ethics Experts

Editor's Note: *Conflicts of interest are a fact of life in today's legal practice. With the growth in the size of law firms, the opportunity for client conflicts also increases. Add in the fact that antitrust lawyers increasingly find themselves engaged in "one-time" representations in litigation or merger matters of companies that are not otherwise clients, and it is the rare antitrust practitioner that has not had to deal with conflict issues. Because the only resolution of many conflict situations is obtaining client waivers, every antitrust lawyer should be familiar with how conflict waivers can be obtained and enforced to avoid disqualifying conflicts.*

This issue's "Ask the Ethics Experts" poses ethical questions that may occur in the context of antitrust practice and then answers them based on the rules of individual jurisdictions and the ABA's Model Rules of Professional Responsibility. Our guest expert for this issue is Kathryn Fenton, a partner at Jones Day in Washington, DC, and Secretary of the ABA Section of Antitrust Law.

If you have questions or topics to suggest for discussion in future issues of The Antitrust Source*, send email to:* antitrust@att.net.

Note: *The responses to hypothetical situations in this feature are presented for informational and discussion purposes only and should not be considered or construed as legal advice applicable to any specific facts or circumstances. They discuss general ethics principles that may not apply universally or in a particular jurisdiction, and readers should take care to determine and consult the legal and ethical standards applicable to any specific issue they confront.*

Waivers of Conflicts of Interest

Q: My law firm, like many others, recently has implemented a policy of seeking waivers of conflicts of interest from all new clients in order to minimize future potential disqualification concerns. In seeking such advance waivers, what factors should we be considering in order to maximize the likelihood that the waivers will be enforced?

A: As law firms grow in size and increase their operations around the globe, the potential for encountering current or future client conflicts of interest correspondingly increases. In response, law firms increasingly are turning to advance client waivers of conflicts of interest as a means of avoiding the potential disqualification risks and other concerns associated with such conflicts.

As the term is commonly used, an "advance waiver" generally means a waiver that is granted by a client or a prospective client before an identifiable conflict arises and before the precise parameters of the conflict (e.g., the adverse party or the specific matter involved) are known. (Advance waiver also are sometimes referred to as "prospective waivers" or "generic waivers.") The most common form of advance waiver, generally sought at the time the attorney-client relationship is first established, seeks to ensure that the representation to be undertaken will not be asserted as a conflict of interest or the basis for a motion to disqualify the law firm if direct adversity with another firm client in a particular matter should arise in the future.

A variety of bar ethics opinions, the Restatement of the Law Governing Lawyers, and the ABA's Ethics 2000 Commission all have acknowledged that advance waivers are permissible in concept, but emphasize that individual waivers will be enforced only where the client providing the waiver can be said to have given informed consent. For example, ABA Formal Ethics Opinion 93-372 (1993) cautions that "[u]nlike the client issuing a specific waiver, the client issuing a prospective waiver cannot know what confidences he will in the future disclose or in what adverse representations the attorney may engage." Thus, the opinion concludes that an advance waiver will not be enforced unless it identifies the likely adverse party, or at least a class of potential opponents, as well as sufficient information for the client to appreciate "the nature of the likely matter and its potential effect on the client." The ABA opinion also emphasizes that client waivers of future conflicts do not necessarily encompass waivers of confidentiality, which should be separately addressed, and strongly urges that any advance waiver be in writing. See also Restatement of the Law Governing Lawyers, § 122, Comment d (2000) ("A client's open-ended agreement to consent to all conflicts normally should be ineffective unless the client possesses sophistication in the matter in question and has had the opportunity to receive independent legal advice about the consent.").

The current version of ABA Model Rule 1.7, the product of the ABA Ethics 2000 Commission review of the Model Rules, includes a comment on advance waivers. Comment [22] to Rule 1.7, "Consent to Future Conflict," states that the general test of enforceability of forward-looking waivers will be "the extent to which the client reasonably understands the material risks that the waiver entails." *Id.* Thus, "[t]he more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations," the greater the likelihood of requisite client understanding. The Comment goes on to note that in the case of conflict waivers that are "general and open ended, . . . the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved." *Id.*

The application of these concerns in an actual dispute regarding the effectiveness of an advance waiver was demonstrated by a recent judicial decision holding that a general advance waiver was insufficient to cover adversity in litigation because the waiver did not expressly refer to this possibility. *Worldspan, L.P. v. Sabre Group Holdings, Inc.*, 5 F. Supp. 2d 1356, 1360 (N.D. Ga. 1998) ("[A]ny document intended to grant standing consent for the lawyer to litigate against his own client must identify that possibility, if not in plain language, at least by irresistible inference including reference to specific parties, the circumstances under which such adverse representation would be undertaken, and all relevant like information.").

A number of state and local bar associations have issued legal ethics opinions holding that advance waivers are permissible and providing guidance on the measures to be adopted to increase the likelihood that the waivers will be enforced. *See, e.g.*, Los Angeles County Bar Ass'n Formal Opin. 471 (1994) (opining that advance waivers are permissible). The New York County Lawyers' Association adopted the approach of ABA Formal Opinion 93-372 regarding the need to disclose potential adverse clients and types of adverse representations. N.Y. County Lawyers' Ass'n Ethics Opin. 724 (1998). It went on to suggest that the lawyer also should disclose the steps to be taken to protect the client (e.g., implementation of screening procedures or adoption of an ethical wall) if a conflict should ultimately arise. *Id.* Recognizing the subjective nature of informed consent, the opinion also stated that for "a sophisticated client, such as a large corporation with in-house counsel, the adequacy of disclosure will be put to a less stringent test than if the client were a small business, an individual unsophisticated with respect to legal matters, a child or an incapacitated person."

The District of Columbia Bar Association expanded on this point and suggested that an advance waiver given by a client with access to independent counsel (either in-house or outside) to review the waiver would be presumptively valid, even if general in character. D.C. Bar Legal Ethics Comm. Opin. 309 (Dec. 2001). In the absence of such independent review, the client consent must be specific as to the "types of potentially adverse representations and types of adverse clients (e.g., a bank client for whom the lawyer performs corporate work waives the lawyer's representation of borrowers in mortgage loan transactions with that bank)." *Id.* The D.C. Bar also recommended that "for the protection of lawyers as well as clients" that advance waivers be in writing. *Id.*

The message lawyers should take from these opinions is clear. Because the burden of establishing the enforceability of advance or prospective waivers will rest with the lawyer, all possible steps should be taken to establish that the waiver was the product of knowing and informed client consent. If possible, the consenting client should be advised by an independent attorney. In cases where such independent advice is not available, the advance waiver should spell out in as much detail as possible the specific types of conflicts that may arise, the potential consequences to the waiving client of these conflicts, and the measures the lawyer will undertake to prevent possible harm to the waiving client. If the waiver is intended to apply to litigation or other forms of dispute resolution, that fact and the resulting implications (e.g., the possibility that hostile discovery or cross-examination will occur) should be fully discussed.

Q: What happens when a client granting waiver of an actual or potential conflict of interest changes his mind and attempts to withdraw the waiver? Can clients engage in such revocation? Does it make a difference at what point in time the waiver is withdrawn? Does this possibility represent a continuing threat that an ongoing representation will be disrupted and withdrawal will be required? Are there means by which lawyers can protect themselves and their other clients against such changes of heart?

A: In many conflict of interest situations, obtaining the consent of both affected clients in the form of a waiver of conflict is the only way to permit the representation to proceed. While the grant of such waivers normally represents the end of the problem in most cases, more than one lawyer has secretly worried about the possibility that the client will undergo a change of heart and attempt to withdraw a previously granted conflict of interest waiver.

The recently adopted ABA Model Rules address this issue for the first time by adding a comment to Rule 1.7 on "Revoking Consent." Comment [21] states that "[a] client who has given consent to a conflict may revoke the consent and, . . . may terminate the lawyer's representation at any time." According to the comment, whether this revocation affects the lawyer's continued representation of other clients "depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of material changes in circumstances, the reasonable expectations of the other client and whether material detriment to the other clients or the lawyer would result."

The practical consequences of attempted repudiation of a previously granted conflict waiver recently were considered in a recent opinion of the Legal Ethics Committee of the District of Columbia Bar. In Opinion 317, issued in November 2002, the D.C. Bar Committee concluded that once a client's waiver of his lawyer's conflict of interest has been relied upon by another client or by the lawyer, the revoking client's subsequent change of heart will not restore the status quo ante and require the lawyer's disqualification.

In considering the implications of a change of heart by a client who had previously waived a conflict of interest, D.C. Bar Opinion 317 focused on the detrimental reliance on the waiver by the lawyer and the other client involved. Concluding that "while nothing can prevent a waiving client from later changing its mind, such an action might not compel the lawyer to withdraw from representing the other affected client."

While noting that a conflicts waiver could be viewed as a contract between lawyer and client, the D.C. opinion decided that the special fiduciary nature of the attorney-client relationship counsels against treating the question of withdrawal or disqualification merely as one of contract law. It noted that a client can discharge its lawyer at any time, but cannot, by the mere fact of discharge, escape existing obligations to the lawyer, such as payment for previously rendered services. The opinion also noted several judicial decisions that had found revocation of consent insufficient to preclude continued representation of the other client where the law firm and the other client had relied upon a previously granted waiver. *See, e.g., Unified Sewage Agency v. Jelco, Inc.*, 646 F.2d 1339, 1346 n.6 (9th Cir. 1981); *Fisons Corp. v. Atochem N. Am. Inc., Inc.*, 1990 WL 180551 *6 n.6 (S.D.N.Y. 1995).

The opinion concluded that detrimental reliance should constitute a similar standard here, and if there has been detrimental reliance by the other client or the lawyer, the lawyer should ordinarily continue representing the other client. The possible arguments in support of this result include the fact that the repudiation of the waiver has effectively discharged the lawyer or that the repudiation constitutes a failure by the client "to fulfill an obligation to the lawyer regarding the lawyer's services," Model Rule 1.16(b)(3) or "obdurate or vexatious conduct on the part of the client [that] has rendered the representation unreasonably difficult." *Id.* Rule 1.16(b)(5). D.C. Rule 1.7(d) dealing with "thrust upon" conflicts also might permit the lawyer to continue the representation if the withdrawal of the waiver (and hence reemergence of the conflict) was not reasonably foreseeable. *See* D.C. Ethics Opin. 292 (1999).

In focusing on possible detrimental reliance by the other client, the opinion cited the Restatement of the Law Governing Lawyers and its examples, including whether substantial time, money, and effort have been invested in the representation, confidential information has been disclosed to the lawyer by the nonrevoking client, and the lawyer or the nonrevoking client has elected to forgo other opportunities in reliance upon the consent. Restatement § 122, comment f (2000). Thus, unlike a revocation of consent announced as soon as the ink was dry on the waiver letter, a revocation that occurred many months after the original consent was given and after significant investment by the lawyer and other client in an ongoing representation likely would not require disqualification from the representation.

Finally, the D.C. Bar Opinion suggested that even the potential for a client's change of heart could be addressed in advance through the initial engagement letter, the communication by which the waiver was initially granted, or some other communication between the lawyer and client. Recommending that such communication always be in writing, the opinion noted that such a document can address whether a client that changes its mind will have a right to continue representation by the lawyer and, if the lawyer is permitted to withdraw from representation of that client, whether the lawyer may continue to represent the other clients involved. ●

Book Review:
Surveying the Landscape of EC Merger Enforcement

Edurne Navarro Varona, Andres Font Galarza, Jaime Folguera Crespo, and Juan Briones Alonso

Merger Control in the European Union

Oxford University Press ▪ 2002 ▪ 870 pages

Reviewed by Frank Fine

Merger control is arguably the fastest developing area of EC competition law. On a purely quantitative basis, the number of merger control cases decided annually by the European Commission continues to greatly exceed the total number of non-merger decisions issued by the Commission under the EC competition rules, including the scores of decisions relating to state subsidies or "aids" as they are known in EC-speak. In 2001 alone, in a year mired in global recession, the Commission adopted 340 decisions—almost surpassing its record of 345 decisions adopted in 2000, when the bull market peaked. On matters of substance, such a torrent of case law has resulted in a rich body of Commission policy (and nuances on policy) on everything from market definition to collective dominance.

Unfortunately, the explosive character of EC merger control not only breeds a constant demand for new, updated works, but also, as a byproduct, it shortens the shelf life of almost everything that is published in this field. Unfortunately for its authors, *Merger Control in the European Union* is only the latest book on EC competition law which will be evaluated, perhaps, more for what the authors were unable to account for by virtue of their self-imposed timetable for delivery of the book, than for what valuable contribution in thinking or synthesis of case law they were able to make. Unfortunate indeed for authors Navarro, Font, Folguera, and Briones because within several months after their publication of *Merger Control*, specifically on December 11, 2002, the European Commission adopted, what it has termed euphemistically as, "the most far-reaching reform of its merger control regime since the entry into force of the EU Merger Regulation in 1990."[1]

Of course, when the Commission announced its "far-reaching reforms," it was reeling from criticism over its handling of the *Schneider/Legrand*[2] and *Tetra Laval/Sidal*[3] mergers. Any experienced observer of the Commission would have already had some skepticism as to whether the Commission changed all that much in EC merger enforcement, or whether it was simply seeking

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[1] Comm'n Press Release (IP/02/1856) of December 11, 2002, http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/02/1856|0|RAPID&lg=EN.

[2] Tetra Laval BV v. Commission, Cases T-05 & T-80/02 (Ct. First Instance Oct. 25, 2002).

[3] Schneider Elec. SA v. Commission, Cases T-310/01 & T-77/02 (Ct. First Instance Oct. 22, 2002).

to end the feeding frenzy that ensued from the reversals of these two Commission decisions by the Court of First Instance.

In matters relating to substantive assessment, Commissioner Monti has already made it clear that he will not adopt the U.S.'s substantial lessening of competition (SLC) standard. The revised Merger Regulation will, however, be amended to make clear that the Regulation will apply to oligopolistic dominance, which was most recently applied in the *Airtours/First Choice* case.[4] There are also draft guidelines now in circulation covering horizontal mergers, in which the Commission will clarify what it has been doing in decided cases. U.S. antitrust lawyers are much more troubled by the Commission's creative assessment of portfolio effects, but guidelines on conglomerate and vertical mergers will have to wait. Efficiencies, however, will be considered by the Commission, although no one (or no one should, at any rate) seriously expect the Commission to apply efficiencies more robustly than the federal agencies have done, as the Commission is only offering this concession as a sop to U.S. critics.

Then there are the "radical" institutional and procedural reforms, such as the hiring of a Chief Economist, the establishment of a peer "review panel" consisting of "experienced officials" with the murkiest of mandates,[5] access to the file upon opening of a second stage investigation (rather than when a Statement of Objections is issued), additional staff for the Hearing Officer, a longer period for settlements and opportunities for "state of play" meetings with case handlers. The most far-reaching change in procedure is the abandonment of deadlines for the filing of notifications. The Commission will be adopting the U.S. approach, whereby the investigation is deemed to begin when notification is made, whenever that should happen to be, and with the consequences attendant in delays, such as inability to complete the deal.

The above far-reaching reforms (and more) are expected to enter into force on May 1, 2004, which is also, coincidentally, when ten countries from Central Europe will have the privilege of becoming EU member countries.

I leave it to the reader to decide whether the Commission's reforms significantly alter the landscape of EC merger enforcement. This author's impression is that the landscape remains largely the same. Those who disagree may at least find comfort in the fact that the Commission's reforms will not take effect for almost one and one-half years. Messrs. Navarro et al., even by this conservative standard, would enjoy a longer shelf life than most authors in the field.

Is *Merger Control in the European Union* worth purchasing? The answer must be an unqualified, "yes."

By the time Messrs. Navarro et al. completed their final draft of *Merger Control*, the Commission had decided approximately 1,600 merger cases. The Commission's reforms will probably not result in the reversal of a single case law precedent, at least for the foreseeable future.

Merger Control covers not only all transactions that are capable of falling within the scope of the EC Merger Regulation, but also the treatment of cooperative joint ventures, which remain subject to Article 81 of the EC Treaty. Particularly noteworthy is the exhaustive treatment of

[4] Airtours v. Commission, Case T-342/99, [2002] E.C.R. II-2585 (Ct. First Instance June 6, 2002). In the context of merger control, oligopolistic dominance goes back to the Kali und Salz case of 1994. Kali und Salz, 1994 O.J. (L 186) 30.

[5] Query as to what "independent" thinking or other added value this review panel can be expected to contribute when the Advisory Committee, which consists of representatives of the Member State antitrust authorities, is already mandated by the Merger Regulation to provide advisory opinions on mergers reviewed by the Commission.

horizontal and vertical mergers, as well as collective dominance. On the procedural side the authors lead the reader through the succession of steps constituting first- and second-stage investigations, which will be of particular interest to U.S. lawyers and which are largely unaffected by the Commission's reforms. The chapter dealing with Article 9 referrals, "legitimate interests" and other institutional concerns is also very informative, although the Commission does plan to simplify Article 9 procedures.

The book contains an Annex, which includes the primary and secondary legislation applicable to EC merger control, and a comprehensive list of Commission merger decisions adopted since the entry into force of the Merger Regulation. This list is particularly useful for its identification of the sector(s) affected by each transaction.

On the negative side, the authors neglect technology and innovation markets almost entirely, and there is no treatment of "unilateral effects," a concept that has been quite fashionable on the international conference circuit, but ignorance of which, if the agitated behavior of some lawyers is any indication, might even be career-threatening. The former is a truly important oversight, which will hopefully be corrected in a subsequent edition. The latter omission should not be deemed significant, due to the rare circumstances in which this notion (or doctrine, if it rises to this distinction) is likely to be applied. Its omission, however, might be considered by some to be unfortunate in view of the controversy surrounding this notion or doctrine.

Merger Control will remind the reader of *EC Law of Competition* (ed. Faull & Nikpay), which Oxford University Press published in 1999. Like the earlier volume, *Merger Control* is comprehensive, thoroughly documented, and provides unique benefits because of the participation of past and present officials of DG Competition, in this case Andres Font Galarza and Juan Briones Alonso. These insights and observations will be well received by practitioners. ●

Harmonization of the IP Misuse Doctrine and Antitrust Law: A Call for Help from the Agencies and Congress

Jeffery B. Fromm and Robert A. Skitol

In recent years, antitrust practitioners have found it necessary to deepen their understanding of intellectual property law while IP practitioners have discovered a need to deepen their understanding of antitrust law. This is not surprising as IP licensing disputes have proliferated throughout the new economy and IP rights have become the most valuable assets—sometimes very powerful weapons—in wars for hegemony across the information technology landscape. During this period of rapid change, courts and enforcement agencies have abandoned old assumptions about conflict between IP and antitrust policies and have instead embraced the idea that these regimes are consistent in their common overriding objective of encouraging innovation.

Notwithstanding much progress in "harmonization" efforts, one area remains in disarray: the intersection between the IP misuse doctrine and antitrust law as applied to a variety of licensing practices. More specifically, Supreme Court decisions from several decades ago have induced lower courts over many years to continue using the IP misuse doctrine to invalidate summarily various kinds of noncompete covenants and royalty payment arrangements that today's antitrust jurisprudence would not treat as necessarily anticompetitive. In fact, as discussed in this article, some longstanding IP misuse precedents cast a cloud over license provisions that modern antitrust thinking would deem procompetitive and thus worthy of active encouragement.

Judge Richard Posner highlighted the problem in his opinion for the Seventh Circuit last June in *Scheiber v. Dolby Laboratories*, 293 F.3d 1014 (7th Cir. 2002), affirming dismissal of a patent owner's suit to enforce a license calling for post-expiration royalties. He based the decision on the authority of the Supreme Court's holding in *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), that contracting for payments on sales after a patent expires is per se illegal patent extension. His opinion, however, harshly criticized *Brulotte* as out of sync with modern thinking and thus invited the Supreme Court to overrule it. Earlier this month, the Supreme Court passed on that invitation in denying the patent holder's petition for certiorari.

Particularly given that lost opportunity, the FTC and DOJ should now want to address the more general need for harmonization of IP misuse and antitrust law in their upcoming report on hearings throughout 2002 on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy."

Congress could also play a role on this front: widely-criticized anomalies in patent misuse doctrine instigated amendments to the Patent Code in 1952 and 1988. A case could be made (and promoted by the FTC/DOJ hearings report) for a more definitive legislative solution addressing misuse in both patent and copyright law in 2003.

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Scheiber and the *Brulotte* Rule

As Judge Posner tells the story, Scheiber, a musician turned inventor, held U.S. and Canadian patents on the audio system known as "surround sound." He sued Dolby for infringement, and the parties then settled by agreeing that Scheiber would license his patents to Dolby in exchange for royalties. The last U.S. patent was scheduled to expire in May 1993 while the last Canadian patent was scheduled to expire in September 1995. Dolby suggested and Scheiber agreed that in exchange for a lower royalty rate the agreement would provide for continuation of royalties on all patents until expiration of the last Canadian patent. Dolby nonetheless later refused to pay royalties on any patent after it expired, precipitating Scheiber's suit to enforce the license agreement. The district court granted summary judgment dismissing the suit on Dolby's argument that the Supreme Court's *Brulotte* decision precludes enforcement of royalty obligations on any patent after it has expired. Scheiber thereupon took his case to the Seventh Circuit Court of Appeals.

IP misuse precedents cast a cloud over license provisions that modern antitrust thinking would deem procompetitive . . . .

As Posner explained, the Supreme Court majority in *Brulotte* "reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and thereby in violation of the law." [1] In Posner's view, however, "[t]hat is not true"; after the patent expires, anyone can make the patented process or product and the patent cannot be used to exclude anyone from doing so. "The duration of the patent fixes the limit of the patentee's power to extract royalties; it is a detail whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time." [2] *Brulotte*, Posner said, was a "free-floating product of a misplaced fear of monopoly" emanating from bygone days when every patent was assumed to create monopoly power in an antitrust sense.[3] Recognizing, however, that the Seventh Circuit has no authority to overrule a Supreme Court decision "no matter how dubious its reasoning" or "even how out of touch with the Supreme Court's current thinking," [4] his opinion affirmed the district court's dismissal.

Scheiber's cert petition asked the Supreme Court to grant review in order to overrule *Brulotte*. He argued that *Brulotte* "is the product of erroneous analysis of monopoly extension"; contractual post-expiration royalties "do not extend the patent monopoly and are consistent with the patent statute"; *Brulotte*'s "rejection of rule-of-reason testing is inconsistent" with more recent judicial rulings on other licensing practices and underlying policy considerations; and its rejection of a rule-of-reason test "inhibits procompetitive patent licensing" arrangements.[5] *Brulotte*, he contended, "is the product of a bygone judicial era hostile to" IP rights, "when proliferation of per se rules invalidated pro-innovative and even procompetitive licensing practices." [6] He more specifically argued as follows:

> The *Brulotte* rule creates an island of per se unlawfulness in the temporal domain, with no counterpart in the subject-matter domain. On that island, holding of illegal extension of monopoly does not require factual testing for market power nor for anticompetitive effect. *Brulotte* prohibits per se licensing practices

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[1] Scheiber v. Dolby Labs., 293 F.3d 1014, 1017 (7th Cir. 2002).

[2] *Id.*

[3] *Id.* at 1018.

[4] *Id.*

[5] Petition for Writ of Certiorari, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689, at 8–21 (Oct. 29, 2002).

[6] *Id.* at 5.

having advantages for licensees and for the market, devalues intellectual property and thereby discourages innovation.[7]

Dolby in its opposition brief argued that any reconsideration of *Brulotte* should be left to Congress which "has directly considered the *Brulotte* rule and elected not to change it"; and that, on the merits, "overruling *Brulotte* would enable patent holders to circumvent the constitutional mandate that patents have finite duration by leveraging their legally temporary rights into a potentially indefinite stream of future royalties based on post-expiration use."[8] Responding to Scheiber's claim that extension of payments beyond the patent period may be helpful to licensees as well as licensors, Dolby contended that *Brulotte* does not restrict "such financing arrangements" so long as "post-expiration payments are not based on post-expiration use of the invention."[9]

Four prestigious academic research institutions filed an amicus brief in support of Scheiber's petition focusing on their experience in negotiating licenses to the fruits of their medical research to pharmaceutical companies that then undertake high-risk investments to develop commercially viable life-saving products.[10] As they explained, ability to contract for payments extending beyond patent expiration (in lieu of higher payments during the patent term) promotes innovation and commercialization efforts by reducing risk to licensees and thereby enhancing their investment incentives:

> [A]mici and other academic institutions frequently grant licenses to early-stage technology related to products that have not been developed and that are of unknown or speculative commercial value. In such cases, their prospective licensees face a particular risk that no viable product or service will be developed within the scope of the licensed patents. . . . In circumstances like these, the patent owner has no economic or market power to impose or coerce monopolistic license terms, and the prospective licensee may itself prefer extended royalties in exchange for reduced up-front (or other fixed) payments.[11]

In short, the patent system's goal to promote the progress of the useful arts "is served by allowing such parties to negotiate freely the license terms that make sense to them in order to maximize" desirable investment in new products; the per se rule of *Brulotte* "disserves this goal and serves no comparable goal of its own."[12]

On January 13, 2003, the Supreme Court denied the petition for certiorari.

IP Misuse Generally

There are several kinds of licensing arrangements now susceptible to harsher treatment under misuse law—at least under some outstanding precedents—than they would receive under currently prevailing antitrust law. Examples from the patent law side, in addition to contracting for post-expiration royalties (at issue in *Scheiber*), are covenants not to deal in competing products

[7] *Id.* at 7–8.

[8] Brief for Respondents in Opposition, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689, at 8-12 (Dec. 6, 2002).

[9] *Id.* at 13.

[10] Brief for Memorial Sloan-Kettering Cancer Center et al. as Amici Curiae in Support of Petitioner, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689 (Dec. 5, 2002).

[11] *Id.* at 14.

[12] *Id.*

[13] *See, e.g.*, Compton v. Metal Prods., Inc., 453 F.2d 38 (4th Cir. 1971); Berlenbach v. Anderson & Thompson Ski Co., 329 F.2d 782 (9th Cir. 1964).

or technologies[13] and royalties on a licensee's total product sales, including those that do not implicate the licensed patent rights.[14] Indeed, both of these arrangements have been found to be misuse without any finding that they were the product of the coercive exercise of market power. While misuse law in today's Federal Circuit would seem to call for treating these arrangements more in accordance with antitrust standards, other circuits remain free to follow the older precedents and may well be inclined to do so.

One might add to those examples "package" licensing and any form of "tying" a patent license to use of an unpatented product. The 1988 amendment to the Patent Code requires proof that the patent provides the patent holder with market power before a tying arrangement can be deemed misuse;[15] but antitrust law, at least as applied in recent decisions across several circuits, allows condemnation only with an additional showing of anticompetitive effect in the tied product market and, even then, the licensor may successfully defend upon proof of an off-setting procompetitive effect or business justification.[16] Indeed, in *United States v. Microsoft Corp.*, 253 F.3d 34, 89–97 (D.C. Cir. 2001), the D.C. Circuit held that tying arrangements involving platform software are subject to a full reason of reason analysis.

The Federal Circuit has addressed the application of the patent misuse doctrine to certain kinds of post-sale restrictions, such as "single-use only" provisions. According to the Federal Circuit, such restrictions cannot be deemed misuse unless they are both (1) found outside the scope of the patent grant and then also (2) found anticompetitive under full application of the antitrust rule of reason.[17] Left unclear is whether or under what circumstances various other kinds of arrangements that might also be considered outside the scope of the patent grant can be deemed misuse without additional evidence of anticompetitive effect or even market power. The Federal Circuit declared sixteen years ago that, "[t]o sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market."[18]

The prospect of conflicting standards from circuit to circuit is all the greater after Vornado.

Other circuits and district courts within them, however, appear less inclined to "converge" misuse and antitrust law; and they are free to go their own way in rulings upon misuse defenses in license enforcement suits that come before them. Indeed, the prospect of conflicting standards from circuit to circuit is all the greater after last year's Supreme Court decision in *Holmes Group, Inc. v. Vornado Air Circulations Systems*, 122 S. Ct. 1889 (2000). *Vornado* held that Federal Circuit jurisdiction exists only where the complaint itself raises a substantial question of patent law; it thereby "invites the regional circuits to expand their own role in defining rules of patent law and

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[14] *See, e.g.*, Zenith Radio Corp. v. Hazeltine Research Inc., 395 U.S. 100, 137–40 (1969); Hull v. Brunswick Corp., 704 F.2d 1195 (10th Cir. 1983).

[15] *See* 35 U.S.C. § 271(d)(5).

[16] *See, e.g.*, Hack v. President and Fellows of Yale Coll., 237 F.3d 81, 86 (2d Cir. 2000); United Farmers Agents Ass'n v. Farmers Ins. Exch., 89 F.3d 233, 235–36 n.2 (5th Cir. 1996); Gonzalez v. St. Margaret's House Housing Dev. Fund Corp., 880 F.2d 1514, 1518-19 (2d Cir. 1989); *see also* U.S. Dep't of Justice and Feeral Trade Comm'n Antitrust Guidelines for the Licensing of Intellectual Property § 5.3 (1995): "The Agencies would be likely to challenge a tying arrangement if: (1) the seller has market power in the tying product, (2) the arrangement has an adverse effect on competition in the relevant market for the tied product, and (3) efficiency justifications for the arrangement do not outweigh the anticompetitive effects."

[17] C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1540 (Fed. Cir. 1998); Virginia Panel Corp. v. MAC Panel Co., 133 F.3d 860 (Fed. Cir. 1997); Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992); B. Braun Med. Inc. v. Abbott Lab., 124 F.3d 1419 (Fed. Cir. 1997).

[18] Windsurfing Int'l Inc. v. AMF Inc., 782 F.2d 995, 1001-02 (Fed. Cir. 1986).

related areas of jurisprudence . . . ."[19] Complaints seeking enforcement or damages for breach of patent licenses are contract suits that do not raise questions of patent law even though patent misuse may be asserted as an affirmative defense (as exemplified by the *Scheiber* litigation and outcome).

Since 1990, the misuse doctrine has come barreling into copyright law. Appellate courts have held both noncompete covenants and exclusive dealing commitments in copyright licenses to be copyright misuse without even considering whether market power was at play, thereupon dismissing infringement suits.[20] This is all the more anomalous because, generally speaking, there is even less basis to presume without evidence that a copyright confers meaningful market power than there is to presume without evidence that a patent confers meaningful market power.

IP owners have at least two major reasons for concern about different standards in this area. The first is that, while antitrust law significantly restricts a licensee's (or other party's) standing to challenge a license restriction under prevailing applications of the "antitrust injury" doctrine,[21] any licensee or indeed even a nonlicensee accused of infringement can assert misuse as a defense.[22] The second is that, while an antitrust plaintiff can get treble damages upon proof of an antitrust violation,[23] a finding of misuse may render the IP at issue completely unenforceable and that result may mean far greater loss to the IP owner than any antitrust damage award.[24]

As a result of those different standing and remedy features, a license arrangement with no consequential anticompetitive effect—yet with significant procompetitive potential—may create severe risk under misuse law even though there would be no prospect of a successful antitrust challenge to it. In turn, this reality may well mean that misuse law discourages license arrangements that antitrust policy encourages or at least condones in the interests of promoting innovation. The misuse doctrine in its current state may thus prevent IP law from being in sync with antitrust law in its encouragement of procompetitive license arrangements.

The Way Forward

There certainly is room for debate—fueled by ambiguous and sometimes conflicting statements over more than eighty years of Supreme Court jurisprudence in this area[25]—on whether the misuse doctrine in either patent or copyright law should, as a matter of sound public policy, encompass a broader array of practices than those running afoul of antitrust law. To what extent should any license arrangement that can be characterized as an extension of the IP grant be a candidate

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[19] Robert Taylor, *New Opportunities for Forum Shopping: The Implications of* Vornado, ANTITRUST SOURCE, Nov. 2002, http://www.antitrustsource.com.

[20] Lasercomb America, Inc. v. Reynolds, 911 F.2d 970 (4th Cir. 1990) (noncompete covenant); Practice Management Information Corp. v. AMA, 121 F.3d 516, 519–21 (9th Cir. 1997), *amended*, 133 F.3d 1140 (9th Cir. 1998) (exclusive dealing).

[21] *See generally* ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 844–50 (5th ed. 2002).

[22] *See generally* ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY MISUSE: LICENSING AND LITIGATION 29–30 (2000).

[23] *See* 15 U.S.C. § 15.

[24] *See generally* INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 216–20.

[25] *Compare, e.g.*, Mercoid Corp. v. Minneapolis-Honeywell Regulator Co., 320 U.S. 680, 684 (1944) ("legality of any attempt to bring unpatented goods within the protection of the patent is measured by the antitrust laws not by the patent law") *with* Transparent Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 637, 641 (1947) (though "control of the unpatented article or device falls short of a prohibited restraint of trade or monopoly, it will not be sanctioned" because "it is the tendency in that direction which condemns the practice and which, if approved by a court either through enjoining infringement or enforcing the covenant, would receive a powerful impetus"). *See generally* INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 3–28; *see also* HERBERT HOVENKAMP, MARK JANIS & MARK LEMLEY, IP AND ANTITRUST 3-3 to 3-10 (2002).

for a misuse finding without any showing of either market power or anticompetitive effect and without entertaining evidence of off-setting procompetitive effect or business justification? That question was squarely presented by the now-denied *Scheiber* petition; it is now one that the FTC and DOJ should want to address in some fashion in their final hearings report because it so directly implicates a host of policy considerations wrapped up in the IP/antitrust "harmonization" theme dominating those hearings.

Misuse law [may] discourage license arrangements that antitrust policy encourages or at least condones in the interests of promoting innovation.

Some participants in this debate who come to it from an antitrust background argue the problem is that misuse as now defined by some courts can condemn what are clearly both innovation-supporting and distinctly procompetitive license arrangements. The academic research institutions' amicus brief supporting the *Scheiber* petition presented a compelling example from their own experience in licensing patents evolving from their medical research. Another example would be a license provision preventing the licensee from dealing in competing products or technologies but where the licensor is a new entrant into the market at issue and the licensee readily accepts the provision in question as a reasonable way of aligning licensor and licensee market development incentives.

Other participants in this debate who come to it from an IP background may counter that antitrust law has become too permissive, enabling abusive licensing practices to escape liability. This may be, for example, because it is often exceptionally difficult if not impossible to prove that a patent holder possesses market power at an early stage in the evolution of a market that the holder is nonetheless destined ultimately to control. Another example may be that it is all too easy for a patent holder to "leverage" the power of its patent in a given market into the suppression of competition within adjacent markets in situations where antitrust liability may not attach since leveraging that does not rise to the level of attempted monopolization is generally not sufficient to constitute an antitrust violation.[26]

There may be merit in both perspectives, suggesting that the goal of overall "convergence" or "harmonization" between misuse and antitrust law could be achieved through some adjustments on both sides. As the misuse doctrine has evolved in recent years, there has been at least on the patent law side an increasing tendency to require some showing of market power and of licensor coercion as opposed to contracting for the "mutual convenience" of both licensor and licensee before an arrangement is found to constitute misuse.[27] As the antitrust rule of reason has evolved in recent years, it may not take detailed and elaborate economic analysis to warrant an initial inference that a given practice threatens anticompetitive effect and thereupon shift the burden to the defender of the practice in question to establish a persuasive business justification.[28] Why not converge or harmonize standards for IP licensing arrangements generally around these aspects of both regimes?

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[26] *See* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447 (1993).

[27] *See generally* Intellectual Property Misuse, *supra* note 22, at 221–25.

[28] *See generally* California Dental Ass'n v. FTC, 526 U.S. 756 (1999). As the Court there observed, "[a]lthough we have said that a challenge to a 'naked restraint on price and output' need not be supported by 'a detailed market analysis' in order to 'requir[e] some competitive justification,' *National Collegiate Athletic Assn.*, 468 U.S. at 110, it does not follow that every case attacking a less obviously anticompetitive restraint . . . is a candidate for plenary market examination" (*California Dental Ass'n*, 526 U.S. at 779); '"[t]here is always something of a sliding scale in appraising reasonableness'" and '"the quality of proof required should vary with the circumstances'" (*id.* at 780 quoting Phillip Areeda, Antitrust Law § 1507 at 402 (1986)); "there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment" (*id.* at 780–81); and "[t]he object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one" (*id.* at 781).

The courts, enforcement agencies, and/or Congress could constructively come to agreement along the following lines. A finding of misuse should in most cases require some proof of market power exercised to coerce the licensee into accepting some significant restraint on its ability to innovate and compete; that showing can appropriately support a misuse presumption. Some practices such as a clear extension of the scope of a restraint beyond the scope of the IP grant—perhaps including an insistence upon patent royalties after the patent has expired—may well warrant a misuse presumption even without an initial showing of market power. In all cases, however, the law should allow the IP holder to establish a persuasive business justification. In short, in our view, no practice warrants irrebutable condemnation as "per se" misuse.

On the other hand, licensees and other adversely affected parties as well as the enforcement agencies should be able to make effective use of the antitrust laws against a licensor shown to possess market power in a relevant market who is undertaking coercively to extend the scope of its IP rights with a discernable anticompetitive effect; the IP holder should thereupon have the ability to defend by establishing mutual convenience of both parties or some other persuasive business justification. Again, consistent with the predominant thrust of antitrust jurisprudence as now applied to IP licensing arrangements generally, licensors should enjoy considerable latitude in maximizing the value of their IP rights. On the other hand, their exploitation of market power to suppress competition or raise barriers to new competition should be as susceptible to antitrust challenge as their anticompetitive exploitation of market power involving any other kind of property.

Under these formulations, a given licensing practice might in some exceptional situation be found to constitute IP misuse without necessarily also being an antitrust violation. Conversely, a given licensing practice might in some exceptional situation be found to constitute an antitrust violation without necessarily also being IP misuse. But inconsistencies or conflict in the sense that one body of law encourages what the other body of law discourages would be avoided or at least minimized.

Three years ago, Mark Ostrau proposed a four-part test for any finding of IP misuse that we would endorse as consistent with our perspectives as outlined above. Under his test, a finding of misuse would require all of the following (in his words):

1. *Undue Extension of Intellectual Property Rights:* The intellectual property owner has engaged in a practice—normally one restricting a licensee's activity—that "extended the scope" of its intellectual property.

2. *Conditioning:* The owner has conditioned the intellectual property license on a licensee's acceptance of the restriction.

3. *Coercion:* Using market power, the owner has coerced the unwilling licensee into accepting the restriction.

4. *Affirmative Justification:* The owner has failed to demonstrate a business justification for having insisted on the restrictive practice despite an opportunity to do so.[29]

With reform of that sort—promoted by the agencies in their hearings report and thereafter by Congress as well—misuse and antitrust law would be in sync in their protection against IP licensing practices genuinely adverse to consumer welfare. At the same time, neither regime would

[29] Intellectual Property Misuse, *supra* note 22, at 221–22.

unduly inhibit licensing flexibility or arrangements that can enhance opportunities for technology dissemination and the growth of new markets that genuinely contribute to consumer welfare. In short, misuse and antitrust law would be on the same page and in the same choir, promoting innovation in a consistent manner. ●

The FTC Cruise Line Merger Investigation
ABA Section of Antitrust Law "Brown Bag" Program

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Editor's Note: *At the end of 2001, Royal Caribbean Cruises and Princess Cruises competed to acquire Carnival Corporation, each of which is in the business of providing cruises to and from multiple locations. The three firms are the largest in a "North American cruise market," which includes a substantial fourth firm (Star Cruises) and a competitive fringe. Within this antitrust market, either merger would have resulted in a single firm with a share of about 50 percent and HHIs that exceeded 3700.*

While post-merger there would still be three large cruise lines, the safe bet would surely have been that either deal would be tanked by the FTC, even under the Muris Commission. Thus, it was a surprise when in a 3–2 vote, the FTC closed its investigation of the deals. What happened to Chairman Muris's repeated claim that the enforcement policies of the Muris FTC would be largely consistent with that of the Pitofsky FTC? Was this decision a signal that "almost anything goes" at the FTC?

On October 2, 2002, the FTC took the unusual step of issuing a public statement to explain how it arrived at its decision (http://www.ftc.gov/os/2002/10/cruisestatement.htm). That statement has afforded legal and economic practitioners something more than a glimpse of why the Commission cleared these mergers (and why two Commissioners dissented, http://www.ftc.gov/os/2002/10/cruisedissent.htm). Anyone familiar with the work of David Scheffman, Director of the FTC's Bureau of Economics, can see his fingerprints all over this statement.

In this issue of the Source*, we offer an edited version of an ABA Section of Antitrust Law "Brown Bag" program on November 21, 2002, during which Scheffman and Competition Bureau Director Joe Simons provided yet even more detailed insight into the reasons for the majority action. (This transcript should be read in conjunction with Scheffman's PowerPoint presentation, available at http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf). As Simons makes clear in his introductory remarks, this was Scheffman's show.*

The Commission statement and Scheffman's more detailed elaboration of the bases for the Commission decision are notable in two respects. First, the explanations are clearly a huge step in the "transparency commitment" that both Bureau Directors have made to the public. Rarely have the antitrust agencies openly given so detailed an explanation about their decision to clear a merger.

Second, it is notable for what we can learn from it. It informs us (as Scheffman has been saying for some time) that telling unilateral effects stories is yesterday's news. It instructs us about the kind of data required to defeat coordinated effects concerns. And *for some, it will cause us to wonder about the weight that the Commission will ascribe to statistical analysis offered by the parties and the staff of the Bureau of Economics. (This PowerPoint presentation is one filled with histograms and line charts with nary a statistical test, although Scheffman promises that such tests were in fact undertaken.)*

The cruise line decision is controversial. But, along with that, the openness of the Commission has been instructive and even courageous in light of the heat the Commission has experienced as a result. In the late 1980s when Scheffman was the Director of the Bureau of Economics for the first time, he espoused the post mortem, i.e., the evaluation of cleared-but-close-call mergers, to determine the soundness of the Commission's decisions and to learn from experience what was and was not important in merger outcomes. Can there be little doubt that in the not-too-distant future, there will be a post mortem of this Commission decision?

—John R. Woodbury

ART LERNER: The topic for today's Brown Bag program is the FTC cruise line merger investigation and the teaching and educational tool it provides for coordinated interaction antitrust analysis. The FTC closed this investigation with an announcement on October 4. It was by a three-to-two vote; that in and of itself is a little unusual.

The decision was notable in a number of respects: First, the Commission elected not to challenge a merger that the majority of the Commission acknowledged would involve very high market shares in what they thought there was reason to believe was the defined product market. So that's unusual. Not by any means rare in and of itself, but unusual, uncommon.

Second, it's unusual because the decision itself was controversial and resulted in a public discussion of the issues by the Commission. The majority explained why they had not issued a complaint and two dissenters explained why they thought a complaint should have been issued. That offers a window into the Commission and its thinking process and creates an opportunity for us to learn more about how the analysis works and what considerations enter into it. While the vote was three-to-two, I think if you read both the majority and minority opinions, both acknowledge that it was a very close call. So the actual difference may or may not be all that great, despite the split vote. I think everybody seemed to think that the same analytical principles would apply.

We have today an extraordinary opportunity to have two exceedingly well-qualified guests talk to us about the thinking process of the Commission and its staff in the cruise line merger investigation. Our guests are the two appropriate directors of the bureaus at the FTC—David Scheffman from the Bureau of Economics, and Joe Simons from the Bureau of Competition.

We're going to ask each of them to provide some perspective on the matter, to explain to you the message that they'd like to get out, and to talk a little bit about how they approach the issues. David has brought a PowerPoint presentation that he will refer to during his comments.

JOE SIMONS: I thank Art Lerner for hosting this, and the Antitrust Section Clayton Act Committee and the FTC Committee for sponsoring this program. This is really primarily going to be Dave Scheffman's show.

What happened here, at least from the perspective of the folks in the Bureau Director's office, was quite interesting. We had two cases going on at roughly the same time—this one and another one, which is still non-public. The other case had superficially very little to recommend it, while the cruise matters looked like they were actually going to turn into a case. In fact, I was of a pretty strong opinion that the Commission was going to vote out a challenge. As we went through nine months—and Janet McDavid will certainly tell you that we went through many months of very exhaustive investigation—what happened was the case I thought was going nowhere had all the evidence come in the other way. It was overwhelming. On the cruise case, conversely, the documents and the testimony came in, and they were ambiguous. The testimony and documents were such that if there was to be a challenge to the transactions, this would be one of those cases where the quality of the lawyers would actually make a huge difference. It was that close.

What happened as time passed, however, was that the data came in. We asked for a huge amount of data. It took some time to get it in; and then because of the way it came in, it was very hard for us to work with and put in shape. In any event, we worked with the data over a long period of time, and what it ultimately showed was really overwhelming. Dave is going to go through that in detail.

The testimonial here today, at least from my perspective, really is for the Bureau of Economics, the economists, and the data. All of those three elements are very important. It may seem unusual for the Bureau of Competition Director to actually give a testimonial for the Bureau of Economics, but most of you know that I am very sympathetic to economics. This case really demonstrates how important the economics and data can be—and particularly how important it is to get it in early and work very closely with Dave and the economists in the Bureau of Economics.

The other thing I'd like to add is that the folks in the New York regional office did an incredible job investigating this case in terms of their analytic ability and their thoroughness. I also want to thank some other folks in my office, particularly Bruce Hoffman and Robby Robertson, who did a tremendous job. And now I'm going to turn this over to Dave.

Basic data analysis can make a difference in decision making. It may support or undermine support for a case. But it improves decision making.

—David Scheffman

DAVID SCHEFFMAN: I want to reinforce what Joe was talking about. The case that turned out to be hot that looked at first to be a dog also turned on analysis of the data. That's the message we're giving today: Basic data analysis can make a difference in decision making. It may support or undermine support for a case. But it improves decision making. And we are working hard to convince our decision makers at the FTC that this is true.

I want to echo what Joe said about the Northeast Regional Office: the New York folks did an extraordinary job on this investigation. The New York staff and the Bureau of Economics staff worked together very closely. As theories of anticompetitive harm were developed during the investigation, we worked together to test the theories with the data.

Of course, I didn't do the data work—the staff of the Bureau of Economics did. David Meyer was the economist, who, with some very good RAs, actually crunched all of these numbers that you're going to see. He was assisted by Mary Coleman, who is of course my Deputy, and Elizabeth Schneirov, who is our assistant. Jim Ferguson was another staff economist on this case, and the supervisor was Jeff Fischer. Pablo Spiller was visiting us the first half of this year, and he was actively involved with developing some of the theories we investigated. So the work by the staff of the Bureau of Economics was really extraordinary.

There were also a number of economists on the outside sifting through and developing various analyses of these data. There were four sets of outside economists, plus our potential experts. Thus, most of the major economic consulting companies were involved in one way or another.

The idea of this presentation is to show you more of the analysis, especially the data analysis, and show you how important that data analysis was. One point to notice is that this is not complicated econometrics. This case was not decided because of complex econometric models. The case was decided on basic data analysis that any lawyer conversant with basic antitrust economics could understand. As I have said in other settings, I think econometrics can be very useful. We regularly use econometrics in the Bureau of Economics as one basis of our recommendations. But if you can't convince the decision makers about the evidence that underlies the more complicated econometrics, you are not going to be persuasive. So my message is that you should supplement the econometrics with basic data analysis that anyone can understand.

But if you can't convince the decision makers about the evidence that underlies the more complicated econometrics, you are not going to be persuasive. So my message is that you should supplement the econometrics with basic data analysis that anyone can understand.

I'm going to go through this quickly. Just to pick up what Art said, there has been discussion of the two Commission statements in this case. This is a Commission that has been extraordinary in its openness in providing guidance. For example, after the Synopsys-Avant! investigation, which was closed five-zero, the Commission issued pretty detailed statements explaining why that matter was closed. This is part of the policy of this Commission to provide more guidance about why we make the decisions we're making. And the Cruise statements were in line with that policy. For those of you who do not know, there was a much more detailed explanation of the Commission's decision making in Joe Simons's recent speech in San Francisco.[1] I'm going to assume that those of you who are interested enough in this have probably read that, which will allow me to go pretty quickly so I can get to the data analysis. This whole presentation, of which I'm only going to give snippets, will be posted next week on our Web site.[2] (This has the Exhibits—and many more—that I will discuss later in this presentation).

For those of you who follow the ABA Brown Bags, the analysis presented here should not be a real surprise. Mary Coleman and I presented at an Economics Committee Brown Bag on coordinated interaction a year ago. Based on our experience working on a number of merger cases involving coordinated interaction, we described our approach to analyzing coordinated interaction with very straightforward data analyses. Basically, what we did in this case was apply that basic methodology. Our paper on analyzing coordinated interaction will be available in March 2003.

Everybody knows that market definition was important in this investigation. There was a lot of evidence, both qualitative and quantitative, that indicated that market definition was going to be difficult and that the demand elasticity was pretty high. The qualitative information is summarized in the Commission statements and in Joe's speech in San Francisco. At best, the evidence in the documents was mixed in pointing to whether there was a cruises market or not. Because this was an industry that had grown very rapidly, the capacity had increased a lot over time—we were able to analyze statistically and in other quantitative ways what had happened to price, entry, and capacity in the market.

Most cases depend on a few facts that catch people's attention, that get them thinking and eventually lead to a decision on the matter. A key fact in this case was that there was a substantial change in capacity between 1999 and 2000. What was interesting was what happened following this increase in capacity: There was a very modest decline in price, although cost had declined a little also. But essentially load factors remained the same. That was a very interesting fact, if you think about it. Think about plunking down, say, 20 percent more hotel rooms in Las Vegas in one year. What do you think would happen? Room rates would fall, but you would expect the occupancy rate to fall substantially too.

What's interesting in Cruises was that it did not happen. Occupancy rates remained about the same, even with the big increase in capacity. That was a sign, certainly from the economist's point of view, that the market was likely to be broad or at least that demand was very elastic. The argument is that the market is broader if cruises are just drawing people from abroad from other vaca-

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[1] *Available at* http://www.ftc.gov/speeches/other/021024mergeenforcement.htm.

[2] The complete version of this presentation can be found at http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf. The page numbers given for charts in the discussion here refer to page numbers in this presentation.

tions. So this natural experiment seemed to indicate that demand was quite elastic even in the short run.

We did more than look at this single change in capacity. We did other analyses of changes in capacity and prices over time to estimate the demand elasticity, as the parties' economists did also, and we concluded that the short-run elasticity in this market was at least (–)2.0 and maybe quite a bit bigger, and that in the long run, elasticity might be considerably larger.

Well, then the parties came in saying that we needed to look at the critical loss, especially because Joe Simons was one of its "inventors." The critical loss in this industry is very small because virtually all the costs are fixed. So the critical loss is very low, much too low given what any reasonable estimate of the demand elasticity was, to sustain the argument that an across-the-board price increase could be profitable. And that, of course, made it clear that market definition was going to be complicated.

The data would not support an across-the-board price increase, with the usual SSNIP test of market definition. However, since this is a hospitality industry, like hotels, airlines, Disneyland, and everyone else, they use yield management. This is a well-established tool in the hospitality industry now. So while maybe an across-the-board price increase would not sustain a narrow cruising market definition, yield management might allow for a price discrimination market. Naturally, because of the relationship to airlines, we thought maybe it is like airlines in its use of yield management. The idea was to determine if there were cruise travelers that resembled airlines' business travelers—passengers who would constitute an antitrust market using the critical loss/ elasticity test. So this is what we began to look for.

We had cooperation with our friends at the Department of Justice on this. Because we do not do airlines, one of their economists who worked on airline matters came over to talk about a number of issues. How did they look at market definition for airlines? Had they looked at leisure travel before? If so, how did they look at leisure travel?

In addition to speaking with DOJ, we did a lot of investigation of yield management in this industry and how it works. I will not go into that in detail now, beyond doing the data, but when the parties came in, one of the first things we said to them was, "We want to talk to your yield management people." We wanted to understand how yield management works in this industry. We met with yield management people of the four major cruise lines and spent a day or more with each of them understanding how their yield management systems work.

Looking at price discrimination from the point of view of market definition means that we are trying to determine who is the customer that could be disadvantaged by the merger. The idea was to find the customers who are being targeted now, like airline business travelers. So first we looked at characteristics of customers. Focusing on characteristics of customers was not a fruitful area because overwhelmingly sales are through travel agents, so cruise lines are not in a position to discriminate based on types of customers. Airlines do not know if you are a business traveler when you call. However, they know whether you want a ticket that can be cancelled, and then they know what to charge you.

Now cruises are not like airlines in that most bookings can be cancelled. In fact, around three out of every four cruise bookings are cancelled. We knew from the documents and depositions that the cruise lines worry a lot about whether, if they change their rates, they are going to cannibalize their own sales, as people are going to come back and rebook. So it's very different from the airlines because you do not get to anything like the level of cancellation penalties as in airlines, or if you do, it is not until fairly late in the booking calendar. Cruise booking starts eighteen months in advance, and a lot of bookings occur pretty early, as I'll show you in the data.

So we're looking for characteristics of purchase behavior in this market. The identifiable characteristics that we looked at were the type of cruise—Alaska versus Caribbean—type of cabin, and time of booking. There are a lot of types of cabins, and cruise lines compete based on this. For example, these days balcony cabins are very important. But there are also interior cabins, outside cabins, and suites. Time of booking is the airline example. So those were the obvious things that we looked at.

In doing a price discrimination market, the bar is high, as you'd better be able to identify who your captive customers are. As I've often said to our lawyers, we'd better have a three-hyphen-or-less description of what the target market is and be able to back it up. That's why we were looking for a captive group of customers that we could argue were being discriminated against now, who were paying higher prices than they otherwise would, and then the theory would be based on them being targeted. That would give you a solid market definition basis for a case. (Of course you would still, according to the Merger Guidelines need to provide and theory supported by evidence, that the merger would be anticompetitive).

As a matter of theory, yield management may give you market definition because a monopolist engaging in yield management likely would be able to raise the *average* fare relative to what would happen under competition. But exactly how a monopolist could do "better" than competition in practice is quite complicated. Under monopoly some people would pay a higher price and probably some people would pay a lower price than they would under competition. Even under a monopoly, you would not necessarily be able to target who would be paying higher prices in the sense of defining a price discrimination market by characterizing the customers. (Defining a market as those paying higher prices won't feed the bulldog. In almost all markets some customers pay more than average). And since we were not dealing with a merger to monopoly, we'd still need to solve the *SunGard* issue of what are the characteristics of the captive customers in our price discrimination market.

But yield management is not necessarily anticompetitive *price discrimination. Yield management, in my view, is the way in a competitive market you price a perishable asset. That's what everyone does.*

Does high concentration plus existing "price discrimination" mean a case? No—without a monopoly or viable dominant firm theory, you have to show that the merger has an anticompetitive effect. That there is "price discrimination" does not prove that. Now we can argue semantically about whether yield management in this industry is really "price discrimination." But yield management is not necessarily *anticompetitive* price discrimination. Yield management, in my view, is the way in a competitive market you price a perishable asset. That's what everyone does. That's what the smallest hotel in D.C. does if it knows what it's doing. It has some sort of yield management system. It does not have any market power. It's just a way of effectively pricing a perishable asset. It's not inherently anticompetitive. (That's also what small sellers do in farmers' markets in changing the price of their produce through the day). As a general matter yield management is likely to be procompetitive compared to a one price "system." More rooms are sold, more berths on cruises sail occupied, and more airline seats are filled because of yield management. Yield management itself is procompetitive compared to the alternative of selling everything at the same price. Now, that does *not* mean that yield management may not be the source of a case, because yield management could be used, as appears to be the case in airlines, to raise prices to business travelers in concentrated markets protected from entry. That's the sort of thing we were looking for. Can we find the cruise equivalent of "business travelers" who are targeted in a very concentrated market?

Let's go to a brief discussion of competitive effects—unilateral effects or coordinated interaction on price or capacity. First, let me touch on unilateral effects. The original Commission statements produced some confusion and rhetoric on the outside about "what happened to unilateral effects" in our investigation? After all, the merger would create a firm with a share of more than 50 percent. Well, the problem again is market definition. As a theoretical matter a monopolist practicing yield management will be able to get average rates up, compared to competition. Now, the issue is what would you do if you have a 50 percent share? If you have a 50 percent plus share, what you might try to do is wait a little longer before reducing your price and see if people will buy at the higher price. The problem with that is what the competitors are doing. Yield management looks for people who are "willing to pay." A dominant firm in such a situation is simply freeing up targets for what the competitors are naturally doing. This is not a facilitating or non-accommodating response; this is just the way competition works in this industry. If there are customers out there who are willing to pay $1100, but you're the dominant firm and you're going to hold out with $1200, it's likely that your competitors are going to find those folks because they're looking for them and they're going to book them. The 50 percent share firm will have lost them, and remember, because critical loss is so low, this means that waiting longer at a high price is not going to be a profitable strategy. Put differently, you don't have a 50 percent share of the people willing to pay $1200, etc. Again, this is a subtle point, as this is not a competitive response sort of theory; it is the way competition works in this kind of industry.

So unilateral effects analysis would not work based just on share. In addition, there was no basis for making any sort of closest competitor argument. All the cruise lines have a range of different cruises and itineraries in which there's a lot of overlap. Since Joe's speech explains more of the analysis of unilateral effects, I'm going to go on to coordinated interaction.

Very quickly, everyone on the staff concluded that we needed to have a theory of anticompetitive price discrimination through coordinated interaction that would be facilitated as a result of the merger. What was interesting about coming back to the Commission, after having been there for ten years in the 1980s, is that there have not been many coordinated interaction cases lately. In the 1980s, almost all of our cases involved coordinated interaction, and we had an approach to analyze them. For example, look at the Warner Polygram litigation and a number of others. In part, the analysis of coordinated interaction has been "lost" because very few coordinated interaction cases were brought in recent years. Most were unilateral effects cases. There were three-to-two cases, but the "baby food" case indicates that you do not have to argue very much about coordinated interaction in the three-to-two cases because there are so few players.

So, in this industry, post-merger there are going to be three substantial competitors and a fringe (which has shown it can expand and redeploy). This means that the current state of competition in the industry is going to be very important to the analysis, since the coordinated interaction theory has got to be that the merger is going to change the nature of competition. You've got to know about what the current state of competition is in some detail and then be able to argue why it's going to change as a result of this merger.

This is a relatively new and dynamic industry. Capacity has increased tremendously over the last ten years, and quality has gone up, while prices and costs have gone down. New capacity and quality features are the main drivers of competitive activity in this industry. Building bigger and fancier boats is one of the prime means of competition. New ships have skating rinks and rock climbing walls and almost anything you can think of because the modern cruise ship is like a Las Vegas hotel.

As capacity has increased very substantially over time, there has been a general modest decline in average fares and costs, yet concentration has also increased. There had been some acquisitions in the past, but concentration is mostly changing because of internal growth—people building more ships. So the question for a coordinated interaction case, at least from an economist's point of view, is whether there is a credible basis of concern that the state of competition will be significantly adversely affected by the merger.

Now let me tell you about the complexity of this market. At one point in the 1980s, we probably would not have gone very far with this case because of the complexity. There are lots and lots of different itineraries. Ships go to Alaska, they go to the Caribbean, they go to Mexico and the Panama Canal, and they go to Europe. There are lots and lots of different types of ships. There are lots of different cabins on a ship. Different ships have different services. Sales are made through travel agents. There are group discounts. There are vouchers for on-board benefits. There are upgrades, which are very important. So you have a lot of arguments for why this is a really complicated industry. If we analyze things like the Commission did in the 1980s, certainly what the economists would have said, and I suspect the Commission would have agreed given the sitting Commissioners at the time, that this is just too complicated an industry for a *price* coordinated interaction case. (I will discuss coordinated interaction theories based on *capacity* below).

. . . the details of the current state of competition provide important evidence in assessing a coordinated interaction theory. You need to understand the current state of the competition in terms of the actual transactions data.

Together with the lawyers, we developed a lot of evidence bearing on coordinated interaction. It is a concentrated "market." These companies do look at one another. They try to monitor what each other company is doing. So now I finally get to why I'm here. Joe and the three Commissioners, I think, would say that this case turned on the data. The parties produced over 100 gigabytes of data. That is a lot, and the reason for the huge amount is to some extent a lack of cooperation by the parties. That's why in second requests, we sometimes say just give us all your data because you will not sit down with us so we can tell you what we want and why we want it. David Meyer and RAs spent a lot of time getting it down to a workable 10–20 gigabytes.

The data were the actual transactions data—the bookings (that "stuck," i.e., for which someone actually paid and sailed) on all the ships, for the last few years, for the four major cruise lines. In my view—and this was the message of my presentation with Mary Coleman at the Brown Bag a year ago—the details of the current state of competition provide important evidence in assessing a coordinated interaction theory. You need to understand the current state of the competition in terms of the actual transactions data. These transactions, these bookings, told us what cabin they bought and sailed in, what itinerary, what date, what ship, all that sort of stuff.

Now I'm going to talk quickly to show you some of the data analyses that we did. The first thing we did was to look at the data. We were interested to know a number of things. The parties say, "We try to sell out." Well, hotels try to sell out and airlines try to sell out, too. But the cruise companies say no, we really do sell out. So we wanted to see whether that was true. We found that, for the most part, they do sail very close to full. We also wanted to see whether there really was a lot of variability in prices. We wanted to see how variable the pricing on, say, balconies was relative to the variability of pricing on inside cabins. So what we did was look at the data in detail, rather than begin with econometrics.

This exhibit is an example of one of the first things we did—a chart (p. 24 of the full Web site presentation[3]) showing the same ship sailing a similar itinerary four consecutive weeks in a row. These lines are the average price of bookings for each sailing for a given month. These are months before sailing, starting with a time thirteen months or more before sailing, down to the last month before sailing. This is for a particular type of cabin. These are the average prices during a month, but we looked bi-weekly, and we looked in lots of other ways, and this is an example. Most

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[3] *Available at* http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf. The page numbers given for charts refer to page numbers in the Web site presentation.

of the examples I'm showing you are among a number of different things we looked at. These bars on the chart are what percentage of the sailing's bookings occurred during that month. So, for example, at this very high price there were hardly any bookings. You do not see much of a red bar down there, so you know there were only a few bookings at a very high price.

We studied this kind of stuff for a long time. We said, let's look at the same ship sailing four consecutive weeks on the same itinerary and think about the variation of prices and bookings we see, and try to think about whether we have a systematic theory of pricing. What we saw was complicated. For example, there's a belief in the industry that prices for a given sailing fall over time. But notice in this example that for two of the sailings prices significantly increase towards the end.

As this chart shows, and lots of other data runs we did confirm this conclusion, prices move all over the place. One reason why there is this price variability is that the cruise lines are going around making all sorts of offers, working with travel agents in certain regions on special deals, trying to find people who will buy a cruise. For example, they may go to travel agents in Cleveland with promotions, and they may or may not get some customers. If not, then they go to Arizona or somewhere else. So you get this kind of pattern—as sometimes they have to have the price lower or higher or whatever. Yield management sounds complicated, and it's somewhat technically complicated, but it's something more like the Faneuil Hall market in Boston, and how the different vegetable stands would work as the day wore on. As vendors wanted to get rid of their stocks, they would bargain with customers, and different people would pay different amounts for the same five pounds of tomatoes because sellers were trying to get rid of the tomatoes, which were worth nothing if they didn't sell. That's in crude terms what's going on in the cruise market.

Probably the single most important factor in people's thinking about this case arose from data for head-to-head cruises. Remember, this is the transactions level data, and it is really quite extraordinary to be able to do this type of analysis. This chart (p. 26 of the full Web site presentation) is for four head-to-head cruises—four different competitors, sailing similar ships, from the same port, the same week, for a particular type of cabin. This is the same as the earlier chart, in that the lines are the average price of a cabin booked in that month, from thirteen months out to the month before sailing, and the bars show what percentage was booked in each month. Well, these are head-to-head competitors. This is *not* what you expect to see arising from head-to-head price competition. Look at this and tell me where that is? Prices are not responding. You can do correlations, but this shows why it's so good to look at the real data. We could have said these data are not correlated, which they are not. But looking at the actual data, you see some prices going up, other prices are going down.

You have one ship which is really late in getting bookings, so they're lowering prices at the end trying to fill up their boat. Meanwhile, another ship is going along and pretty much holding around the same price. It's pretty daring, but it has more of a pricing strategy flavor—okay, I've got this price and I'm going out to try and sell my boat. That seems to work for that cruise, but the other ships seem to have to find pockets of people around the country to fill up.

This was actually consistent with what the yield management people told us about how competitive pricing figured into their own pricing. They said it was a factor, and that they do spend a lot of time trying to monitor it, but they said it was often not very important to the extent that it actually changes their tactical pricing. We knew they were prepped and that's what they would say, but that's why the data were important, because it actually looks to be true that there's really not much relationship between prices.

If you look at the figure, what appears to be moving the prices of the different ships, at least in part, is their load factors. When they're not very full, they are likely to cut their price, and when they are getting pretty full, they may hold or raise their price. But it's actually a lot more complicated than that, as we found from doing statistical modeling of it—i.e., there is not a close statistical relationship between load factor and price trends through the booking season. The relationship is much more complicated and more specific to the circumstances of the specific cruise.

Returning to coordinated interaction theory, I think of coordinated interaction theories as being in one of four categories. First, we have the small numbers theory, 3 to 2 mergers for example, which because of the "baby food" cases have a very strong presumption that they are illegal. But more generally than that we have cases in which we are able to show the number of competitors actually makes a difference. The data may show that there's a correlation between the level of prices and the level of concentration or the number of competitors. Another theory comes from dynamic oligopoly theory. The focus of this theory is: Are the facts consistent with achieving a consensus, detect deviations, and the punishment of deviations? (*See*, for example, the European Court's decision in *Airtours*).

Third, you have the theory of the maverick, which Jon Baker has written a lot about. These cases can be easy, as you've got a good argument. The factual argument is that the maverick is going to be absorbed by one of the non-mavericks. In markets where the maverick can be demonstrated by sound evidence that it is really important to the state of competition, that's obviously an easy case.

And then finally, is there evidence of existing coordination?

We did an analysis of these coordinated interaction pricing theories. We tested the small numbers theory. We did that in various ways. We looked at concentration in different areas, such as in Alaska versus the Caribbean (and many other comparisons), and we analyzed how changes in concentration over time impacted prices in these geographic areas. Essentially we analyzed what we call a "natural experiment." (This sort of natural experiment analysis is one of the most important tools in analysis of mergers).

As I mentioned before, the growth of the cruise industry has led to increases in concentration but also to falling prices. In addition, to this general macro data trend, our analysis of individual geographic trades did not show a relationship between the number of parties and "price."

The next thing we looked at was whether we could find something equivalent to the airline business traveler. We did a lot of analysis trying to identify the cruise equivalent of the business traveler. One of the first things we looked at was cabin type. There are balconies, there are suites, there are inside cabins, and they vary significantly in price. So, was there effective price discrimination? This is an area in which Pablo Spiller helped us with the theory. He said, well, if you have more effective price discrimination in balconies, what you should see is a different distribution of prices. You should see a tighter distribution of prices for balconies compared to the distribution of prices for inside cabins. Essentially, you might see everyone in a balcony cabin paying "close" to the same price, but then you see inside cabin prices all over the place as they were just looking for cabin purchasers to fill up the ship.

So both BE and the parties looked at that theory in the data. We did various summary statistical measures like coefficient of variation, but I'm a practical guy so I say I want to see the histograms. This histogram (p. 31 of the full Web site presentation) shows the percentage of the sales for two different cabin categories at various prices. This is one representative example for one sailing, which showed there was no evidence that there was a difference in the distribution of prices for outside cabins than for inside cabins. If you look at the variation in prices, outside cabins did not look different than inside cabins, instead of more grouped together at the high end if outside cabins were a price discrimination market. That's not surprising, because it goes to whether cruises are the market, as people are making the decision of whether to go on a cruise or take some other form of vacation. So people who buy balconies are thinking about having a balcony or going to a fancy Caribbean resort and people buying inside cabins are thinking about doing that or driving to Disneyland. So it's not obvious why there would be a difference in distribution of the prices.

The next thing we looked at was time of booking. Is there a relationship between the time people book and price? Is there something systematic happening like the cruise lines are harvesting early bookers or late bookers? Remember, in the airlines it's the late bookers that are harvested but it's more complicated than that. It's late bookers who will not purchase non-cancel tickets.

This slide (p. 34 of the full Web site presentation) is very complicated, and you'll have to look at this on the Web to digest this. Cruises are booked over a period of roughly eighteen months. What we did is analyze the percentage of cabins booked at different time points. We looked at a number of different measures. So, in this example we looked at how many of the ships' berths were booked 120 days or more out from the date of sailing. What this bar graph shows, and this is across all sailings, is what percentage of all sailings had sold what percentage of their cabins by 120 days prior to sailing. So this 55 percent bar here says that ships for which 55 percent of the berths were booked 120 days or more out account for about 8 percent of all sailings. So about 8 percent of all the cruises we had transaction data on had 55 percent of their sales more than 120 days out. What this summary measure shows is that there is no consistent pattern as to when sailings are booked—that it is all over the place. So, one idea was to see if cruise companies could get people to pay higher prices closer to the time of sailing. The problem is you cannot tell how fast people are going to book. Any given ship may book up really fast or it may book up slowly. It's very hard to tell ahead of time. Yield management is about trying to manage what happens when the average does not happen. So there's just tremendous variation in bookings.

Remember why 120 days is important. Most of the bookings are made when there is not a significant penalty for cancellation. In fact, something like 3 of 4 bookings are cancelled. So it's like the leisure air travel market, and as far as I know, I do not think that DOJ has brought an airline case specifically on the leisure market as opposed to a fortress hub case focusing on business travel. But again cruises are different in some important respects than airlines. If you add a new airline that goes between Dallas and Des Moines, load factors are going to go down on that route and fares are going to go down. What's different about cruises is you always find enough people to essentially fill up your boat to practical capacity on average over all the seasons.

The last main theory on price we investigated with the data was stimulated by the lawyers. In depositions and documents there were indications that the cruise companies cared a lot about what the price was early in the booking season. The reason for this is the way yield management systems work, which is that you try and calibrate the system to get out there with the right early price and then work off that. So it's understandable why they were concerned about that because that's the fundamental input of yield management. So the theory was, well, yes, this pricing is really complicated but, it's simple because they'll just coordinate on the early price and they'll raise their early price and that'll drag all the other prices up.

Now my first reaction to that was, wait a minute, that's the list price theory. That's like taking an industry where there are list prices and saying there seems to be coordination on prices because the lists are similar. But the problem with that is the actual transaction prices might be all over the place. We already knew that transaction prices were all over the place, so this was not much of a theory. But it needed to be tested, so we looked to see if there was a relationship between the early price and what prices were later. We looked at this in a lot of different ways. We looked at the data and found a price that seemed to be the early booking base price and then looked at what percent of this price did the later bookers pay. What this chart (p. 36 of the full Web site presentation) shows is that the discount off the early price varies a great deal. That is, there is no systematic relationship between the early price and what happens later, which is not surprising if you set the early price wrong. If you set the early price wrong, you are going to have to lower your price a lot or you may not drop it as fast or you may even raise it. That led us to another analysis.

This chart (p. 39 of the full Web site presentation) looks at the difference between the average price for bookings made before and after 120 days prior to sailing. It shows the distribution for all cruises for three years. For example, for 14 percent of all cruises the average later price was 15 percent below the early price. But for 6 percent of all cruises the later price was 5 percent higher than the early price. In essence, they made a mistake and set the early price too low. So again, it's all over the map. There isn't a systematic relationship between the early price and the later prices.

we're going to ask for all the data we need and we won't stop asking until we get it. We're going to analyze it. You can look at our best practices on the Web site. If you meet us halfway, we'll tell you what we're doing with it, we'll tell you what results we're getting.

We did a number of other analyses. We did statistical and econometric analyses of all sorts. For example, we did various correlation analyses. We also tried to model econometrically the relative importance of competitors' prices versus load factors and other things on pricing. David Meyer tried a lot of different models and found nothing conclusive, other than the fact that on average the load factor was more important than anything else, but even that was not very consistent as an explanatory variable. All of these analyses informed the way we thought about things, and then we translated it into something that the lawyers and Commissioners would find was credible evidence.

At the end of this data analysis, I think staffs were in agreement on the viability of a pricing theory. We did not have a viable pricing theory. We had a problem with market definition, although we thought we could sustain that in court—at least for a hypothetical monopolist. But we had a real problem with a viable price theory, given what the data showed.

The obvious thing, the easier thing, would be to focus an anticompetitive agreement on capacity instead of price. But there were a number of problems with a capacity theory. First, there was a lot of capacity already committed to coming on line in the next few years. The industry was going to increase capacity almost 30 percent over the next few years—a very rapid increase. Most of these commitments were firm. And the history in this industry showed that any cruise ship that can still sail will, as we've had cruise companies go under and someone else gets that cruise ship and sails it.

In assessing the viability of capacity theories we did a lot of financial analyses. In one of our financial analyses, we looked at the profitability of adding ships taking into account potential cannibalization. We looked at coordination industry-wide or by hypothetical colluding groups. We did a lot of analysis of various types that looked at the profitability of redeployment. (Another problem with capacity theory, consistent with some of the analysis in the European *Airtours* decision, was that in Europe the big travel agents entered and added capacity, about 30 to 40 percent capacity increase, in a couple of years. This suggested a possible problem with showing entry barriers.)

Let me conclude by stating that data analysis is not a one-way street. Data analysis in this case may have rebutted the coordination case for some Commission decision makers, yet in the other case Joe talked about, it has provided important support for a case. So data analysis is not the secret for getting difficult cases through. We won't know until we analyze the data. In any event, we're going to ask for all the data we need and we won't stop asking until we get it. We're going to analyze it. You can look at our best practices on the Web site. If you meet us halfway, we'll tell you what we're doing with it, we'll tell you what results we're getting. We're interested in hearing your ideas and seeing what you have. Janet McDavid can tell you about how she worked with us on that.

Finally, importantly, what I reported was not "rocket science." It was basic economic and financial analysis of data that anybody (you do not have to be an econometrician) could understand. Even though there was in some cases econometrics or statistics underlying the analysis, we are able to present the analysis in a way that the decision makers could fully understand and assess its weight in light of other evidence in the investigation. ●

Interview with
R. Hewitt Pate, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice

January 6, 2003

R. Hewitt Pate

Editor's Note: *The Antitrust Division's leadership is in a period of transition with the departure of Charles James, William Kolasky (International Deputy), and Michael Katz (Economics Deputy). On November 15, 2002, Attorney General John Ashcroft announced that R. Hewitt Pate had been named the Acting Assistant Attorney General for Antitrust. In this interview,* The Antitrust Source *discusses Acting AAG Pate's goals for the Division during this transition period and his views on issues of current interest to the antitrust practitioner, including the merger clearance process, the role of economic analysis, gun jumping, remedies, and the* Goldwasser *decision.*

Preceding his appointment as Acting AAG, Mr. Pate served as a Deputy to Charles James, overseeing transportation, airline, energy, and regulatory matters. Prior to joining the Antitrust Division in 2001, Mr. Pate was a partner at Hunton & Williams, where he litigated cases involving antitrust, patent, trade secrets, false advertising, and other business tort issues. In 1999, he was Ewald Distinguished Visiting Professor of Law at the University of Virginia School of Law, where he taught Unfair Competition.

Mr. Pate graduated first in his class from the University of Virginia School of Law, where he was a member of Order of the Coif and the Executive Editor of the Law Review. After law school he clerked for Supreme Court Justice Anthony Kennedy (1989–1990), former Supreme Court Justice Lewis F. Powell, Jr. (1988–1989), and Judge Harvie Wilkinson III, U.S. Court of Appeals for the Fourth Circuit.

ANTITRUST SOURCE: Everybody is interested in knowing how things have changed as a result of your appointment as Acting Assistant Attorney General. Can you tell us a little bit about how responsibilities have been reshuffled?

R. HEWITT PATE: Debbie Majoras and I are trying to use this interim period to make sure that the Division and its enforcement work stay on track, that we follow through on a number of initiatives that Charles James started, and that we keep the Division running well and doing high quality work. Debbie is now the Principal Deputy at the Division. That means that she is responsible for a very broad range of matters, and all six of the civil sections now report directly to Debbie. On the international front, Ed Hand (who is the Foreign Commerce chief) is serving as the Acting International Deputy for the present time. We are also heading towards a transition at EAG with Michael Katz departing as the Economics Deputy. So we have a lot of change going on at the Division. Sometime in March, David Sibley will succeed Michael Katz as the Economics Deputy. We hope to add an additional Legal Deputy soon. If we can get an additional Legal Deputy on board while I am here as the Acting AAG, international matters probably will be a primary part of that Deputy's focus.

ANTITRUST SOURCE: During this current period before an AAG is nominated and confirmed, what do you expect the priorities within the Division to be?

PATE: I am not sure I can add much more to what I just discussed. I do not think that in the Acting position it is incumbent upon me to announce any broad policy initiatives or directives. I think Charles's primary message was that we want to do good law enforcement, to continue to focus on criminal enforcement, to run the merger program well, and likewise to bring the appropriate civil non-merger cases when and where we find them. Particularly during this interim period, the key thing is to make sure that the Division operates well. So, for example, training, litigation management, and things like that, are going to be a focus for us. We are having a retreat and management meeting, combined with the Antitrust Institute, a training session for our new attorneys and economists later this month. Connie Robinson, the Director of Civil Enforcement, has been working very hard on these events. This sort of nuts and bolts work is where we need to keep our focus for the next few months.

ANTITRUST SOURCE: Does the Division intend to initiate any Section 2 cases?

PATE: At any given time we have many investigations ongoing, and if we find an appropriate Section 2 case we certainly will bring it. But I do not have for you today a pre-announcement of any sort of case.

ANTITRUST SOURCE: Would Section 2 rank high or low on your list of priorities?

PATE: I really would not characterize it that way. Section 2 ranks co-equally as an important part of the Sherman Act, which is one of the key statutes we enforce. I do not have a rank order of priorities in mind. Criminal enforcement is an extremely important part of what we do, as are the merger program and the civil non-merger program. We have to do a good job in all areas.

ANTITRUST SOURCE: The Division disbanded its Health Care Task Force last year, and in the merger allocation agreement conceded most of the health care area to the FTC. However, the DOJ recently entered into a consent agreement with Mountain Healthcare,[1] which raises the question whether the Division intends to play an active role in antitrust health care enforcement. Can you comment?

PATE: Let me start out with respect to what you referred to as the "merger allocation agreement"—that being the initiative that FTC Chairman Tim Muris and Charles James undertook to more clearly set forth for the bar and other interested parties how the FTC and the DOJ were going to go about sharing their antitrust enforcement jurisdiction. As it turned out, while I think the effort that was made on the clearance agreement was worthwhile, it did not result in the announced allocation agreement that the Agencies had initially advocated. It is true that in the health care area, in the energy area, in the media area, and in other areas, the clearance agreement would have made

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[1] Press Release, U.S. Department of Justice, Justice Department Requires Mountain Health Care to Disband (Dec. 13, 2002), *available at* http://www.usdoj.gov/atr/public/press_releases/2002/200552.htm.

some of the allocations crisper and clearer. That clearance agreement did not remain in force, however, and it is not being enforced now, so there has not been any de facto attempt to follow the clearance agreement. We have tried to continue in place what some of the congressional and other commenters on the clearance process suggested, which was to work hard on trying to make the clearance process that we had under the existing agreement work well. And I think while the level of merger activity has not been high, we have made some improvements in trying to avoid unnecessary delay or contention between the FTC and the Division on clearance matters.

But, with all that wind-up, you wanted to ask about health care. We did have a temporary Health Care Task Force. By definition it was a task force—it was not a full fledged section. As part of Charles's reorganization last year, he put health care, which is a very important area of the economy, on a footing with other industries and assigned health care to lawyers in the existing sections. The Division is going to continue to be active in health care. The Asheville case you mentioned does not really represent any sort of a change in what we have seen following the demise of the clearance agreement. We are going to continue to be fully engaged in health care antitrust enforcement. We may have some different emphases than the FTC; for example, Charles often mentioned the insurance side, which had been expressly reserved for the Division under the clearance agreement. That may be a focus for us, whereas Tim Muris, for example, has announced that he is interested in looking at consummated hospital mergers.

The long and short of it is that we continue to be, and expect to be, an active player on the health care front. I was recused from the *Mountain Health Care* case so I do not want to get too much into the details of that particular matter. I can talk about what was publicly reported when the matter was resolved—I think it is a traditional provider-side case of the type the Division has been involved in and the announcement we made about the case speaks for itself.

ANTITRUST SOURCE: How will the Division and the FTC allocate responsibility for health care mergers going forward?

PATE: We are going to apply the clearance agreement that we have. I do not have in mind any sort of a formal allocation. We are going to continue to be active in the health care area, and I know that Tim Muris is very interested in it. So far I would say that we work together well and I do not see any clearance problems on the horizon. I hope we will not have any.

ANTITRUST SOURCE: There are two significant projects underway at the Division: a review of how the Division evaluates coordinated effects in merger cases, and the antitrust remedies study. What is the status of those efforts?

PATE: Let me start with the Coordinated Effects project and describe it together with the Remedies project that Charles James initiated, because I think my answer is going to be roughly the same for both, which is that these were important initiatives that Charles got underway, and one of the things I hope to do while I am here as Acting AAG is to keep them moving forward. On the coordinated effects side, Andrew Dick and others at EAG have been doing a great amount of work in collecting economic literature, case law, past Division practices, and analyzing them in order to provide resources for doing our jobs better. I am not sure what form it will take, but I am sure that some of the fruits of our efforts will be shared with the bar and other interested persons through speeches as the year progresses. I think the same is probably a fair description of the status of the Remedies project. On the merger side, we have had some staff taking a look at past lessons we have learned and hopefully what future best practices we can develop. In terms of how our work might be shared with the bar and other interested persons, it is probably going to be through Division employees' participation in ABA panels, Conference Board panels, and other sorts of CLE programs.

ANTITRUST SOURCE: When can we expect announcement of the results of these studies?

PATE: I do not know if there will be any formal "announcement," but I think you will start to see some of the benefits of these initiatives beginning in the spring and throughout the rest of 2003. I would say the timetable is roughly the same for both.

ANTITRUST SOURCE: Telecommunications has been a focus area of yours, at least prior to taking your current position as Acting AAG. The Division has recently recommended the approval of many of the Regional Bell Operating Companies' Section 271 requests to provide regional long-distance services after a history of generally refusing to go along with those proposals. Does that reflect a change in the Division's policy or does the Division believe that the competitive landscape has changed?

PATE: No, I do not think it reflects any change in policy. From my perspective, I look at the Division's 271 work as having developed in three stages. The first stage took place when Joel Klein was AAG and Marius Schwartz and others worked to develop the standards for evaluating 271 applications. During this time the Division reviewed several initial applications. I do not think it is surprising that many of the initial applications did not meet with success. At that time this was all a very new enterprise; incumbents were just coming to grips with some of their responsibilities, and the Department was coming to grips with the standards to apply. Then, in the second stage of the 271 work, there were a larger number of applications that represented an attempt to work through the process of trying to get, for example, OSS up to the standard that would support competitive entry which, as you know, was an issue in a number of those applications. In a number of cases, two or three applications were required in order to iron out some of those problems. I think now we are in a third stage in which it is pretty clear what standards the Division is going to apply. A number of the incumbents operate their systems on a regional or system-wide basis, and so, as almost all of them have generally moved through the process of getting at least some applications successfully completed, it is not very surprising that follow-on applications will be more likely to meet with success. So I think we are coming to a phase where the remaining applications are likely to go through in a more predictable and smoother fashion. That does not mean we are changing what we are doing. We have a number of talented people in the Telecommunications and Media section who are very carefully going through applications to make sure that the incumbents are meeting the obligations they have to meet in order to get a 271 application approved. I do not know whether there has been a change in the competitive landscape. There have been some recent media reports suggesting such a change—I think in particular of a recent *Wall Street Journal* article that suggested that there has been an uptick in competitive entry in regional telephone service. On the other hand, our standards for evaluating 271 applications have never focused on a particular threshold of entry as the standard. Rather, they are focused on whether the systems or practices of the incumbent are open to competition so that entry could take place. So, while I think there are some hopeful signs in terms of competitive entry, that is not really the focus of our 271 work as a test for decision.

ANTITRUST SOURCE: The FCC is reportedly planning to end the requirement that the Regional Bell Operating Companies offer their networks to competitors at wholesale rates. Has the Division been involved in that or been consulted about it? What's your view of it?

PATE: On 271 matters, for example, we work closely with the FCC. In terms of the rulemaking that is ongoing, no, I would not say that we have been participating directly in that. And as to the media reports, I think you must be referring to a report I saw today that indicated the FCC had in draft some proposal to change the TELRIC principles or the wholesale rates at which it requires RBOCs to offer service. I do not think it would be appropriate to comment on something that, as far as I know, is just a single media report that I saw for the first time this morning.

ANTITRUST SOURCE: A follow-up question on the Division's view of the *Goldwasser*[2] case in the Seventh Circuit. Reading the amicus briefs filed in the *Covad*[3] matter in the Eleventh Circuit and recently in the *Trinko*[4] case (which has a petition for certiorari pending), the *Covad* brief seems critical of *Goldwasser*, but the *Trinko* brief seems to take the Second Circuit to task for not following *Goldwasser*. Is there any tension in the positions taken in those two amicus briefs, and does the Division still stand behind the brief it filed in the Eleventh Circuit in the *Covad* case?

PATE: I do not think there is any tension in those positions. The Division, as far as I know, stands behind every brief that we have filed in the so-called *Goldwasser* area, whether it be the *Intermedia*[5] brief, the Eleventh Circuit *Covad* brief, the *Trinko* amicus brief in support of cert that we recently filed, or the *Covad*[6] D.C. Circuit brief that we recently filed. While different people have read Judge Wood's decision in *Goldwasser* in different ways, we think it is very important that that case not stand for the proposition that there is any sort of implied repeal of or implied immunity from the antitrust laws in areas that also happen to be covered by the obligations of the 1996 Act. I think you will notice in *Trinko*, which did not primarily address that issue, we reiterated our position. On the other side of the coin, we think it is important for courts to understand that the obligations of assistance imposed by the 1996 Act, which include very detailed duties of assistance at rates that are determined through processes put in place by and under standards promulgated pursuant to the 1996 Act, do not, by virtue of the 1996 Act, become part of the generally applicable Section 2 standards of antitrust law. I think we have been consistent in putting out both sides of that message in all the briefs that you mentioned.

ANTITRUST SOURCE: Is a failure to comply with the '96 Act requirements irrelevant in your view to the determination of whether or not there has been an antitrust violation?

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[2] Goldwasser v. Ameritech Corp., 222 F.3d 390 (7th Cir. 2000), *available at* http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=7th&navby=case&no=981439.

[3] Brief of Amici Curiae, Covad Communications Co. v. BellSouth Corp., No. 01-16064-C (11th Cir. Dec. 17, 2001), *available at* http://www.usdoj.gov/atr/cases/f9700/9708.htm.

[4] Brief of Amici Curiae, Verizon Communications, Inc. v. Law offices of Curtis V. Trinko, No. 02-682 (2d Cir. Dec. 2002), *available at* http://www.usdoj.gov/atr/cases/f200500/200558.htm.

[5] Brief of Amici Curiae, Intermedia Communications, Inc. v. BellSouth Telecommunications Inc., No. 01-10224-JJ (11th Cir. Mar. 28, 2001), *available at* http://www.usdoj.gov/atr/cases/f7700/7777.htm.

[6] Brief of Amici Curiae, Covad Communications Co. v. Bell Atlantic Corp., No. 02-7057 (D.C. Cir. Dec. 17, 2002), *available at* http://www.usdoj.gov/atr/cases/f200500/200567.htm.

I think it is very clear that simply to assert any violation of the standards of the '96 Act or even a series of violations of the '96 Act does not necessarily amount to an antitrust violation. I think most courts have been pretty consistent on that point, and our briefs certainly have been.

PATE: I am not sure that I know exactly what you mean by the question. Is it possible that conduct that could violate an obligation of the '96 Act might also violate the antitrust laws? I think we have been clear in saying that the answer is yes, that the fact that conduct is covered by or in the same area as, or to use the term that the *Goldwasser* court did, "linked with" conduct covered by the '96 Act does not mean that the antitrust laws are displaced. On the other hand, I think it is very clear that simply to assert any violation of the standards of the '96 Act or even a series of violations of the '96 Act does not necessarily amount to an antitrust violation. I think most courts have been pretty consistent on that point, and our briefs certainly have been.

ANTITRUST SOURCE: With regard to the wireless industry, there's been a lot of talk in the press about potential consolidation. How would the Division look at mergers between significant players in the wireless industry?

PATE: Ever since I started working at the Division eighteen months ago, I have been told that any day we would be seeing either a major transaction or a series of transactions in the wireless industry, so your guess is as good as mine as to whether or when that might happen. Over the past few years and in these past eighteen months, we certainly have seen a move toward a situation where we have six national players, and different numbers of players in various markets across the country. We would look at a wireless merger in the same way and use the same tools to review any other merger in the telecom area or otherwise. I think these transactions will raise some interesting issues that we have not seen posed in recent transactions, and we will have to take a careful look at the market in each case. By that I mean we must consider issues such as the possible substitution of wireless service for landline service. Certainly the U.S. is not in the same position as Europe on that front, but there is no question there has been some substitution of that type, so market definition issues will be interesting when and if those transactions occur. Another interesting issue may arise if one of these transactions is announced, and it is followed closely by a string of others. The Division may find itself in one of those situations where a number of transactions are pending. But the bottom line is that we will use the traditional tools and methods that we always use in looking at any mergers that come up.

ANTITRUST SOURCE: In the wireless setting, is there an argument that consolidations would be procompetitive because of the efficiencies in generating improvements in existing services and deployment of new so-called 3G services?

PATE: On that point, I would be very surprised to see a merger come to the Division where the parties did not make the argument that consolidation would lead to greater efficiencies that could be enjoyed faster if the merger were allowed to go through. In the context of 3G development, or otherwise, that might be one of the features that is held out as a beneficial part of the merger; it might depend on which of the carriers was seeking to combine with which other carrier. So, I do not know without being able to get into the details of it what we would do if an actual transaction came up.

ANTITRUST SOURCE: Let's turn to international competition issues. Can you describe for us the recent work that members of the Division have been involved in for the International Competition Network?

PATE: We have put a lot of effort into the ICN. It is an organization that is particularly valuable for the enforcement community because it is composed of government officials who are actually involved in doing enforcement work, as opposed to some of the broader bar and other groups that sponsor most of the educational and policy programs in the antitrust area. It has the benefit of being a virtual organization without a bureaucracy. While he was International Deputy, Bill Kolasky chaired the ICN merger working group. Since Bill has departed, Debbie Majoras has taken over that task, at least for the present time. In terms of programs, Connie Robinson, our Director of Civil Enforcement, and some of her staff put a tremendous effort into a recent conference that we held on investigative techniques. There were approximately 40 countries represented at this meeting in Washington. We had almost 100 lawyers and economists at the conference, and the Israeli Competition Authority took a significant part in developing the program, as did others. We will continue to have a variety of programs at which enforcers from various countries come together and discuss their experiences, discuss how their different approaches work, and hopefully learn from one another.

ANTITRUST SOURCE: What is the Division doing or planning to do with the information gathered at the joint DOJ-FTC Intellectual Property hearings?

PATE: As the year unfolds, I think that we will be working toward the development of a joint report with the FTC. I am not exactly sure what format the report will take, but we expect to work closely with the FTC and to arrive at a joint product that will be useful to the bar and to others in this area. We certainly conducted extensive hearings, received a lot of written material from a lot of very smart people with a lot of experience in this area, including academics, lawyers, corporate witnesses, and others. I am not sure about the timeframe, but it is something that Susan DeSanti over at the FTC and Frances Marshall, who is our Senior Counsel for Intellectual Property at the Division, are going to be giving their primary attention for 2003.

ANTITRUST SOURCE: Do you expect the report to issue this year?

PATE: That would be my hope.

ANTITRUST SOURCE: Is there any possibility that it will issue in conjunction with or lead to the issuance of new Intellectual Property guidelines?

PATE: I do not have in mind any revision of the IP guidelines right now. That is not the goal with which the hearings were undertaken. I would not rule out that at some point it might make sense to revise the IP guidelines, but I think it is more likely that what you will be seeing is a joint report of the type I have mentioned.

ANTITRUST SOURCE: Another initiative that Charles James mentioned last year was that the Division would be providing guidance to the bar and business community on gun jumping under the HSR Act. Is that initiative still in process?

PATE: Yes. The form that guidance is likely to take is going to be speeches and appearances by Division staff at various events. I talked about gun-jumping at a recent antitrust panel. More importantly, the way the Division makes clear its position on the law and on enforcement is to undertake investigations and bring cases. On that front we may see some developments this year in terms of gun-jumping cases. It is something that we take very seriously.

More broadly than the gun-jumping area, one of the things we want to focus on in the Division is making sure that the rules that govern the HSR process are respected and that the Division's requests for information are respected, and so that sort of enforcement of process is going to be an important focus for us.

ANTITRUST SOURCE: Can you give us a status report on how the Merger Review Process Initiative is working out?

PATE: We think it has been a tremendous success so far. We think it can be even more useful than it already has been as counsel begin to understand the opportunities that exist to make the process work better. As you know, under the Merger Review Process Initiative, we held out the possibility that where appropriate, counsel can agree to undertakings with respect to a schedule for decision and a schedule of meetings with officials at various levels of the Department, so that we can attempt to focus investigations in a way that will lead to a quicker and better resolution. While I cannot go into the details of specific cases, I have in mind several situations where that has been done and where, by getting cooperation with the parties up front in terms of access to information, we have been able to focus on potentially dispositive issues and to bring an investigation forward. At the same time, this has both minimized the burdens of the process, and, more importantly, allowed us to obtain the information that will help us make an appropriate decision about whether to challenge a merger and make us better prepared to challenge it if necessary. It takes two in order for this process to work, though. Counsel need to understand that the Merger Review Process Initiative is not a one-way street in which we expect them to come and demand things from us. If parties want the process to work better, that means they are going to need to be forthcoming and responsive in their dealings with us during an investigation. But I think the answer is, so far so good. We think it has been a tremendous success. While the level of merger activity has not been anywhere near what it was during the '98–'99 merger boom period, we think that efficiencies of the process will be even more important in periods where we return to higher levels of merger activity, which history would show is likely to happen at some point.

On that front we may see some developments this year in terms of gun-jumping cases. It is something that we take very seriously.

ANTITRUST SOURCE: Has here been any attempt to quantify the increased efficiencies associated with the Merger Review Process Initiative?

PATE: I do not have any quantification in mind right now. I think it may be too early to say that I can demonstrate in a quantifiable way efficiencies from the Merger Review Process Initiative.

ANTITRUST SOURCE: What is the Division's current thinking on challenging mergers that have already been consummated?

PATE: It is certainly the case that we can always challenge a consummated transaction if we find a violation, and we would be ready and willing to do so if circumstances warrant it. I think it is obvious, however, that challenging a transaction after it has closed, particularly if it closed a long time ago, is a much more difficult undertaking than stopping a transaction that should not have gone forward in the first place. So my answer would be that we would not rule it out, but we recognize that it would be a difficult undertaking.

ANTITRUST SOURCE: The FTC has expressed an affirmative interest in attacking health care mergers after they have been consummated. Has the Division's appetite for post-consummation merger enforcement increased?

PATE: No, I think the considerations that I mentioned have historically guided us and will continue to guide us in the future. I do not think there is any pronounced change of appetite. If it is appropriate, we will do it, but there are difficulties involved in post-consummation challenges.

ANTITRUST SOURCE: Is there anything going on at the Division with respect to analyzing the role of efficiencies in merger analysis? And are there any plans in the works for new merger guidelines?

Factual investigation is critical. It cannot be replaced by running simulation-based exercises. Rather, econometrics and other techniques can supplement and be an important tool in merger investigations.

PATE: There are not any plans afoot for any new merger guidelines. You may recall that Charles James said that he would be perfectly pleased if he were able to complete his tenure as AAG without the promulgation of guidelines. That being the case, I have not inherited any such project, and I certainly do not have any intentions to start a project like that now. As to efficiencies, I think you can always expect to hear more from the Division on efficiencies because it is such a perennial topic of antitrust programs. We think they are an important part of doing good merger analysis.

ANTITRUST SOURCE: What are the Division's current views on the use of econometrics in merger investigations?

PATE: Econometrics can be an important tool in merger investigations. Our economists stay up to date on econometrics and are very comfortable with it. As with all economic evidence, I would say that econometrics and other simulation-based work can be important and helpful. On the other hand, we cannot lose sight of the fact that we need to develop the actual facts that relate to the competitive situations we are addressing. Factual investigation is critical. It cannot be replaced by running simulation-based exercises. Rather, econometrics and other techniques can supplement and be an important tool in merger investigations.

ANTITRUST SOURCE: How does that comment relate, if at all, to the decision to challenge the Echo Star Direct/TV merger[7]?

PATE: My comment was not directed toward the Echostar/DirectTV merger, but I will say that based on the facts that we developed in our investigation of the merger and based on the economic work that a number of our good economists at EAG undertook, we thought it was quite clear that the merger needed to be challenged. We did that, and we are pleased that the merger did not go forward, because that's going to preserve competition in all areas of the country. In more populated and urban areas, it's going to ensure at least three providers for satellite or for MVPD services. In more rural areas, the merger would have had many attributes of a two-to-one transaction and left many of viewers without any choice at all as to their MVPD provider.

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[7] United States v. Echostar Communications, Corp., Civil No. 1:02CV02138 (D.D.C. Oct. 31, 2002), *available at* http://www.usdoj.gov/atr/cases/f200400/200409.htm.

ANTITRUST SOURCE: Was there any way that that transaction could have been fixed?

PATE: I am not going to speculate on that. Our job is to take the transactions as proposed and try to evaluate whether or not they comply with the law. There was a lot of speculation in the press about what might, could, or should have happened with that deal that involved a lot of parties. That is for those private parties to deal with, and not for me to speculate about.

ANTITRUST SOURCE: You have noted a decline in the amount of the number of mergers brought to the Division for analysis. Has that resulted in a reallocation of resources to non-merger activity?

PATE: It has not resulted in any reallocation. Certainly we have had more time to put into policy initiatives, such as reviewing coordinated effects, remedies, and merger process. It has been easier, for example, to find time to devote to training activities that are designed to enhance our litigation capabilities. We always try to make a good use of attorneys' and economists' time, no matter what is the level of merger activity. I think we are doing that, but we have not reallocated anyone's functions on the basis of merger activity levels. ●

Paper Trail: Working Papers and Recent Scholarship

***This edition of the* Paper Trail** *notes two lengthy recent articles, both of which use empirical methods to address issues involving industries whose complexities have posed special challenges for antitrust courts. In the first, Mark Lemley examines how standard-setting organizations (particularly in high-technology network industries) regulate the incorporation of firms' intellectual property into the standards that they adopt. In the second, Peter Hammer and William Sage report and analyze the results of an extensive empirical study of opinions in cases involving antitrust in health care markets. The study focuses on how courts factor issues of quality into their antitrust analyses.*

As always, suggestions for coverage in the Paper Trail *are welcome. Please email John Woodbury (jrw@crai.com) or Bill Page (page@law.ufl.edu).*

Papers and Summaries

Mark Lemley, Intellectual Property Rights and Standard-Setting Organizations, 90 Cal. L. Rev. 1889 (2002)

In this article, Mark Lemley examines how standard-setting organizations (SSOs), particularly in network industries, deal with firms' actual or potential claims of intellectual property rights in proposed standards. He surveys forty-eight SSOs and finds significant diversity in their IP requirements. Most require disclosure of IP rights or insist on royalty-free licensing of rights in standards. But the SSOs differ in the nature of rights they regulate and in the extent to which they require firms to search for potential IP claims in proposed standards. Lemley considers when a firm's concealment of IP rights in the standards process should result in contract, tort, or antitrust liability.

The primary antitrust focus in the piece is on the possible liability of the standard-setting organizations themselves for, e.g., insisting on licensing of IP rights in the standards process. Lemley argues that antitrust courts should be highly deferential to SSOs' efforts to "clear overlapping IP rights, particularly in network markets where standardization is important" to competition and innovation. He characterizes the standard-setting process as a form of "messy" but generally efficient private ordering that ameliorates some of the anticompetitive potential of IP rights in particular industries. In the final section of the piece, Lemley suggests seven principles SSOs should follow in formulating their policies. For example, he recommends that they "permit licenses that control fragmentation" and "give content to the reasonable and nondiscriminatory licensing requirement."

For some recent articles on related issues, see Michael G. Cowie & Joseph P. Lavelle, *Patents Covering Industry Standards: The Risks to Enforceability Due to Conduct Before Standard Setting Organizations*, 30 AIPLA Q.J. 95 (2002); Janice Mueller, *Patenting Industry Standards*, 34 J. Marshall L. Rev. 897 (2001); Mark R. Patterson, *Inventions, Industry Standards, and Intellectual Property*, 17 Berkeley Tech. L.J. 1043 (2002).

—WHP

Peter J. Hammer & William M. Sage, Antitrust, Health Care Quality and the Courts, 102 Colum. L. Rev. 545 (2002).

In this article, the authors examine the problematic role of health care quality in antitrust analysis. They note that antitrust courts are relatively comfortable with determining the likely effects of practices on price and output, but have more difficulty incorporating considerations of quality, even in industries like health care, in which quality is obviously central to the functioning of the market. Hammer and Sage adopt the novel methodology of conducting an empirical analysis of all judicial opinions addressing antitrust and health care between 1985 and 1999, focusing on the courts' treatment of issues of health care quality. They gave student research assistants (for which all law professors should be very grateful) a "coding instrument" to analyze each case according to "the descriptive characteristics of the parties, the procedural posture of the case, case outcomes, the substantive antitrust allegations discussed by the court, the methods of antitrust analysis performed by the court, and a lengthy set of quality and nonprice concerns."

The survey results are provided in a series of tables, which we can't hope to summarize. The authors observe that over 90 percent of health care cases are private, and most of these involve physician/hospital disputes, almost all of which the defendant won on a pretrial motion. The authors marvel at the remarkable persistence of these lawsuits despite their abysmal success rate. Given the prominence of this kind of suit, the authors conclude that private antitrust litigation in health care serves no obvious social purpose.

Public enforcement, on the other hand, was found to be far less common, with a very different focus: The authors note "Compared to private litigation, public enforcement concentrated on policing corporate combinations (48% of public disputes), and maintained a substantial presence in insurance (29%) and information (13%) cases, while devoting few resources to exclusive contracting (10%) or staff privileges (2%) disputes."

The study's data do confirm that, although courts frequently acknowledge quality concerns in antitrust cases, they have no good theory of nonprice competition or how to take account of it in antitrust analysis. For example, "[t]he theoretical effects of competition on quality in health care markets are largely uncontested." A variety of influences leads courts to frame issues in terms that avoid any real examination of quality, except in the limited sense of preserving consumer choice. (The authors note that in a few merger cases, courts "veer toward heresy, explicitly questioning the desirability of competition as a vehicle for determining the cost and quality of medical services.") The authors observe that, although *California Dental* may seem to express "judicial skepticism about the effects of competition in health care," the Court's reasoning is conventionally economic, resting on a finding of asymmetric information and the possible procompetitive effects of the advertising restrictions.

Hammer and Sage conclude that:

> it is our impression in reviewing the cases in conjunction with the results of the survey instrument that courts deciding medical antitrust issues managed to get the big picture right. By applying traditional antitrust principles to health care markets, courts helped break down professional resistance to price competition. After managed care took hold, courts by and large were not deceived by self-interested efforts to use the antitrust laws to undermine its growth. Moreover, some courts have begun to sense and address the competitive risks of integration and consolidation within managed care.

—WHP