Antitrust Remedies in the 21st Century:
Too Many Actions? Too Much—or Still Too Little—Recovery?

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MODERATOR

Roxane C. Busey
Chair, ABA Section of Antitrust Law, and Partner, Gardner, Carton & Douglas, Chicago, IL

PANELISTS

Michael L. Denger
Partner, Gibson, Dunn & Crutcher, Washington, D.C.

Harry First
Professor, New York University School of Law

Robert Pitofsky
Professor, Georgetown University Law Center

Hon. Susan Illston
U.S. District Judge, Northern District of California

Hon. Lewis A. Kaplan
U.S. District Judge, Southern District of New York

Editor's Note: *At the ABA Section of Antitrust Law's 50th Annual Spring Meeting, on April 25, 2002, Section Chair Roxane Busey moderated a panel discussion of antitrust remedies in the 21st century. The panelists—representing a wide array of views on the topic—considered whether the current structure of antitrust remedies strikes the right balance and achieves the goals of deterring antitrust violations, punishing wrongful conduct, and compensating injured parties. The panel participants were: Michael L. Denger, a partner at Gibson, Dunn & Crutcher; Harry First, professor at New York University School of Law and former Chief of the Antitrust Bureau of the N.Y. State Attorney General's Office; Robert Pitofsky, professor at Georgetown University Law Center, Of Counsel to Arnold & Porter, and immediate past Chairman of the Federal Trade Commission; The Honorable Susan Illston, a district court judge in the Northern District of California; and The Honorable Lewis A. Kaplan, a district court judge in the Southern District of New York.*

After brief introductory remarks, the panelists participated in a lively give-and-take led by Chair Roxane Busey. We've highlighted here some excerpts from the speakers' prepared comments as background for the edited Question and Answer portion of the program, which is published in full below. With marquee-name cases—such as Vitamins, Mylan, *and* Microsoft*—as their text, the exchange among panelists proved to be both interesting and enlightening.*

Introductory Comments of Roxane Busey (excerpts)

Everyone knows that an antitrust violation may expose a company and its officers to legal actions in multiple fora, with various types of relief, and that this system did not come about as a result of any grand scheme. Instead, it was just a series of events, for better or worse, that gave us the current enforcement system and the remedies—federal civil and criminal enforcement actions, state enforcement actions, private treble-damage actions, indirect-purchaser suits, opt-out litigation—resulting in treble damages, corporate fines, individual fines, prison sentences, restitution, and disgorgement. As a result of all of these possible remedies, it is no surprise that we have seen duplicative recovery and multiple suits being brought in several cases. I would like to focus your attention on three cases.

The first, of course, is the *Vitamins* case,[1] where we saw criminal fines exceeding $900 million. State parens patriae actions also were brought and settled for $335 million. Federal private actions were settled for $224 million, but there were 224 opt-out cases as a result of individual plaintiff decisions. In addition, the European Commission added 855.22 million Euros to the liability, and the Canadian authorities imposed a fine of 93 million Canadian dollars.

Mylan[2] is a case that also illustrates the potential for duplicative recovery. The FTC and thirty-two states settled this case for $100 million, but there is still pending a direct-purchaser class action suit. Third-party payers settled for $35 million.

We all know about the *Microsoft* case,[3] in which the Department of Justice and twenty states and the District of Columbia sought to break up Microsoft. There is a proposed settlement with the Department of Justice and nine states, but nine other states and the District of Columbia continue to seek additional remedies, and that litigation is currently pending before the court. At one time there were sixty federal cases and over one hundred state indirect-purchaser cases filed against Microsoft. There is also a European Commission investigation pending.

There is a piling-on effect of these remedies. Given the goals of remedies, which are related to compliance, deterrence, punishment, and compensation, I think there is a question whether this is the best system that we could have, or could we do better. Some possible modifications are: (1) federal preemption; (2) the repeal of *Illinois Brick*[4] to permit federal indirect-purchaser suits; (3) state *parens patriae* actions for indirect purchasers; (4) consolidation of civil and criminal suits in federal court before one judge; and (5) extending diversity and removal to consolidate civil suits in federal court while preserving a role for state courts to certify the class and apportion damages.

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[1] *In re* Vitamins Antitrust Litig., 2001-1 Trade Cas. (CCH) ¶ 72,862 (D.D.C. Mar. 31, 2000), *aff'd*, 215 F.3d 26 (D.C. Cir. 2000).

[2] FTC v. Mylan Labs., Inc., 62 F. Supp. 2d 25 (D.D.C.), *reconsideration in part*, 99 F. Supp. 2d 1 (D.D.C. 1999).

[3] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001); information relating to the current settlement proceedings is available at http://www.usdoj.gov/atr/cases/ms_index.htm.

[4] Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

Highlights from the Panelists' Opening Remarks (excerpts)

Michael L. Denger

- The overall multifaceted, uncoordinated federal and state criminal and civil system of remedies for cartels is in serious need of re-examination.
- The present system does not insure that injured customers and consumers are fairly compensated for injuries actually incurred, gives rise to windfalls and excessive legal costs, imposes unnecessary burdens on the parties and the judicial system, and is not an effective vehicle for preserving and promoting a competitive structure for the industries affected. In particular, the current approach of direct purchaser damage actions in federal court and indirect purchaser actions in state court is inefficient, gives rise to the potential for double recovery, and makes coordination wholly dependent on the voluntary efforts of the counsel and courts involved.[5]
- To better address the problem, a single federal court should be given exclusive jurisdiction over all criminal and civil proceedings relating to a cartel, including indirect purchaser actions for damages and proceedings for monetary relief by state attorneys general.[6]

Harry First

- The current system, notwithstanding its unplanned and chaotic structure, works and has important strengths that help explain why antitrust enforcement in the United States is so robust. Having multiple enforcers allows enforcers to magnify the resources available for antitrust enforcement, work cooperatively, bring different perspectives, and do a better job jointly than an individual agency could do by itself.
- For deterrence, penalties need to be set high enough so that violators will not profit from their violation, and this includes some multiplication of the penalty to take account of the fact that not every violation is caught; and penalties should take account of the social cost of anticompetitive conduct.
- It is pretty well accepted that damages rarely exceed single damages, for a variety of reasons. And there is certainly the question of whether the now-incomplete indirect purchaser right is bringing compensation to all who are injured by antitrust violations.

Robert Pitofsky

- Antitrust doctrine is in reasonably good shape but the enforcement mechanism, including remedies, is deficient.
- Some remedies are inadequate to deter and compensate the victims, and other antitrust remedies are excessive.
- Relatively short jail sentences and heavier fines are better for deterring antitrust violations.

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5 For a more comprehensive review of the problem, *see* Michael Denger & D. Jarrett Arp, *Does Our Multifaceted Enforcement System Promote Sound Competition Policy?*, Antitrust, Summer 2001, at 41.

6 A proposal along these lines, which would require legislation, was set forth in the *Report of the ABA Section of Antitrust Law Task Force on the Federal Antitrust Agencies*—2001 at 21–24 (Jan. 2001), *available at* http://www.abanet.org/antitrust/antitrustenforcement.pdf, on which Mr. Denger served. *See also* Denger & Arp, *supra* note 5, at 45.

Judge Susan Illston

- When an individual defendant appears before me for sentencing for an antitrust violation, I put the individual at the end of the calendar so that he can hear the sentences of other criminal defendants and note the longer sentences for far less volumes of commerce.
- Changing the system, including repealing *Illinois Brick*, likely will have the unintended consequence of spawning substantial legislation and massive litigation as the new legislation is interpreted and applied. This is what happened in commercial litigation when the Private Securities Reform Act was passed to solve procedural problems in the securities field.
- It has been suggested that all antitrust cases should be assigned to one judge and that the criminal case should proceed first and stay the civil case pending the outcome of the criminal. In my experience, white-collar criminal cases that actually are litigated take a very, very long time. If you do hold the civil case until the end of the criminal case, your civil cases will be placed in a limbo that may or may not ever end. That may not be an appropriate solution to the problems that we face.

Judge Lewis Kaplan:

- Obviously, as a judge, my role here is certainly not to suggest an answer to the question, and I do not, and nobody should understand me as suggesting an answer to that. I guess my message is only that we have been built for over 200 years on a system of checks and balances. Some of this inefficiency really is the same sort of checks and balances that has served us well in other areas of our national life for a very long time. If we are to consider changing the structure of the system, we at least ought to recognize that we are talking about changing something very important, something that has to do with more than transaction costs.
- I cannot intelligently discuss the question of the severity of antirust penalties without asking "compared to what?" It has been very much in my mind lately because I have sort of gained from anecdotal evidence the sense that the sentences that the Sentencing Guidelines require all of us to hand out for nonviolent crimes of the sort almost always committed by the least-educated, the poorest, the most-poorly-represented, the least-influential members of our society can be very severe, particularly in comparison to white-collar cases of all kinds and antitrust cases in particular. I had a case where a single mother with no prior criminal record was caught carrying less than half a gram of crack across the street for $100 in order to get enough money to feed her family and she was facing 41 to 51 months in jail. The Guideline range for price fixing by a first offender involving commerce of less than $1 million, on the other hand, tops out at 8 to 14 months, of which only 4 months actually have to be served in jail. I leave to you the question of whether that is a right balancing, but it is on my mind.
- The net of all of this is that to talk about criminal sentences for antitrust violations without talking about them in a very detailed and analytical way in comparison to the sentences for the whole range of things that people are punished for in the criminal justice system is tunnel vision of absolutely the worst kind. Our criminal sentences reflect a political sense of the community through a whole bunch of imperfect institutions that embody a judgment about what we ought to do, what is the humane thing to do, what sits right in our gut when we go to sleep at night. And we cannot forget in talking about antitrust sentences that those considerations are just as important in determining penalties for criminal violations of the antitrust laws as they are for drugs and assault and embezzlement and everything else.

Questions and Answers

MS. BUSEY: If we were to make changes in criminal sanctions, what would we change and how do we avoid having tunnel vision so that we have a good rationale for whatever changes we make?

PROF. PITOFSKY: I would add to what Judge Kaplan said about the disparity of the enforcement for comparable white-collar crimes. For example, where the victims are defrauded out of $100 million to $200 million, the United States Sentencing Guidelines are astonishingly different. For antitrust violations the average recommended prison time is ten or eleven months, but for securities fraud and other types of white-collar crime, the average is about fifteen years.

Yet, the people who wrote the Sentencing Guidelines knew what they were doing. They said that the theme of the Sentencing Guidelines for antitrust would be relatively short prison terms and very heavy personal and corporate fines. Accordingly, my emphasis has been on whether the fines are as heavy as they ought to be as a practical matter. I was very impressed by Mike Denger's explanation of how difficult it would be for the current fine standard—"twice the loss, twice the gain"—to be measured in litigation.

I do not think that the time in jail ought to be changed radically. We have gotten away from attitudes that account for the famous case in which someone was caught engaged in a price-fixing cartel, and the judge did not want to give him any time in jail; as a result, the judge sentenced the party, as an alternative sentence, to run a golf tournament for charity. Then, the next year, the price fixer came back to report on how his year had gone, and he did say, more or less the following: "Judge, that was such an uplifting experience, I wonder if you would sentence me to another year." That is an attitude that I think is corrosive.

Now, we have adopted a different approach. Mr. Taubman's sentencing, which apparently will require him to serve a year or less in prison, shows that we have gotten away from that approach. The participants in the Archer-Daniels-Midland price-fixing conspiracy, including the top executives in those corporations, are serving prison time. Now, whether they should be serving five and ten years rather than three is a separate issue, and, I do not think they should. I would rather put the emphasis on corporate fines that are sufficient to deter companies from knowingly engaging in these hard-core crimes, and discount that by the fact that we all know that many of these crimes are not detected.

PROF. FIRST: One interesting thing about sentencing is that this fits within another system, and that is the Sentencing Guidelines and what the Sentencing Commission does, which, of course, takes a broader cut than just antitrust. Also, then-Judge Breyer was originally heavily involved in crafting the Guidelines, so the Commission was not without antitrust insight.

I am agnostic on increasing the maximum penalty, in part because I think that judges are not going to impose it in the general range of cases. Judges have much more discretion to do what they want than it might appear from just looking at the Guidelines.

What I would prefer to see is a continuation of prosecuting corporations and individuals, not just corporations, and getting closer to the maximum sentencing level. It took a long time after the amendment to the Sherman Act in 1974 that made antitrust violations a felony with a potential three-year prison sentence, for courts to sentence antitrust defendants to prison terms anywhere near that maximum level. So I am not certain that increasing the maximum level is the right approach.

If there is an equity problem between antitrust and other crimes, there are two ways of dealing with the inequities: one is to raise the antitrust penalties; the other is to lower the penalties for other crimes, such as the penalty for minor amounts of crack cocaine possession. I would prefer the latter. I think our prison sentences are probably too long generally in the United States. So the equity issue can go either way.

MR. DENGER: First of all, on the corporate fine issue, I think we have to place that in the context of the entire system of monetary penalties that a corporation is going to face, including federal direct-purchaser damages, indirect purchaser damages, and penalties paid to the state attorneys general, and assess the fine issue in that light.

As far as individuals are concerned, I think most antitrust violators probably violate the laws because they do not think they are going to get caught. I believe that serious consideration should be given, both for equity reasons and for antitrust policy reasons, to exploring whether more significant sentences are in order on an individual basis, both personal fines and jail terms. Notwithstanding the fair amount of literature written over the years to assess how much of a monetary penalty is needed to provide adequate deterrence, the fact is, very simply, that no one knows. So when we look at criminal penalties, I think we need to consider the system as a whole and, possibly, consider elevating the fines and jail terms for individuals.

MS. BUSEY: You have anticipated my question to the judges, which is: as a practical matter, to what extent do judges take into account civil damage awards when they award penalties? Do judges ask, "Is there civil litigation pending and have there been any settlements?" Is that even a consideration in terms of the award of sentence?

JUDGE ILLSTON: I can tell you that since I first began hearing these abbreviated plea bargains in the criminal cases, I always ask, "What about restitution?" The U.S. Attorneys' eyes would generally glaze over and they would say, "Well, we are not seeking restitution in this case, but there are civil class actions out there." Often, when grilled about the details of that, nobody really knew, so I am not sure how serious the lawyers were about that. But for those who are concerned about the piling on, there certainly was a sense from the U.S. Attorneys that they were happy to leave the damages issues to the civil side and deal only with the criminal penalties.

The other question I have, just as a policy question, is: why can't the fines be used in some way to complement the damages that go to the victims? That apparently is not the way it is done at this time, but it would seem to me that that would be a useful thing to think about.

MS. BUSEY: Judge Kaplan, you raised this equity issue most forcefully in terms of creating equitable prison sentences. You commented in terms of prison sentencing and discussed the inequities among sentences. Harry First has suggested reducing sentences for violations other than antitrust in order to establish equity. For commercial and economic offenses how do you envision adjusting the fine penalties in order to address the inequities?

JUDGE KAPLAN: On the issue of fines generally and their relative severity, I do not really have a horse in that race.

But to respond more directly to the question you asked of Judge Illston, certainly all of this came together in an interesting way in the *Auction House* cases.[7] In the criminal case, the government had a Type C plea that called for a fine of $45 million, which required a modest downward depar-

[7] *In re* Auction Houses Antitrust Litig., 164 F. Supp. 2d 345 (S.D.N.Y. 2001) (settlement approval).

ture, and no restitution. There had not yet been a settlement on the civil side. I deferred a decision on whether to accept the plea in the criminal case and called for a lot more information on ability to pay and so forth. I ultimately did not decide to accept the plea until I decided to accept the settlement that then was struck in the civil cases.

Now, that all came about as a result of a complete fluke. That is to say, the criminal case against the corporation happened to come out of the assignment wheel with my name on it. It ordinarily would not have gone to me in our district, and certainly it might have been filed in another district. So this is a good example to support the argument for putting this all in front of one judge, at least the federal civil and criminal cases.

MS. BUSEY: I would like to know your rationale. Why was it important to have the additional ability-to-pay information? What were you going to do depending on what the settlement was? Why did it matter?

JUDGE KAPLAN: I certainly entertained the possibility before the settlement was reached, in the magnitude that it was, of rejecting the plea on the ground that it did not adequately deal with the issue of restitution.

MS. BUSEY: So in your view the restitution was of prime importance?

JUDGE KAPLAN: It was important.

MS. BUSEY: I would like to pick up on the notion of treble damages in class actions. Mike Denger said damages could be treble or quadruple. Harry First explained that treble damages were popular in 1914. In 2002, do we want treble damages and do we want them mandatory? What would that mean in terms of the change to the system?

MR. DENGER: I'm not exactly sure here. My problem is not with the class-action vehicle itself. My problem is when there are twenty-eight class actions, including indirect-purchaser class actions in twenty-seven different forums, and when the federal class action is settled, the settling party does not get any credit for the settlement payments, or, for that matter, a judgment against the others. That's the direct and indirect purchaser double payment problem.

I think class actions are an efficient vehicle, and the proposal that we had is sort of a semi-class action, in that we would put all of the claimants, direct purchasers, indirect purchasers, and state attorneys general in one forum. Liability would be determined, and then damages would be determined. There would be an allocation of those damages, be they double, treble, or quadruple among various claimants.

But I think we ought to try to pick a rational number in light of the entire system. When treble damages were established originally, we did not have fines based on 20 percent of the affected volume of commerce and we did not have both direct purchaser actions in federal court and indirect-purchaser actions in state court.

So whatever number we pick, I think we need to look at the system as a whole and try to make some sort of rational determination of whether or not that is the appropriate way to compensate victims and achieve an appropriate level of deterrence.

PROF. FIRST: I like treble damages. It's an appropriate number. We have deviated from it historically only in a few areas where we are concerned with over-deterrence, and we have done that very rarely. Before we move away from treble damages, I would want to see some indication that we picked the wrong multiplier and that what we are seeing is somehow excess compensation and over-deterrence. I just do not think we are there.

I think that there is much to be said for Mike Denger's suggestion to examine everything together. One of the things to be said is that if we look at everything together, we still do not have treble damages, even in a case like *Vitamins*. When the numbers are added up, even if we put in the criminal fines, the direct and indirect-purchaser settlements, and value the opt-outs at their original value, or a bit higher, we still do not have treble damages. So we are still not there. We may in that case be a little beyond single damages, but even then it is single damages with regard to commerce in the United States. It does not even take account of the profits earned abroad.

So if what we are thinking is, "Gee, we really ought to deter these cartels," I simply do not think the deterrence is at an adequate level yet. Until we see proof that we are there, I would leave the system in place and do what we are doing now, which is to get closer to what the current system always held out as promise but which we are only now starting to reach.

PROF. PITOFSKY: I would do two simple things. First, I would add interest from the time of the wrongdoing on the illegal gains accumulated by the wrongdoer. A project headed by Steve Salop and Larry White examined extensively law enforcement in the late 1970s and 1980s, and it revealed treble damages are really close to single damages, just a little more than single damages. But if we added interest from the beginning, it really would be treble damages.

If we did that, then I think we ought to consider doing away with mandatory treble damages. I have seen cases involving activity in which the issue of violation was border line. The company decided to engage in the activity, and the company landed in court. The trial did not work out well; the witnesses did not perform as hoped. The company lost the case, and the result was treble damages for a corporation that really was engaged in borderline activity.

So add the interest and take away the mandatory feature, and then leave the question of the severity of the violation and the issue of whether it should be single, double, or treble damages to the judge.

JUDGE KAPLAN: I think there is a lot to be said for differentiation in types of antitrust behavior. I would not take away mandatory treble damages in hard-core price fixing. But, surely, we have all been exposed to cases in which liability was a very, very close call, not because of evidentiary problems but because of a real issue about whether or not the conduct should have been viewed as unlawful. Mandatory treble damages are something that perhaps might be reexamined in those kinds of areas.

JUDGE ILLSTON: I was just going to say that because so few parties actually litigate these cases we are talking about a theoretical question and not really a day-to-day, bread-and-butter question.

MS. BUSEY: Let's talk about incentives. If you change the treble-damage action, you might have different incentives in terms of the class action suits that are brought. Do we want to discourage class actions? Will changing the multiplier from treble to single do that? Again, I think we need to consider the consequences. That would at least still enable everyone to have the rights they had. They are cut back a little, but they are still there. Any thoughts about that?

JUDGE ILLSTON: But the parties still do not try the cases.

MS. BUSEY: But maybe they would then. Maybe that would change the whole dynamics.

MR. DENGER: I just think, with joint and several liability and a lot of the other things that go into it, we are still going to have a relatively high percentage of cases that settle, particularly in the cartel area, as opposed to distribution cases and things of that nature.

But I do think Bob Pitofsky's thoughts about making treble damages in certain circumstances not mandatory and taking into account when the offense occurred and possible adjustments for time value of money are thoughts that are worth considering.

PROF. FIRST: I like the idea of considering the time value of money. I am concerned about moving away from mandatory trebling at least because of its impact on settlements. To the extent that it is uncertain whether damages will be treble, that will be taken account of. It will be another litigation uncertainty that will affect the level of settlement, and not necessarily in a correct way.

So if people settle on the notion that there might be treble damages, or there might be single damages, I think people will still settle, but of course they will not settle for a number that approaches treble damages. The numbers will go down. From an overall system point of view of deterrence and compensation, we have to think clearly about whether that is the right direction we want to go.

MS. BUSEY: What are your views on repealing *Illinois Brick*?

MR. DENGER: It is my opinion that *Illinois Brick* should be repealed.

MS. BUSEY: And what would be the consequences of that?

MR. DENGER: I would also probably preempt state indirect-purchaser cases. Otherwise, you would get the worst of both worlds, where you would have indirect-purchaser cases in federal and state court.

MS. BUSEY: Okay. Let's take the preemption and indirect purchaser questions together.

PROF. FIRST: First, of course, is the irony that interest in repealing *Illinois Brick* is directly related to the number of state indirect-purchaser statutes that are being enacted. The more the states enact these and the more cases we have, the more interest there will be in repealing *Illinois Brick*.

I think we are getting there, and I think it is a good idea. I would amend the Hart-Scott-Rodino state *parens patriae* provision to allow states to bring indirect-purchaser consumer cases—*parens* cases—in federal court, as I think Congress probably intended originally in 1976.

I would not preempt state law. We have not preempted it for direct purchasers. I do not see the reason to preempt it for indirect purchasers. I agree with Justice Brandeis on this—not that he spoke about preempting state antitrust laws, but, with regard to his famous statement that one of the happy incidents of the federal system is that the states can act as laboratories, experimental laboratories. I think we are seeing the benefit of it now because, thanks to the states, we are actually interested in changing the law and giving compensation to indirect purchasers.

MS. BUSEY: One consequence of this repeal or *Illinois Brick* preemption would be an increased caseload for the federal judges. So I would be interested in your perspective on what that means and whether, in the theoretical as well as the practical sense, it is a good solution.

JUDGE ILLSTON: Well, you better fill our vacancies if you increase the number of federal cases.

MS. BUSEY: Let's assume we fill your vacancies.

JUDGE ILLSTON: Then I think there is an enormous logic to it if you did fill the vacancies. I think these cases are enormously well-suited to being handled by one court. The real inequity that Mike Denger has been talking about and the piling on that we hear about, is because there is not one place where 100 percent of the damages inflicted is determined and then divvied up and analyzed so that one person has an overview of all the consequences. I think that makes eminent good sense.

I express no view, however, with respect to the question of whether there should be preemption, therefore, taking from the states their opportunities—or the citizens of the states their opportunities—to litigate those issues in state court. But to the extent that, for example, *Illinois Brick* were repealed and we had indirect-purchaser actions available in federal court, then I do think that we would have a lot of mechanisms at our fingertips to improve the quality of the decision making on the civil side in the antitrust area.

JUDGE KAPLAN: I agree entirely with Judge Illston. I would leave to Congress and whoever else gets involved the question of whether to repeal *Illinois Brick*.

But certainly, it is my very strong view that, to whatever extent there is federal jurisdiction over any of this, it all ought to be before the same judge—civil, criminal; direct purchasers, indirect purchasers.

I think *Lexecon*[8] ought to be overruled legislatively. I think the multidistrict litigation judge ought to have it forever, or for such shorter period of time in which he or she is capable of resolving it. There is just no argument about that. I did recently get a multidistrict litigation case, which the lawyers happily told me I will have forever because it involves latent injury issues, and I am told I will spend the rest of my life with it. But it is not an antitrust case.

MS. BUSEY: But, Judge Kaplan, how does the judiciary feel about this? What if that actually happened and certain judges would get the antitrust cases?

JUDGE KAPLAN: My sense of the way this all works in the federal system is that the judges who receive long-term cases are going to be the judges that the Multidistrict Panel selects. My sense of the way that game is played is that nobody who does not want a multidistrict litigation case ever has one.

PROF. PITOFSKY: First, I was never in favor of the decision in *Illinois Brick* in the first place, and I am glad to hear that all these other people now think it was a wrong initiative. I think it should be repealed.

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[8] Lexecon, Inc. v. Milberg, Weiss, Bershad, Hynes & Lerach, 523 U.S. 26 (1998).

Second, I do think that cases, to the extent feasible constitutionally and practically, which involve all these different sorts of remedies ought to be tried in one courthouse in front of one judge, if we can do it. That is a challenge.

Yet, if putting all of the cases in one courthouse requires preempting state enforcement, I have several reactions. First, I do not think preemption will happen because the current trend in Congress and the Supreme Court is to depend more on the states.

Second, in light of the periods in our history when, in my view, the only authority engaged in adequate antitrust enforcement were the states, I would not like to see the states precluded from the antitrust enforcer role. If states coordinated their role—and they certainly have made great strides in doing that—and then coordinated with federal and private enforcement as well, so that we do not get the chaos that Mike Denger fairly talks about, the result would be excellent, and it would be a challenging reformation of remedial enforcement law in the United States.

MR. DENGER: I think the state attorneys general can play a very important coordinating role in reaching settlements when we have, for example, indirect-purchaser actions pending in twenty or twenty-five states. I think that the mechanism the state attorneys general have in place, layered on top of private counsel, can be a useful approach to trying to reach a resolution of some of these cases on a global or national basis.

MS. BUSEY: But that is inconsistent with your proposal. So is this your second-best choice?

MR. DENGER: No. I was just saying that in the present system there are some things that occasionally make life easier.

MS. BUSEY: In light of *Mylan* and *Microsoft*, what has been the role of the states? Is this positive or negative?

PROF. PITOFSKY: With respect to *Mylan*, the judge played a very strong role, and so there really were not that many difficulties. But the notion of an enforcement system that, because of administrative difficulties, leaves the ill-gotten gains in the hands of the person who violates the antitrust laws is intolerable to me.

And I understand that there are great difficulties in handling restitution and disgorgement cases. I think disgorgement can be made to work, especially in a courtroom with a strong judge.

As to *Microsoft*, I do not want to discuss the merits of *Microsoft*, and I do not think any of us up here do. But I do want to say one thing: it seems to me that, given the unanimous opinion of the court of appeals and then the remedy that was negotiated, it is a fair question to put to a judge as to whether or not the remedy is adequate, given the opinion on a formal record.

Now, is judicial review of Department of Justice settlements inefficient? It is, and I am sure you could close that thing down by just saying, "Anything the Department of Justice decides is going to have to be the last word on this." I prefer the inefficiency, and I think the nine states that have not gone along with the settlement, whether it turns out in the end that they are right or wrong, have raised legitimate issues.

PROF. FIRST: One of the things that helps to make our networked system of antitrust work is that in the end we have a judicial system that gets to decide. So if there are different policies, in the end the courts are going to make the decisions.

This is true in *Microsoft*. If we are talking about having things in front of a single judge, *Microsoft* is a great example of this. There is some benefit to having these issues actually tested and subject to some degree of litigation, not just simply determined by what is going to happen under the Tunney Act. So we may think of it as inefficiencies or we may think of it as cost/benefit, in that there are benefits along with the costs.

In general, with regard to the states, I think the states deliver remedies. With regard to *Mylan*, I never looked at *Mylan* as just a Federal Trade Commission case. I am sure the FTC did not either. This was a case of coordinated effort. I think it is very important to see that, as a descriptive matter, as Mike Denger has pointed out, these various groups are cooperating to a large degree and this cooperation has tremendous benefits, including eventually getting money to injured consumers, as in *Mylan*.

Historically, this is nothing new. Remedies are what the states have really concentrated on in terms of their antitrust enforcement, and it has been a very important part of the antitrust system. Now we are seeing more zeroes attached to it with settlements like *Mylan* and *Vitamins*, and I think that is all to the good.

MR. DENGER: There are a couple of things that we should keep in mind on *Mylan*. I am not so concerned about the particular case in *Mylan*. I think it was an egregious situation. But remember this: we now have a principle that all of the states, using the "little FTC Acts," which are pretty broad based, potentially can seek restitution. And we also have a decision that suggests that the restitution remedy may not preclude damage remedies. Restitution is to disgorge the gain. Damages are for the loss to the victims. So while we may not have a problem in *Mylan* per se, the seeds of mischief are loose, and I think we all have to remember that.

As far as *Microsoft* is concerned, I am not going to talk about the case. But I think that since we have a national and an international scope for many, many industries, there are questions of whether or not and what role states should have in certain aspects of antitrust policy. I am not talking here about recovering damages for a state's consumers and citizens, but in determining Section 2 policy, Section 7 policy, for global industries. I think we have to consider this.

I think if we examine a lot of state antitrust statutes, not only will we be thinking about the state attorneys general, but also the county prosecutors and a lot of others who have authority to bring actions under state antitrust laws. There is, in my view, a real issue—and I am not trying to resolve it—as to what role the states should have in certain areas of antitrust policy, particularly in national and international industries.

Finally, there are criminal penalties in a number of the states as well. So not only could the Antitrust Division of the Department of Justice indict, but there is also exposure under state laws. So I say let's have a coordinated and efficient system. We need some checks and balances in case there are times when one part of the system is not enforcing the antitrust laws. But I think it is also a real mistake to have this uncoordinated patchwork of approaches to remedies without thinking it through as a whole.

MS. BUSEY: Judge Kaplan, I think you referred to a more centralized system. How do you reconcile that with our system of federalism? What would you propose realistically?

JUDGE KAPLAN: I was not proposing anything. I was saying that we ought to recognize that we must deal with this question. I would just put it this way: Winston Churchill was quoted as saying that democracy is the worst form of government known to man except for the alternatives. We have the worst form of antitrust enforcement structure and remedies except for any alternative that anybody has ever yet come up with.

MS. BUSEY: Let's talk about some of the proposals that have been made. Mike Denger proposed putting everything in a federal court where there is a criminal proceeding.

MR. DENGER: I envision the various layered systems that we have today in cartel enforcement. I would not apply this proposal to things like vertical restraints cases and it certainly would not apply to a lot of other areas of state and federal enforcement activity.

But when we focus on all monetary penalties, including fines and damages, I think a single court is in the best position to determine how to compensate the victims, how to avoid windfalls, and what monetary level of fines and damages is appropriate for deterrence because that judge can see all of the parts of the system and how they fit together.

MS. BUSEY: It does not seem like a very realistic proposal. It seems very efficient but not very realistic. Am I wrong?

MR. DENGER: In terms of getting it through Congress?

MS. BUSEY: Yes.

MR. DENGER: I do not think that is probably in the cards unless there is a real concerted effort among a lot of people to try to get behind it. But, I think, if we care about antitrust policy, if we care about the purposes underlying antitrust enforcement, and if we want to have a more rational and efficient system instead of feeding all the lawyers, which our present system does pretty well, I think we ought to look at various alternatives. Maybe some are more realistic and can at least make steps in the right direction.

MS. BUSEY: Judge Kaplan, I think we are all interested to know what you would have said if you had more time in your opening remarks.

JUDGE KAPLAN: Well, I said most of it, but not all of it. Getting rid of the *Lexecon* decision to let the Multidistrict Panel or the transferee judges in a multidistrict litigation just keep all of these cases in one place is certainly on my list.

A second thing on my list is assigning closely related, overlapping civil and criminal cases to the same judge. There are just too many problems that arise that should be resolved in view of the entire case. For example, Judge Illston pointed out the problem of staying discovery or not staying discovery in a civil case where a grand jury or criminal prosecution is sitting or pending, and there are many other problems.

The other thing that is on my list—this is opening Pandora's box—is doing something about compensating the private bar in these class actions. The simple fact of the matter is that anybody who thinks that federal judges, or any other judges, are in a position to exercise any serious critical oversight about fee awards based on the typical lodestar approach is smoking a controlled substance. It is impossible. It is more complicated and more time-consuming than dealing with the case on the merits.

And furthermore, our law clerks would not know a legal fee from a Fed.2d. At least you can send the clerks to do research on the law. They do not know what a lawyer ought to be charging to do something or whether you really need 279 depositions in a case. Something has to happen there.

MS. BUSEY: Can you comment on the auction system you used to select plaintiffs' lead counsel in the *Auction Houses* case[9] and whether you would say that is a good or a best practice for judges?

JUDGE KAPLAN: I would say it was the best practice for that case. It was a unique case. Liability was a slam-dunk from the day the first class action was filed. The sequence of events was that *The New York Times* broke the story that Christie's had joined the amnesty program, and so one knew from the moment the story broke that there was going to be an indictment and there were going to be big settlements. That was surely one thing that favored the auction selection process.

A second thing that favored the process was the fact that figuring out damages in that case, although I do not mean to suggest that it was a trivial exercise, was absolutely nothing like many, many other cartel cases. The industry was, for all practical purposes, a duopoly. One company was public. The two companies basically had one line of business each. If you got the 10-K and spent forty-five minutes with a calculator, you had a pretty good order of magnitude as to what the exposure was.

And then, of course, I had half the class-action lawyers in America in that courtroom, all thirsting after this case because of the huge exposure and the clear liability. So I knew that if I auctioned the counsel selection, I would have an efficient auction market, as indeed I did. I got something like twenty qualified bids. So it was absolutely the perfect case for it.

Finally, I practiced in this area. I have been a member of this Section for about thirty years. There were very few lawyers in that courtroom whom I had not been for and against at various times in my career. So I felt that I did not have to make decisions about quality of representation purely on the basis of firm résumés from people I had never heard of.

You cannot make rules for selecting lead counsel on the basis of serendipitous events like that. But I think that was an advantage. So it clearly worked.

I would not even begin to suggest that an auction for lead counsel is an answer for every case. In fact, in the opinion I wrote, I acknowledged the fact, particularly under the bidding structure I used, that, in theory, there was a massive risk in that case, and the risk was that somebody was going to bid a number at which they would get no fee and then get surprised in the course of the litigation and find out there was no way they could recover the number and, therefore, that they were working for free. What would have happened then? I decided to take that risk because I had some confidence in the lawyers, in their assessment of the case, and in my own assessment of the case.

But, you know, there are risks in everything, and one of the things we get paid for is making judgments. That was a judgment. It happened to work in this case. It is not a prescription for everything else. I was motivated to try it because I just could not imagine dealing with the fee applications down the road. I was just horrified at that thought, and there was a better alternative in this instance.

MS. BUSEY: Did you pick the low-cost bidder?

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9 *In re* Auction Houses Antitrust Litig., 197 F.R.D. 71 (S.D.N.Y. 2000) (auction process).

JUDGE KAPLAN: Yes. There were two identical bids, and I picked one of them.

MS. BUSEY: And you judged quality on the basis of your dealing with these people in the past? How did you ensure quality?

JUDGE KAPLAN: Look, this was not a hard call. You know that David Boies was the guy who won. I just did not find it a close call.

MS. BUSEY: Finally, in closing, I will ask each of the panelists, first, whether they think that, given all the practical problems that we would have if we were to move forward on changing remedies in any way, should we as a Section consider this further and, if so, what should we focus on? Where should we spend our time? Do we do it across the board and air everything? Do we focus on certain aspects?

PROF. PITOFSKY: There is not likely to be a bandwagon effort to change remedies in this country in a radical way. But that does not mean that the effort should not be undertaken. I think it should.

I do not see incremental approaches (you nip here and you paste there). It seems to me that what you want to do is have a comprehensive review that takes deterrence and compensation into account. That could mean changing many things—some easing of the law with respect to some defendants, some making it a bit tougher.

I do think it is time to start. I have no particular place in which I would start but would rather have hearings that encompass the kind of discussion that was held here, either before the regulatory agencies like the Federal Trade Commission or in Congress.

PROF. FIRST: I agree. I think this is an important area, and I think it needs to be looked at on a system-wide basis, inevitably looking at individual things like indirect-purchaser legislation and other issues. But this is a very complex system that we have and I think we have to understand how it is operating as we are tinkering with it, because tinkering may produce unintended consequences if we do not think about the broader system.

MR. DENGER: I guess I am on record, as part of the Section Task Force on the Federal Antitrust Agencies, as saying that we should have an examination of our remedy system. I would encourage Section efforts to get participation by both federal antitrust enforcement agencies, by the state attorneys general, and by all parts of the bar.

I would start in the areas where the greatest number of sectors or components of our system are involved, and I think that would be cartel enforcement and potentially the restitution area—-the monetary areas as opposed to the structural areas.

JUDGE ILLSTON: I would focus on efforts to make sure that there is one federal forum for all federal claims. So, without suggesting what those federal claims wind up being, I do think that a first step that could be accomplished is to encourage those changes that would be required in order to ensure that all federal claims be brought in one federal forum so that one overview of all the federal issues involved could be applied by one judge.

JUDGE KAPLAN: I agree generally with Bob Pitofsky and I agree very strongly with Judge Illston. I would reiterate only what I said before. I think it is critically important to the correct and appropriate treatment of the subject, as well as to the credibility of this organization, that this be viewed in its broader context, as part, for example, of the criminal justice system as a whole, not simply as special pleading on behalf of the kinds of clients that probably 70 percent of the members of the Antitrust Section typically represent. I do not know what the numbers really are, but that is just a ballpark idea. It has to be a dispassionate, intellectually honest enterprise. ●

Fresh Thinking About the FTC/DOJ Interface:
Return to the Wilson-Brandeis-Elman Vision

Robert N. Cook and Robert A. Skitol

Senator Ernest Hollings's success in killing the FTC/DOJ Clearance Agreement that was announced earlier this year could be considered a pointed reminder of the role of Congress in the allocation of antitrust responsibilities between the two agencies. On the other hand, it left unaddressed more fundamental issues relating to the whole rationale for two separate antitrust agencies and the desirable relationship between them. The best starting point for fresh inspiration in addressing these issues is a speech delivered by former Commissioner Philip Elman in 1967 at the First New England Antitrust Conference. His main themes on that occasion are as timely today as they were when presented thirty-five years ago.

The Elman Speech

Elman began by delineating the universe of antitrust concerns within the "majestic generalities of the Sherman and Federal Trade Commission Acts." He then focused on the differences between, on the one hand, "simple and easily applied" per se rules and, on the other, "difficult and complex gray problem areas" governed by "the broad and amorphous Rule of Reason." He suggested that, in dealing with unambiguously harmful conduct covered by per se rules, "the use of conventional judicial procedures and remedies in lawsuits brought in the federal courts by the Antitrust Division and private plaintiffs" had been "quite successful," "appropriate and effective." But in the gray areas antitrust "cannot be played as a cops-and-robbers game with 'good guys' on one side and the 'bad guys' on the other." Here "a determination that certain business conduct ought to be forbidden . . . should carry no necessary connotation of unethical or immoral behavior"; instead, for these areas, "a specialized, expert administrative agency, not functioning like a prosecutor or a court of general jurisdiction, is uniquely qualified to make an indispensable contribution to antitrust enforcement."

Elman thereupon reminded the audience that it was dissatisfaction with the judicial process that led Congress in 1914 to establish the FTC. While "full-blown Sherman Act violations" appeared amenable to judicial correction, Congress determined that prevention of incipient restraints "was too big and complex a job for untrained judges, unaided by expert assistants and compelled to work within the limits of traditional adversary litigation." In short, "[t]here was widespread agreement upon the need for an independent, expert administrative agency with broad and flexible powers to investigate and resolve trade regulation problems."

As he then elaborated, "the Congress of 1914 intended the Commission to supplement, and not to duplicate, the work of the courts and the Department of Justice in antitrust enforcement." The creation of the Commission, in his view, "reflected a basic shift in emphasis" from "punishment and moral opprobrium to administrative adjustment, correction, and regulation." Yet, he observed, "con-

***Robert N. Cook** is counsel and **Robert A. Skitol** is a partner at Drinker Biddle & Reath LLP, in Washington, D.C.*

ventional case-by-case litigation in the courts" continued to be the principal method of antitrust enforcement "even in the gray problem areas where novel and difficult questions of law and policy are presented" and require analysis of complex economic facts. "Today, no less than in 1914, the ability of courts of general jurisdiction to handle such questions is subject to inherent limitations." The FTC was intended to overcome those inadequacies and weaknesses:

> As an instrument for helping make the antitrust laws more certain, more predictable, and more effective, the Commission is what the federal judiciary is not: a single tribunal whose only duty is trade regulation. Congress considered that a commission would be able to make reliable predictive judgments regarding the competitive effects of questioned business conduct. An administrative agency has methods of finding facts, and basing judgments of policy on its accumulated knowledge and specialized experience, that courts do not generally have. A judge typically knows about a general economic problem little more than what he can extract from the record of the particular case. A commission, however, can and should draw upon its collective institutional experience and expertise, as well as relevant economic studies and reports. Difficult factual and policy determinations required under the merger statute, for example, are most reliably made by a tribunal constantly immersed in problems of competition and trade regulation, rather than by a tribunal where such matters may be novel and esoteric.

"As an instrument for helping make the antitrust laws more certain, more predictable, and more effective, the Commission is what the federal judiciary is not: a single tribunal whose only duty is trade regulation."

—Philip Elman

Those considerations led Elman to believe that "the time ha[d] come to reassess and redefine, in a more meaningful way, the respective functions and responsibilities" of the FTC and Antitrust Division. "We should develop a more creative and fruitful relationship between the two agencies" and "[c]ooperation should mean more than not competing" for the same defendants or cases. Specifically, he proposed:

- "the Commission's role as policeman and prosecutor should be substantially deemphasized";
- the "job of investigating and prosecuting specific violations of law by particular companies can be, and is, handled very well by" the Division;
- the FTC "should look to those areas of antitrust enforcement where an administrative agency, with distinctive powers of gathering and analyzing economic data, has special competence"; and
- the FTC's "principal job should be to assist in the orderly development of a coherent body of antitrust policies and doctrines in harmony with economic realities and the basic regulatory goals established by Congress."

The "larger and more creative role" thus suggested for the FTC implied, in his view, an expansion rather than diminution of the responsibilities of the Antitrust Division. Specifically, he suggested that the Division's investigative and prosecutorial functions be extended "to cover the whole area of antitrust violations," including practices addressed by the FTC under the Robinson-Patman and FTC Acts. But, under his scheme, where the Division finds a probable violation of any of the antitrust laws, "it should have a choice of proceeding either in a federal district court or before the Commission," selecting the latter for all matters within areas of that agency's demonstrated expertise. He noted that this proposal would not necessarily require amendment of existing laws, "which permits the Attorney General to intervene in Commission proceedings under the Clayton and FTC Acts" (even though he has never done so).

Elman concluded that the "failure to differentiate clearly the role" of the FTC from that of the Division was "most regrettable"; that "[i]t is a fair question whether the unfinished business of antitrust and the unfulfilled promise" of the FTC "are not intertwined"; that Wilson and Brandeis conceived the FTC as "an indispensable instrument of information and publicity" and "an instrumentality for doing justice to business where the processes of the courts or the natural forces of correction outside the courts are inadequate"; that "[t]his should be a time for reexamination, and renovation, not complacency or indifference, in antitrust enforcement"; and that "[w]e should seek to fulfill the vision of Wilson and Brandeis and the Congress which enacted the great antitrust acts of 1914."

Where possible, investigations should be undertaken by the agency with the most institutional expertise in the industry to be investigated. This approach, however, unfortunately devolved some time ago into a form of institutionalized turf warfare, in which DOJ and the FTC vigorously contest each other's claims for clearance . . .

Antitrust Today

Sound antitrust enforcement requires at least as much "special competence" today as in the past, and we tend to believe it now requires more expertise than at any time over the past several decades. Certainly over the 1990s, antitrust enforcement became increasingly involved with technologically complex businesses, such as the computer, telecommunications, and pharmaceutical industries, while at the same time antitrust questions increasingly had to be disentangled from questions relating to intellectual property rights. The end of the high-technology boom years at the beginning of the new millennium added a further layer of complexity by making it necessary to weigh already complex antitrust issues in the context of industries undergoing shakeouts. But the increasing need for special competence is not limited to high-profile enforcement actions against Microsoft or Intel, or high-profile mergers Like AOL/Time Warner or Hewlett-Packard/Compaq. Government antitrust enforcement actions generally have involved to a growing extent sophisticated factual and economic analysis.

The interagency clearance process that recently caused so much trouble between Senator Hollings and FTC Chairman Timothy J. Muris is in fact based on the indisputably sound principle of special competence. Where possible, investigations should be undertaken by the agency with the most institutional expertise in the industry to be investigated. This approach, however, unfortunately devolved some time ago into a form of institutionalized turf warfare, in which DOJ and the FTC vigorously contest each other's claims for clearance—especially on investigations involving the most intellectually and politically interesting industries—because the agency to which a matter is cleared has the superior claim to clearance on the next investigation in that industry. Some have seen an institutional incentive to expand the scope of investigations for the purpose of improving subsequent clearance claims. In the course of these interagency turf wars, the agencies describe their proposed investigations in terms closely adhering to descriptions of past investigations for the purpose of enhancing arguments for clearance. Of course, once clearance is resolved, the investigating agency is free to take its investigation wherever the facts lead. It is the final scope of the completed investigation, and not the initial proposal submitted for clearance purposes, that normally counts in the next clearance fight.

This approach to agency clearance has resulted in something of a patchwork, even when the system is at its best. When the system is not at its best, many firms—especially those with mergers subject to government review—have over the years found themselves bedeviled by a process they are powerless to influence. The government does not begin a merger review in earnest until agency clearance is resolved, and the entire process (including agency clearance) must be completed within the initial Hart-Scott-Rodino Act waiting period, which normally ends thirty days after a premerger filing is made. Waiting too long for clearance can be prejudicial for "close call" mergers, in which the government requires significant input from customers or other third-party sources. There have been far too many instances of the agency clearance process eating up three weeks or more of the thirty-day review period, so that Second Requests go out to companies that might have avoided them if agency clearance had been resolved more promptly. With non-merger matters, the agencies have at times seemed to let clearance languish indefinitely, though that has hardly been of concern to would-be targets of investigations.

It was apparently with the good intention of reforming such an ungainly process that FTC Chairman Timothy J. Muris and DOJ Assistant Attorney General Charles A. James sought to institute reforms reducing delay in the agency clearance process. The centerpiece of reform was an expanded list of areas in which matters would be allocated automatically to a particular agency instead of bargained for in horse-trading sessions between the front offices of the two agencies. The reformed process was followed for a while and appeared to be successful at reducing time lost to interagency clearance fights, until the reform had to be abandoned as a result of political opposition born of political mistakes. Criticisms of the now-defunct reform focused on the fact that, in the name of simplification, markets were not always allocated to the agency with the historical claim of expertise. No one appeared to question the rationality of the ad hoc expertise system as the basis for the clearance process, whether in simplified form as adopted by Muris and James, or with all the intricacies of its original.

The attempted reform of the agency clearance process incorporated the input of a panel of former antitrust officials from both political parties but apparently no input from either Congress or Chairman Muris's fellow FTC Commissioners. As a result, the reform effort drew strident criticism, both from Capitol Hill and from inside the FTC. One lingering criticism, for example, was that the new allocation of responsibility would have given cable television mergers to DOJ under the broader rubric of "media and entertainment" even though the FTC, which investigated the AOL/Time Warner merger, arguably has greater cable television expertise than DOJ. The underlying concern, however, appears to have been a lack of prior consultation.

Perhaps in response to political criticism, the final release of the FTC/DOJ Clearance Agreement included testimonials from the Chair and the Ranking Member of the Antitrust Subcommittee of the Senate Judiciary Committee.[1] Additional endorsements came from the Business Roundtable, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the Antitrust Section of the American Bar Association.

FTC Commissioner Mozelle Thompson was not appeased, however. He particularly criticized Chairman Muris for committing the FTC to the arrangement without involving the other Commissioners, especially as private-sector attorneys (though from both parties) were consulted and provided significant input.[2]

The Senate Commerce Committee, which oversees the FTC, was likewise not consulted, which enraged at least one powerful senator, who was not mollified by the endorsement of his colleagues on the Senate Judiciary Committee. Senate Commerce Committee Chairman Hollings told the press, "I am trying to eliminate" FTC Chairman Muris in retaliation for taking such action without even a "heads up" to the agency's oversight committee, which he chairs. Senator Hollings also ordered a study of cost savings that might be realized if the FTC were to eliminate the salaries of FTC Commissioners, senior managers, and public affairs staff—a total of approximately 50 jobs out of a workforce of 1,100. Because Senator Hollings also chairs the Senate Appropriations Committee, he wields considerable influence over the FTC's annual budget.

Much of the sound, though perhaps not all the fury, emerging from Senator Hollings's office died down once the agencies dropped the Agency Clearance plan, which meant a return to a status quo ante that virtually all knowledgeable observers regard as far less than ideal. Neither Senator Hollings nor Commissioner Thompson ever denied that the clearance process needed reform even as they objected to the manner in which reform was attempted.

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[1] *See* http://www.ftc.gov/opa/2002/03/clearance/kohldewine.pdf.

[2] *See* http://www.ftc.gov/opa/2002/03/clearancemwt.htm.

A Modest Proposal

Philip Elman believed the lack of meaningful differentiation between FTC and DOJ enforcement activities created a muddle, a situation that many believe to have continued up to the present day. Elman's solution was to preserve the FTC's role as an expert antitrust adjudicator while making DOJ the principal antitrust investigator and prosecutor. His willingness to consider virtually scuttling the FTC's enforcement mission may have been a product of his time. He presented these ideas in 1967, only two years before the Kirkpatrick and Nader Reports seriously weighed the option of closing down the FTC as a way of protecting the integrity of the antitrust enforcement mission—so far had the FTC fallen. As a Commissioner in 1967, he saw that the FTC had a serious institutional malady and may have assumed the condition to be incurable. Today, however, thirty-five years after his speech, the FTC has recovered to become a well-regarded agency, the professionalism of which is not seriously questioned.

Senator Hollings may or may not have been thinking of consolidating the FTC and DOJ antitrust enforcement operations when he threatened to eliminate the salaries of the FTC's top managers and government relations experts. It may be that the foremost thought in his mind was puzzlement that the agency's management and government relations specialists would not have notified the agency's oversight committee of a major policy development prior to releasing it to the press. (In all fairness to Muris and company, agency clearance decisions had historically been a matter of negotiation between the two agencies without input from Congress.) Senator Hollings, however, might just as well have focused upon the proposition that the national budget did not need to support two organizations with largely overlapping responsibilities.

Industry expertise is the name of the game in antitrust, and the FTC was originally established for the purpose of developing the expertise—or "special competence" in Elman's words—necessary to understand difficult antitrust issues.

Industry expertise is the name of the game in antitrust, and the FTC was originally established for the purpose of developing the expertise—or "special competence" in Elman's words—necessary to understand difficult antitrust issues. The nature of disputes between the DOJ and the FTC over the right to particular antitrust investigations underscores the importance of expertise, since clearance claims are developed piecemeal based on each agency's history of conducting particular investigations in particular industries.

The apparently unquestioned acceptance of expertise as the basis of agency clearance is an acknowledgement of the need to apply special competence in antitrust investigations and also of the fact that no one has come up with a better idea. The system, however, does have shortcomings that are rooted in the fleeting nature of institutional expertise, which depends on the willingness of individuals with expertise to stay with the institution. As a result, the importance of expert lawyers and economists in antitrust investigations is confirmed by the very fact of the controversy over agency clearance reform.

Like a private sector service business, antitrust enforcement agencies watch their principal assets go down the elevator every night and head for home. Institutional expertise can exist only to the extent it is embodied in individual lawyers and economists who remain employed by the institution. Because individual lawyers and economists are free to move on to other pursuits, clearance fights between the FTC and DOJ are sometimes based on assertions of expertise derived from investigations that were conducted primarily by lawyers and economists who have since departed. FTC or DOJ institutional expertise may thus reside in a lawyer who, no matter how talented, played only a subordinate or niche role in the investigation on which the claim of expertise is based. Such situations are not uncommon, given that the gap between public sector and private sector compensation has now increased to where even the agencies' most senior executive and managerial staff are paid salaries comparable to those of first year associates at the largest national law firms. The DOJ's increasing use of "special counsel" during the 1990s may have created additional problems of vanishing expertise.

It should by now be self-evident that having two antitrust agencies with overlapping responsibilities is more costly and less efficient than having only one. After all, the two agencies do not actually compete; they merely allocate, and do so in a markedly inefficient manner. One solution worthy of consideration would be to transfer the DOJ's civil antitrust enforcement role to the FTC—along with economists and the lawyers now handling civil cases—while moving the DOJ's criminal antitrust enforcement role from the Antitrust Division to the Criminal Division, along with the lawyers who perform that role.

Consolidating all civil antitrust enforcement activity within the FTC would in one stroke eliminate the entire clearance problem. More fundamentally, it would bring to all civil antitrust enforcement activity the strengths of the FTC's administrative process and its advantages over the judicial system that Commissioner Elman so eloquently described thirty-five years ago and that remain true to this day. Similarly, folding all criminal antitrust enforcement activity into the Criminal Division could generate significant economies of both scale and scope in the prosecution of white-collar crime of all kinds.

Consolidation of all merger enforcement with the FTC would also eliminate anomalous differences between the two agencies in their merger programs. In the current environment, the FTC is better positioned to obtain preliminary injunctions under Section 13(b) of the FTC Act, which provides a considerably more deferential standard than that confronting the DOJ under general equity principles; the FTC is not burdened by Tunney Act requirements that often induce the DOJ to resolve merger concerns without consent decrees; and the FTC can challenge consummated deals in administrative proceedings, an option the DOJ cannot effectively pursue in district court. In all three of these respects, the FTC is the more advantaged merger enforcer. There is no logical argument for a system in which these advantages are available with regard to mergers in some industries because they have been assigned to the FTC but not with regard to mergers in other industries because they have been assigned to the DOJ.[3]

Finally, savings from these consolidations could be used to increase the ability of the government's antitrust enforcement apparatus to retain institutional expertise. This could be accomplished by increasing the pay of the lawyers and economists whose expertise makes it possible for the government effectively to perform its antitrust enforcement mission, thereby reducing their incentives to take their industry-specific antitrust expertise out of the government.

Under our proposed reallocation, the FTC would be responsible for all of what Commissioner Elman characterized as the "difficult and complex gray areas" of antitrust, while the DOJ would concentrate on what he called "simple and easily applied per se rules." The result would be the "more creative and fruitful relationship between the two agencies" that he sought. The FTC, moreover, would come closer to fulfilling what he portrayed as "the vision of Wilson and Brandeis" under which this uniquely situated agency would promote "the orderly development of a coherent body of antitrust policies and doctrines in harmony with economic realities and the basic regulatory goals established by Congress." We would in this light expect to see Senator Hollings leading the applause from Capitol Hill for this proposed allocation plan. ●

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[3] *See* Robert Skitol, *How the Agencies' Clearance Agreement Can Affect Merger Review Outcomes*, FTC: WATCH, May 20, 2002, at 2–4.

Point

Per Se Legality for Unilateral Refusals to License IP Is Correct as a Matter of Law and Policy

Jonathan I. Gleklen

The most fundamental question in the interface between antitrust law and intellectual property law is the issue of whether the antitrust laws prohibit an intellectual property owner from refusing unilaterally to license its intellectual property. In other words, can an intellectual property owner violate the antitrust laws by doing precisely what the Patent Act and Copyright Act authorize? This question was squarely addressed in Federal Circuit's decision in the *Xerox* case,[1] which rejected contrary Ninth Circuit precedent in the *Kodak* case[2] and held that an IP owner's unilateral exercise of rights granted by the Patent Act and Copyright Act cannot violate the antitrust laws.[3] The *Xerox* and *Kodak* decisions have provoked extensive commentary, and there remains a substantial dispute among members of the antitrust bar regarding the scope of antitrust liability for refusals to license intellectual property.[4]

There is no serious dispute that ownership of intellectual property provides no general immunity from the antitrust laws. A tying arrangement involving a patented good can be just as unlawful as a tying arrangement involving unpatented goods.[5] And *United States v. General Electric*[6] notwithstanding, price fixing involving patented goods is recognized as just as unlawful as price fixing of any other good or service.[7] But neither the Patent Act nor the Copyright Act authorizes tying or price fixing. Both do, however, expressly authorize intellectual property owners to refuse to provide their inventions and works to others.

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***Jonathan I. Gleklen** is a partner at Arnold & Porter, Washington, D.C. He served as counsel to Xerox in* In re Independent Service Organizations Antitrust Litigation (CSU, L.L.C. v. Xerox Corp.)*, 203 F.3d 1322 (Fed. Cir. 2000), cert. denied, 121 S. Ct. 1077 (2001).*

1 *In re* Independent Serv. Orgs. Antitrust Litig. (*CSU, L.L.C. v. Xerox Corp.*), 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied*, 121 S. Ct. 1077 (2001) [hereinafter *Xerox*].

2 Image Technical Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997).

3 *See Xerox*, 203 F.3d at 1328 ("Xerox was under no obligation to sell or license its patented parts and did not violate the antitrust laws by refusing to do so."); *id.* at 1329 ("Xerox's refusal to sell or license its copyrighted works was squarely within the rights granted by Congress to the copyright holder and did not constitute a violation of the antitrust laws.").

4 A full day was devoted to the subject during the FTC-DOJ Hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy." Presentations and papers, including materials from the author, are available online at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%201: .

5 Indeed, some of the Supreme Court's leading tying cases involved intellectual property. *See, e.g.*, United States v. Loew's Inc., 371 U.S. 38 (1962); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

6 272 U.S. 476 (1926).

7 In *General Electric* the Supreme Court held that fixing the price at which a licensee must sell a patented good is not unlawful. *Id.* at 489–90. Although the case has never been overruled, it was limited in subsequent decisions. *See, e.g.*, United States v. Univis Lens, 316 U.S. 241, 249–51 (1942) (*General Electric* does not apply after the "first sale"). The Department of Justice has sought a case in which *General Electric* could be overruled, but a DOJ official has stated that the Department could never find a potential defendant willing to defend its conduct. *See* Remarks of Richard Stern, 377 PAT. TRADEMARK & COPYRIGHT J. (BNA) E-2 (May 4, 1978).

[C]an an intellectual property owner violate the antitrust laws by doing precisely what the Patent Act and Copyright Act authorize?

Although a number of Supreme Court decisions contain dicta that seem relevant to the dispute, the Court has never directly addressed this fundamental question. Indeed, antitrust challenges to unilateral refusals to license intellectual property were few and far between for the Sherman Act's first hundred years. This began to change, however, in the early 1990s. The challenges came from independent service organizations (ISOs) that serviced durable equipment manufactured by Data General, Kodak, Xerox, Siemens, and others and sought access to patented parts and patented or copyrighted diagnostic software. A flurry of decisions in these cases over the last decade have thus confronted this issue head-on, yielding a variety of proposed standards for evaluating unilateral refusals to license IP. Commentators have proposed still more standards.

This article addresses the question of how to resolve this conflict between the antitrust laws and the intellectual property laws. The statutory scheme, principles of statutory construction, and the little relevant legislative history all support a rule of per se legality for unilateral refusals to license intellectual property. This result is supported by the best reading of the relevant Supreme Court precedents and by sound policy considerations. Finally, the alternatives to a rule of per se legality that have been proposed suffer from both legal and policy flaws.

The Statutory Scheme and Legislative Intent

The Patent and Copyright Acts. The Patent Act authorizes the owner of a patent "to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States."[8] The Copyright Act affords copyright holders the right to exclude others from reproducing or distributing the copyrighted work.[9] As the Supreme Court has held many times, the core right of an intellectual property owner is the right to exclude.[10]

The entire American intellectual property system is built around this key principle. Intellectual property owners are granted only the right to exclude. They have no statutory right to commercialize or profit from their inventions and works. (For example, commercialization might be barred by the existence of essential IP rights owned by others; I may receive a patent for an innovative new microprocessor technology, but I'm likely to need additional IP rights from others to commercialize and profit from my technology.) Because IP rights provide no right to compensation at all, it makes no sense to say that an IP right provides a right that is limited to compensation (i.e., selling at a high price) rather than exclusion.

Accordingly, infringement of a patent will be enjoined no matter the economic harm to the infringer or the public; permanent injunctions against infringement have been denied only in the rarest of circumstances presenting a direct threat to public health.[11] As the Supreme Court noted in *Dawson Chemical Co. v. Rohm & Haas Co.*, "[c]ompulsory licensing is a rarity in our patent system"; although compulsory licensing has occasionally been considered by Congress, it has never

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[8] 35 U.S.C. § 154(a)(1). When the patent claims a process, a patentee also has the "right to exclude others from using, offering for sale or selling throughout the United States, or importing into the United States, products made by that process." *Id.*

[9] 17 U.S.C. § 106(1), (3). The Act also permits the copyright holder to prevent others from making derivative works, and in the case of literary or artistic works, to prevent others from publicly performing or displaying the work. *Id.* § 106(4)–(5).

[10] *See, e.g.*, Dawson Chem. Co. v. Rohm & Haas Co., 448 U.S. 176, 215 (1980) ("essence" of the patent grant is the "right to exclude others from profiting by the patented invention"); Stewart v. Abend, 495 U.S. 207, 228–29 (1990) ("a copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work").

[11] *See, e.g.*, City of Milwaukee v. Activated Sludge, 69 F.2d 577, 593 (7th Cir. 1934) (denying injunction in case involving patent on sewage treatment technology because "the health and the lives of more than half a million people are involved").

been adopted.[12] The Court's rejection of compulsory licensing in *Dawson* is consistent with the principle that courts hesitate to act where Congress has refused to do so.[13]

The Copyright Act similarly creates no general requirement that a copyright owner license his work. "The owner of the copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property." [14] Although the Copyright Act, unlike the Patent Act, does provide for certain limited forms of compulsory licensing (generally involving the entertainment industry[15]), Congress's creation of compulsory licenses under limited circumstances indicates a legislative intent not to require compulsory licensing in other circumstances.[16]

The 1988 Patent Act Amendments

In 1988 Congress amended Section 271(d) of the Patent Act to add, inter alia, a new subpart (4). The statute provides: "No patent owner otherwise entitled to relief for infringement or contributory infringement shall be denied relief or deemed guilty of misuse *or illegal extension of the patent right* by reason of having . . . (4) refused to license or use any rights in the patent."[17] The best reading of this amendment under established principles of statutory construction, as well as the legislative history of the section, suggest that it operates to bar antitrust claims based on a refusal to license patents, not just assertion of a misuse defense.[18]

First, reading the statutory language "illegal extension of the patent right" to mean nothing more than patent misuse would render the phrase a nullity; under this reading the statute would provide that a patent owner could not be guilty of "misuse or misuse." Such a reading conflicts with the "elementary canon of construction that a statute should be interpreted so as not to render one part inoperative . . ." [19] Indeed, such a reading would render the entire statute a nullity, for where "conduct [does] not constitute patent misuse, neither [can] it be violative of the antitrust laws." [20] "[I]nterpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available." [21] The interpretation of Section 271(d)(4) consistent with the legislative purpose is one that bars a finding of antitrust violations, not just misuse.

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[12] 448 U.S. 176, 215 (1980).

[13] *See, e.g.*, Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 60 (2000) (rejecting FDA's claim to jurisdiction over tobacco where Congress had consistently rejected legislation giving it such jurisdiction).

[14] Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932).

[15] *See* 17 U.S.C. § 111(d) (compulsory licensing for secondary transmissions by cable TV systems); *id.* § 115 (compulsory licensing for creation of sound recordings of previously published dramatic works); *id.* § 116 (compulsory license for public performance using coin-operated jukeboxes).

[16] *Cf., e.g.*, United States v. Brockamp, 519 U.S. 347, 352 (1997) ("explicit listing of exceptions" to running of limitations period considered indicative of Congress' intent to preclude "courts [from] read[ing] other unmentioned, open-ended, 'equitable' exceptions into the statute"). The Latin version of this canon of construction is *"expressio unius est exclusio alterius."*

[17] 35 U.S.C. § 271(d)(4) (emphasis added).

[18] *See generally Xerox*, 203 F.3d at 1325 (noting that "[t]he patentee's right to exclude is further supported by section 271(d) of the Patent Act"); ISO Antitrust Litig., 989 F. Supp. 1131, 1135–36 (D. Kan. 1997) (discussing statutory construction and legislative history of Section 271(d) in depth).

[19] Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985) (citation omitted).

[20] Zenith Radio Corp. v. Hazeltine Research, Inc. 395 U.S. 100, 134–35 (1969).

[21] Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982).

Second, the legislative history of the statute supports a reading that would bar antitrust claims based on unilateral refusals to license. The relevant legislative history is that of the original 1952 statute, which contains the "misuse or unlawful extension" language. Although we do not have any direct expressions of legislative intent one way or the other regarding preemption of antitrust claims, we do have some helpful hearsay. Wilbur Fugate, testifying on behalf of the Department of Justice, specifically objected to the provision that became Section 271(d) because "its effect might be to carve out an area in which the antitrust laws would not operate. . . . The proponents of the bill indicate that such a result is contemplated in the language of section [271(d)]."[22]

[A]lmost every court to address the question has held that Section 271(d) bars both antitrust claims as well as a misuse defense.

Consistent with the principles of statutory construction and the legislative history discussed in this section, almost every court to address the question has held that Section 271(d) bars both antitrust claims as well as a misuse defense.[23]

The Sherman Act

Section 2 of the Sherman Act makes it unlawful to "monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several states."[24] The language of the statute itself tells us nothing about whether Congress intended that exercise of a right conveyed by the intellectual property laws could violate the Sherman Act. But the legislative history of the Sherman Act, although sparse, is helpful on this point. Senator Sherman, the Act's sponsor, stated on the Senate floor that, "A limited monopoly secured by a patent right is an admitted exception, for this is the only way by which an inventor can be paid for his invention."[25]

Reconciling the IP Laws and the Sherman Act. Consistent with this legislative history, the Supreme Court has on several occasions stated that the exercise of patent rights is an "exception" to the antitrust laws. Most famously, in *Simpson v. United Oil Co. of California*, the Court noted that "[t]he patent laws which give a 17-year monopoly on 'making, using, or selling the invention' are *in pari materia* with the antitrust laws and modify them *pro tanto*."[26] In other words, because the patent laws modify the antitrust laws "as far as they go," that which is lawful under the patent laws does not violate the antitrust laws. Section 271(d)(4) of the Patent Act only reinforces this result. The *Simpson* principle, combined with Section 271(d)(4), requires a rule of per se legality for unilateral refusals to license IP. In such a case the IP owner is doing only what his patent or copyright authorizes him to do.

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[22] Hearings before Subcommittee No. 3 of the Committee on the Judiciary, House of Representatives, 82 Cong., 1st Sess. on H.R. 3760, June 13, 14, and 15, 1951, Serial No. 9, at 207. Moreover, even the legislative history of the 1988 amendments to Section 271(d) that expressly immunized refusals to license supports a reading of the provision as barring antitrust claims. Representative Kastenmeier, the prime sponsor of the legislation, cited *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1203–06 (2d Cir. 1981), as a basis for the statute, but the *SCM* case involved only antitrust claims, not patent claims or a misuse defense. *See* 34 Cong. Rec. H10646, H10648 (Oct. 20, 1988).

[23] *See* ISO Antitrust Litig., 203 F.3d 1322, 1326 (Fed. Cir. 2000); Carpet Seaming Tape Licensing Corp. v. Best Seam, Inc., 616 F.2d 1133, 1143 (9th Cir. 1980) (citing Section 271(d)(3) to conclude that "[a]ttempted enforcement of a patent does not amount to a violation of the antitrust laws."); Polysius Corp. v. Fuller Co., 709 F. Supp. 560, 576 (E.D. Pa. 1989) (finding, based on Section 271(d)(1), that "Congress has mandated . . . [that] plaintiffs cannot be guilty of either antitrust violations or patent misuse . . ."); Rohm & Haas Co. v. Dawson Chem. Co., 557 F. Supp. 739, 835 (S.D. Tex.) (Section 271 "necessarily extends into the antitrust arena" because "it would be superfluous to sanction and protect activity within one area of the law and concurrently prohibit and expose a patentee to damages by reason of another body of law."), *rev'd on other grounds sub nom.* Rohm & Haas Co. v. Crystal Chem. Co., 722 F.2d 1556 (Fed. Cir. 1983). *But see* Image Technical Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195, 1215 n.7 (9th Cir. 1997) (Section 271(d) applies only to misuse claims).

[24] 15 U.S.C. § 2.

[25] 21 Cong. Rec. 2457 (Mar. 21, 1890).

[26] 377 U.S. 13, 24 (1964).

It is a commonplace that "exemptions from the antitrust laws are strictly construed and strongly disfavored"[27] and that such exemptions "have only been found in cases of plain repugnancy between the antitrust and regulatory provisions."[28] Although "it is crystal clear from the legislative history and accepted judicial interpretations of the Sherman Act that competition on prices is the rule of congressional purpose and that where exceptions are made, Congress should make them . . . [t]he monopoly granted by the patent laws is a statutory exception to this freedom for competition."[29] Accordingly, a patentee's decision "to exclude others from the use of the invention . . . is not an offense against the Anti-Trust Act."[30] It is true that this language is not found in cases directly addressing antitrust liability for unilateral refusals to deal. But the question of antitrust liability for unilateral refusals to license presents a case of "true repugnancy" between the antitrust laws and the IP laws. As discussed below, we cannot apply standard antitrust rules to refusals to license IP without reading the right to exclude out of the IP laws.

But the question of antitrust liability for unilateral refusals to license presents a case of "true repugnancy" between the antitrust laws and the IP laws.

The Limited Benefits of Any Compulsory Licensing Obligation. Even if compulsory licensing were required in some cases to avoid antitrust liability, it is not clear how this would serve to benefit consumers unless the antitrust laws imposed not just an obligation to license, but an unprecedented obligation to license at some "reasonable" price. "A patent empowers the owner to extract royalties as high as he can negotiate with the leverage of that monopoly."[31] Indeed, it is not unlawful for an IP owner to set a price so high that it is the equivalent of a refusal to deal. In *Stewart v. Abend* the Court rejected the idea that it was in any way improper for a copyright holder to "make demands—like respondent's demand for 50% of petitioners' gross proceeds in excess of advertising expenses—which are so exorbitant that a negotiated economic accommodation will be impossible."[32]

Even if the antitrust laws were read to require an IP owner to set a price that is not the equivalent of a refusal to deal, surely nothing in the antitrust laws would require an IP owner to set a price that would allow the licensee to undercut the price that the IP owner charges. Even a firm with monopoly power is not required to help its competitors "by holding a price umbrella over their heads."[33] Assuming that Xerox is not required to charge a price that allows ISOs to undercut its price, the consumer benefit of any rule requiring compulsory licensing is unclear. And even some other hypothetical benefit, such as some consumers' preference for ISO service, would hardly

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[27] Square D Co. v. Niagara Frontier Tariff Bureau, Inc. 476 U.S. 409, 421 (1986).

[28] U.S. v. National Ass'n of Securities Dealers, Inc. 422 U.S. 694, 746 (1975).

[29] U.S. v. Line Material Co. 333 U.S. 287, 310 (1948); *see also* Precision Instrument Mfg. Co. v. Automotive Maint. Mach. Co., 324 U.S. 806, 816 (1945) ("[A] patent is an exception to the general rule against monopolies and to the right to access to a free and open market.").

[30] U.S. v. United Shoe Mach. Co., 247 U.S. 32, 57 (1918).

[31] Brulotte v. Thys Co., 379 U.S. 29, 33 (1964). Accord Stewart v. Abend, 495 U.S. 207, 228 (1990) (high price for copyrighted work "was contemplated by Congress and is consistent with the goals of the Copyright Act"). In this regard, an IP owner is no different than any other lawful monopolist. *See, e.g.*, Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1412–13 (7th Cir. 1995) ("A natural monopolist that acquired and maintained its monopoly without excluding competitors by improper means is not guilty of 'monopolizing' in violation of the Sherman Act, and can therefore charge any price it wants, for the antitrust laws are not a price-control statute or a public-utility or common-carrier rate regulation statute.").

[32] 495 U.S. at 228.

[33] United States Football League v. National Football League, 842 F.2d 1335, 1360–61 (2d Cir. 1988).

appear to outweigh the disincentives for innovation created by a compulsory licensing scheme.[34]

Alternatives to a Rule of Per Se Legality. Another reason for a rule of per se legality for refusals to license IP is that none of the alternatives that have been proposed are workable, let alone consistent with precedent.

Treat IP Like Any Other Property. Some, including Professor MacKie-Mason, have suggested that because the right to exclude is a key attribute of all property, there is no basis for treating a refusal to license IP differently from any other refusal to deal.[35] As an initial matter, this argument oversimplifies the issue significantly. Unlike the case of IP, where the statutory right to exclude is absolute (with the limited exceptions discussed above), the right to exclude from private property has never been absolute—it is limited, for example, by the common law doctrine of easements. Moreover, regardless of whether state law property rights are limited or absolute, Federal law (including antitrust law) preempts inconsistent state law.[36] But the federal antitrust laws do not preempt inconsistent federal law. Quite the opposite; the Supreme Court has held even outside the IP law context that conduct expressly authorized by federal law cannot violate the antitrust laws.[37]

The Solicitor General suggested in the *Xerox* case that no special rules should apply to refusals to license IP, and that under general antitrust principles a refusal to license will not be unlawful "if it does not involve a sacrifice of profits in order to exclude competition and thereby create market power."[38] But even if the "sacrifice of profits test" were an accurate summary of the caselaw on anticompetitive conduct—and it is not a complete one[39]—the test would invalidate unexceptionable refusals to license.

Because of the low marginal cost of many products built on IP rights (think of pharmaceuticals or software), introducing additional competitors will result in a speedy decline in prices. The magnitude of these declines is such that it will almost always be more profitable to be, for example, the monopoly supplier of a pharmaceutical than to be a monopoly licensor of the pharmaceutical

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[34] In his Counterpoint, Professor MacKie-Mason notes that existence of a strong right to exclude may discourage follow-on innovation. Jeffrey K. MacKie-Mason, *Antitrust Immunity for Refusals to Deal in (Intellectual) Property Is a Slippery Slope*, ANTITRUST SOURCE, July 2002. As he recognizes, this loss is entirely speculative. It is also irrelevant to the Xerox case, because ISOs were certainly not engaging in any form of innovation.

[35] *See id.*

[36] *See, e.g.*, Hisquierdo v. Hisquierdo 439 U.S. 572, 582 (U.S. 1979) (collecting cases in which state property laws were held preempted by federal legislation).

[37] *See, e.g.*, United States v. Rock Royal Co-op., 307 U.S. 533, 560 (1939) (defendants' price fixing authorized by agricultural cooperative statute activity did not violate the antitrust laws even "[i]f ulterior motives of corporate aggrandizement stimulated their activities . . .").

[38] *See* Brief for the United States as Amicus Curiae at 11–12, *CSU, L.L.C. v. Xerox*, 121 S. Ct. 1077 (2001) (No. 00-62) (quoting Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985) and citing ROBERT H. BORK, THE ANTITRUST PARADOX 144 (2d ed. 1993)) (defining predation as conduct "that would not be considered profit maximizing except for the expectation" of a resulting reduction in competition), *available at* http://www.usdoj.gov/osg/briefs/2000/2pet/6invit/2000-0062.pet.ami.inv.pdf. Douglas Melamed and Ali Stoeppelworth make the same argument in a draft article submitted for the FTC hearings. *See* A. Douglas Melamed & Ali M. Stoeppelwerth, The *CSU* Case: Facts, Formalism and the Intersection of Antitrust and Intellectual Property Law, *available at* http://www.ftc.gov/opp/intellect/020501adouglasmelamed.pdf.

[39] Courts have held that the category of anticompetitive conduct "can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties." Caribbean Broadcasting v. Cable & Wireless PLC, 148 F.3d 1080, 1087 (D.C. Cir. 1998). Even the Solicitor General's standard, which he attributed to *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, is actually a gloss on the Court's actual standard in *Aspen*, which held that conduct is anticompetitive where a monopolist is "attempting to exclude rivals on some basis other than efficiency." 472 U.S. 585, 605 (1985).

IP to firms making generics.[40] This choice could be characterized as trading off short-term profits from licensing for monopoly profits from the exclusion of downstream competitors. But plainly the antitrust laws do not (and should not) require the owner of a drug patent to license generic manufacturers to avoid antitrust liability—precisely the result mandated under the "sacrifice of profits" test.

The problem with the "sacrifice of profits" test is that it inappropriately focuses on static efficiency (the impact of the refusal to license upon competition with the IP owner) and ignores the long-term effects of a rule requiring licensing upon incentives to innovate. As the First Circuit noted, however, in *Data General Corp. v. Grumman Systems Support Corp.*:

> [I]n passing the Copyright Act, Congress itself made an empirical assumption that allowing copyright holders to collect license fees and exclude others from using their works creates a system of incentives that promotes consumer welfare in the long term by encouraging investment in the creation of desirable artistic and functional works of expression . . . We cannot require antitrust defendants to prove and reprove the merits of this legislative assumption in every case where a refusal to license a copyrighted work comes under attack.[41]

It is hard enough to do the static efficiency analysis. Given the uncertainty regarding the long-term effects of any particular IP rule, it is essentially impossible to know whether dynamic efficiency is served by permitting a given refusal to license.[42]

An Exception for "Leveraging." Because most would agree that the owner of a pharmaceutical patent need not license a generic firm, some have suggested that IP owners be subject to antitrust liability when they "leverage" market power afforded by a patent to obtain a monopoly in a "different" market. This argument is usually based on footnote 29 of the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services, Inc.*, that "power gained through some natural and legal advantage such as a patent, copyright, or business acumen can give rise to liability if a seller exploits his dominant position in one market to expand his empire into the next."[43]

There are a number of problems with this approach as well, not the least of which is the fact that footnote 29 addresses tying arrangements, not unilateral refusals to deal.[44] As the Supreme Court has recognized, "The difference is clear and vital between the exclusive right to use the machine, which the law gives to the inventor, and the right to use it exclusively with prescribed

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[40] Imagine a pharmaceutical firm that has developed IP that will lead to a blockbuster drug, perhaps a cancer vaccine. While the drug is in clinical trials, the firm receives requests from generic drug firms for licenses that would permit them to sell generic versions of the blockbuster. Given that a generic will sell for half the price of the branded product, the generic suppliers could never pay a license fee that would compensate the branded firm for the lost profits on sales of branded product (regardless of what the branded firm does with the pricing of its own product). Thus, the branded firm will always refuse to license because it is more profitable to become a drug monopolist than to reap "monopoly" licensing profits as the sole licensor of the relevant IP. In other words, the branded firm will always sacrifice the short-run profits available to it as a monopoly licensor for the long-term monopoly profits available to it as a monopoly seller of the blockbuster drug—monopoly profits available only because it has foreclosed generic competitors.

[41] 36 F.3d 1147, 1186–87 (1st Cir. 1994).

[42] Several economists on the DOJ-FTC hearings May 1 panel addressed this issue. Their papers are available at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%201:.

[43] 504 U.S. 451, 480 n.29 (1992).

[44] The footnote appears in the Court's discussion of tying claims, and the footnote characterizes its discussion as one of Kodak's "tying policy" and "tying in derivative aftermarkets." 504 U.S. 480 n.29. *See generally Xerox*, 203 F.3d at 1326–27 (distinguishing footnote 29 on these grounds).

materials . . ."[45] There is a world of difference between telling licensees that you will license your IP only if they buy another product or service from you (or refuse to buy from your competitors, which is the same thing), and refusing absolutely to license your IP. Similarly, in holding a price-fixing scheme involving intellectual property unlawful, the Court noted that it "does far more than secure to inventors the 'exclusive right' to their discoveries, . . . [i]t gives them a leverage on the market that only a combination, not a patent by itself, can create."[46] Unilateral refusals to license are lawful because the only "leverage" that an IP owner receives when it refuses to license—regardless of the number of markets affected—is the leverage created by the "patent by itself."

More fundamentally, a "leveraging" rule would arbitrarily limit the patent "monopoly" (when it conveys one) to a single market. But patents convey the exclusive right to use an invention, which may have utility in a number of markets. One patent on a key photocopier part in the *Xerox* litigation noted that invention had utility "in the production of cooking utensils and other surfaces used in the culinary arts." But Xerox has the right to exclude competitors from using goods that infringe the claims of the patent regardless of whether the competitors seek to use photocopier fuser rolls or non-stick cookware. Any other rule would read the right to "use" out of the Patent Act, for all inventions are by definition "used" in markets other than the market in which they are "sold."

Moreover, despite the complaint that Xerox's patents do not give it the right to monopolize a "service market," there would be nothing to stop Xerox from adding a method or process claim to its patents claiming the use of the invention in the servicing of a copier.[47] In such a case, it would be the patent itself that affords the right to prevent others from servicing copiers using the part. A patentee could avoid liability under the "leveraging" test simply by clever claim drafting. Antitrust liability should not turn on such exaltation of form over substance.

An Exception for "Conditional" Refusals to Deal. Closely related to the proposed "leveraging" exception is the exception, proposed by Professor MacKie-Mason and others, for "conditional" refusals to license.[48] This exception has no support in the caselaw.

An IP owner has a "right to select its licensees."[49] Even the Ninth Circuit in *Kodak* recognized that the distinction between "a selective refusal to sell" and "an absolute refusal to license . . . makes no difference."[50] As the Supreme Court held in *United States v. United Shoe Machinery Co.*, an owner of intellectual property "necessarily has the power of granting [a license] to some and withholding it from others."[51]

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[45] Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 512 (1917). *Accord* D.B. Cole v. Hughes Tool Co., 215 F.2d 924, 937 (10th Cir. 1954) (antitrust laws do "not prohibit [the patentee] from inhibiting the manufacture, use or sale . . . of the patented device by others," but only "prohibits the patentee from making a contract which imposes limitations beyond his lawful patent monopoly on the right of his lessee or purchaser to use or deal in goods . . .").

[46] Unites States v. Line Material Co., 333 U.S. 287 (1948).

[47] Xerox has actually done this for some of its inventions. For example, Patent 5,202,726, assigned to Xerox, claims a "method of servicing a reproduction machine" using the claimed invention.

[48] *See* MacKie-Mason, *supra* note 34.

[49] Genentech, Inc. v. Eli Lilly & Co., 998 F.2d 931, 948 (Fed. Cir. 1993).

[50] 125 F.3d at 1216. Two other ISO cases have reached the same result. *See* Service Training, Inc. v. Data Gen. Corp., 963 F.2d 680, 690 (4th Cir. 1992); Advanced Computer Servs. of Michigan v. MAI Systems Corp., 845 F. Supp. 356 (E.D. Va. 1994).

[51] 247 U.S. 32 (1918). *See also* E. Bement & Sons v. National Harrow Co., 186 U.S. 70, 94 (1902) (lawful for patentee to grant license but agree to refuse to license others); Extractol Process Ltd. v. Hiram Walker & Sons Inc., 153 F.2d 264, 268 (7th Cir. 1946) ("No legitimate attack can be made on the patent or patent grant because the patentee chooses A and B as its licensees and refuses a license to X, Y, or Z.").

Although a "failed tie"—one not accepted by the buyer—is just as illegal as a consummated tying arrangement,[52] it is a mistake to characterize every conditional refusal to license as a tying arrangement. At the extreme, every refusal to grant a bare IP license can be characterized as a tying arrangement; a refusal to license a pharmaceutical patent could be characterized as a tie between a license to use the pharmaceutical IP and the purchase of a pill. But it makes no sense to characterize such a refusal to license as an illegitimate exercise of IP rights.

There is a straightforward way to distinguish these unlawful "failed ties" from lawful conditional refusals to license: strict application of the "two products" test from Justice O'Connor's concurrence in *Jefferson Parish*.[53] Under that test, it is irrelevant whether consumers might wish to purchase the tying product alone; what matters is whether they wish to buy the tied product alone. Because there is no demand for my pharmaceutical pills (the tied product) without the IP right to use them (the tying product), there is no tying agreement and my refusal to license is lawful. In contrast, because there is plenty of demand for salt without salt machines, refusing to sell salt machines to customers that won't buy salt is unlawful.[54] The refusal to sell patented parts to ISOs in the *Xerox* case is not unlawful because even if there is demand (by the ISOs) for parts without also buying service from Xerox, there is no demand (by anyone) for service without parts.[55] Indeed, the *Xerox* plaintiffs never even alleged a tie between parts and service.

Intent and "Pretext." After remand from the Supreme Court and a jury verdict against Kodak, the Ninth Circuit affirmed a finding of liability based on a refusal to sell patented parts because Kodak's justification was "pretextual"; the evidence showed that "Kodak was not actually motivated by protecting its intellectual property rights."[56] This focus on subjective intent is meaningless. Because IP rights are by their very nature exclusionary, there is no difference between an intent to "protect intellectual property rights" and an intent to foreclose competitors. As the Supreme Court recognized, "[C]ondition[ing] a copyright upon a demonstrated lack of anticompetitive intent would upset the notion of copyright as a limited grant of monopoly privileges intended simultaneously to motivate the creative activity of authors and to give the public appropriate access to their work product."[57]

Any rule that relied on subjective intent would turn every case involving a refusal to license into a disputed question of fact. No IP owner would be entitled to summary judgment, let alone a motion to dismiss, and every case would need to go to the jury. Any such rule would impose huge costs on IP owners, for little or no benefit to consumers.

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[52] *See, e.g.*, Thompson v. Metropolitan Multi-List, Inc., 934 F.2d 1566, 1572 (11th Cir. 1991).

[53] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 38 & n.8 (1984) (O'Connor, J., concurring).

[54] *See* Int'l Salt Co. v. United States, 332 U.S. 392 (1947).

[55] *See* Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 494 n.2 (1992) (Scalia, J., dissenting). I recognize that this was the view of the dissent, not the majority. But the majority's factual support for the idea that there was demand for parts without service was minimal, albeit enough to require reversal of the grant of summary judgment. *Id.* at 463 & n.7. The plaintiffs in *Kodak* did not pursue their tying claims after remand. *Kodak*, 125 F.3d at 1201.

[56] *Kodak*, 125 F.3d at 1219.

[57] Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 64 (1993). *Accord* Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1072 (Fed. Cir. 1998) (if a [patent infringement] suit is not objectively baseless, an antitrust defendant's subjective motivation is immaterial"); Data Gen. Corp. v. Grumman Sys. Support Corp., 36 F.3d 1147, 1189 (1st Cir. 1994) (holding that a "search for an overriding 'antisocial' motivation" behind the exercise of IP rights is "unilluminating"). *See generally ISO Litig.*, 203 F.3d at 1327–28 (citing *Nobelpharma* and noting that the court saw "no more reason to inquire into the subjective motivation of Xerox in refusing to sell or license its patented works that we found in evaluating the subjective motivation of a patentee in bringing suit to enforce that same right.").

Conclusion

The statutory scheme of the IP laws, the legislative history of the IP and antitrust laws, and sound policy all support a rule of per se legality for unilateral refusals to license. The benefits of such a rule are reinforced by the modest benefit (if any) of a rule of compulsory licensing and the failings of alternative rules that would govern compulsory licensing.

Counterpoint

Antitrust Immunity for Refusals to Deal in (Intellectual) Property Is a Slippery Slope

Jeffrey K. MacKie-Mason

The Federal Circuit's decision in *CSU v. Xerox*[1] has generated enormous controversy.[2] However, there seems to be emerging agreement among both critics and supporters on a correct, narrow reading of the decision. Whatever else the decision stands for, it appears to declare antitrust immunity for unilateral refusals to sell or license patented or copyrighted intellectual property (IP).[3]

What was at stake in *Xerox* is whether a firm with a legitimate property right in the design of certain parts has the right to condition sale of those parts with terms that enable Xerox to obtain a monopoly in a different market, for service labor. More broadly, what is at stake is a safe harbor for conduct that previously has been found illegal. For, although much emphasis is placed on whether this was a *unilateral* refusal to deal (as opposed to a concerted agreement, which would not be exempt from Section 1 scrutiny), it is at least as important that this was a *conditional* refusal. As I show below, the meaningful distinction between this conditional refusal to deal and a conventional illegal tie is nil. Further, if an antitrust exemption is given to all conditional unilateral refusals to deal, this formalistic shield will be easily available in the future to firms that would otherwise be subject to antitrust liability for tying or other concerted agreements.[4]

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1 *In re* Independent Serv. Orgs. Antitrust Litig. (*CSU, L.L.C., v. Xerox Corp.*), 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied*, 121 S. Ct. 1077 (2001) [hereinafter *Xerox*].

2 *See, e.g.*, *Symposium: The Federal Circuit and Antitrust*, 69 ANTITRUST L.J. No. 3 (2002), especially Ronald S. Katz & Adam J. Safer, *Should One Patent Court Be Making Antitrust Law for the Whole Country?*, *id.* at 687; Peter M. Boyle et al., *Antitrust Law at the Federal Circuit: Red Light or Green Light at the IP-Antitrust Intersection?*, *id.* at 739; *see also* the papers and presentations of the economists (including this author) and lawyers at the May 1, 2002 FTC-DOJ Hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy," *available at* http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%201:.

3 Jonathan Gleklen agrees in his companion article, *Point: Per Se Legality for Unilateral Refusals to License IP Is Correct as a Matter of Law and Policy*, ANTITRUST SOURCE, July 2002.

4 FTC Chairman Robert Pitofsky criticized the *Xerox* decision as "leap[ing] from the undeniable premise that an intellectual property holder does not have to license anyone in the first instance to the unjustifiable conclusions that it can select among licensees to achieve an anti-competitive purpose or can condition a license (for example, you receive a license only if you agree not to do business with my competitor) to achieve an anti-competitive effect." Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy, Address Before the Berkeley Center for Law and Technology (Mar. 2, 2001), *available at* http://www.ftc.gov/speeches/01speech.htm.

Jeffrey K. MacKie-Mason *is Arthur W. Burks Professor of Information and Computer Science and Professor of Economics and Public Policy, University of Michigan. Professor MacKie-Mason testified as an expert economist in several cases cited, including* Creative Copier Service v. Xerox *(*In re *Independent Service Organizations Antitrust Litigation*)*, 203 F.3d 1322 (Fed. Cir. 2000),* cert. denied*, 121 S. Ct. 1077 (2001) (companion case to* CSU v. Xerox*);* Image Technical Services, Inc. v. Eastman Kodak Co., *125 F.3d 1195 (9th Cir. 1997);* Intergraph Corp. v. Intel Corp., *253 F.3d 695 (Fed. Cir. 2001);* Virtual Maintenance, Inc. v. Prime Computer, Inc., *11 F.3d 660 (6th Cir. 1993);* Data General Corp. v. Grumman Systems Support Corp., *36 F.3d 1147 (1st Cir. 1994).*
I am grateful to Janet Netz, Bill Jaeger, Jonathan Gleklen, and Mike Barnett for helpful comments.

The *Xerox* Rule Is Not Supported by Economics

Economic theory and empirical research do not resolve whether blanket immunity for unilateral refusals to deal IP, all else equal, is on balance good or bad for social welfare.[5] What is understood is that such a rule involves tradeoffs, with some beneficial and some adverse consequences. When considering other uses of intellectual property rights with ambiguous overall effects, Congress and the courts have uniformly established that IP rights are *limited*. Owners of IP rights may not, for example, use them to engage in tie-in agreements, nor to facilitate price-fixing agreements.[6] Indeed, even the right to exclude unilaterally others from use—the right that is central to the *Xerox* controversy—is fundamentally limited: it extends for only a fixed number of years. These limitations on IP rights are intended to balance the benefits and harms that follow from granting property rights to ideas in the first place.

The right to exclude others from making, using, or selling intellectual property is intrinsically an artificial right, created to further a public policy goal. One of the intrinsic features of ideas is that many can use them simultaneously without diminution in substance. That is, ideas are not excludable, unlike tangible property: if you sit on my chair, you are denying me the ability to sit on it. The U.S. Constitution delegates to Congress the power to grant authors and inventors exclusive rights for limited times "to promote the progress of science and useful arts."[7] Since IP rights are children of government, in service of an explicit public policy goal, it is important to analyze their implementation and enforcement in terms of their effect on social welfare.[8]

[W]hen a firm has market power, some refusals to deal harm consumers and some do not.

The economic impact of the *Xerox* rule depends on both immediate and future effects on consumer welfare. The immediate effects are those usually associated with antitrust policy; the future effects are the concern of both antitrust and intellectual property policy.

Immediate Effects on End Consumers. If a firm refuses to sell or license items embodying its intellectual property, consumers may face higher prices, less desirable variety, or less desirable quality. For example, in *Xerox* the defendant refused to sell replacement parts for its high-volume photocopiers to independent service organizations (ISOs). The ISOs complained they were not able to compete because Xerox had a monopoly on (at least some) parts, and thus consumers faced higher prices and less variety in service options.

If we focus for a moment on this question alone, and ignore other effects (discussed below), a refusal to deal IP is economically equivalent to a refusal to deal any other type of property. A variety of economists have shown that when a firm has market power, some refusals to deal harm consumers and some do not. That some refusals harm consumer welfare is not controversial.[9] Thus, the usual economic justification for limited antitrust restrictions on conduct holds for refusals to deal.

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[5] This argument is developed with more detail in my paper, "What to Do About Unilateral Refusals to License?", written for the FTC-DOJ Hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy," *available at* http://www.ftc.gov/opp/intellect/020501mackie2.pdf.

[6] *Xerox*, 203 F.3d at 1327.

[7] U.S. Const. art I § 8 cl. 8.

[8] *See* Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932) ("The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors").

[9] *See, e.g.*, Dennis Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal: Why* Aspen *and* Kodak *are Misguided*, 68 Antitrust L.J. 659 (2001); Severin Borenstein, Jeffrey MacKie-Mason & Janet Netz, *Exercising Market Power in Proprietary Aftermarkets*, 157 J. Econ. & Mgmt. Strategy 9 (2000); Michael D. Whinston, *Tying, Foreclosure and Exclusion*, 80 Am. Econ. Rev. 837 (1990).

Indirect Effects on Future Consumption. Refusals to deal may also have effects on future consumption by affecting the incentives to invest in risky innovation projects. This, of course, is the well-known reason for granting property rights to exclude others from intellectual property. Because ideas are non-excludable, without government-enforced property rights inventors and authors may not earn a sufficient return to induce the socially desirable effort to innovate. An unlimited right to exclude is a strategic option that will, on average, increase the returns a firm can expect to earn on its innovations.

[W]hile stronger rights to exclude sometimes induce greater innovation, they sometimes reduce *innovation.*

What is less widely recognized, and indeed, almost absent from most recent discussions of antitrust and IP in both scholarship and before the courts, is that while stronger rights to exclude sometimes induce greater innovation, they sometimes *reduce* innovation. When one firm gains exclusive rights to crucial technology, other firms can be discouraged from innovative effort in related areas. Blocking patents and large patent portfolios can have this effect.[10] More generally, economists have agreed for decades that innovative effort may either increase or decrease when a firm gains monopoly control of a market.[11]

Thus, even if we consider solely the effects on future innovative effort, economics does not provide an unambiguous recommendation that society is better off with unfettered antitrust immunity for unilateral refusals to deal in IP.

Optimal Policy? What we learn from economics is that antitrust immunity for unilateral refusals to deal IP is not guaranteed to improve social welfare. Due to the ambiguity of the results, the converse statement cannot be made with any greater assurance. What is clear is that under some circumstances, consumers will face higher prices and less desirable variety and quality. Further, in some markets "progress of science and the useful arts"—the very public policy purpose that justifies the legislative creation of intellectual property rights in the first place—would be served better by a limited right to exclude, because total innovative effort can be reduced when a firm gains monopoly power.[12]

There is little debate that in most regards, the use of intellectual property rights is limited in time and manner of use. What we know from economics suggests that limiting the right to unilaterally exclude could also advance social welfare and the policy objective that underlies the creation of the rights.

The *Xerox* Law Is Not Supported by Prior Case Law

Supporters of *Xerox* argue that intellectual property rights are, by definition, rights to refuse to sell, and that these statutory rights should trump antitrust restrictions on such refusals.[13] However, the right to refuse to deal is inherent in any tangible or intangible property right, as courts have recognized.[14] Generally, a monopolist is entitled to choose with whom to deal. That intellectual prop-

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[10] *See, e.g.*, Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools and Standard Setting*, *in* Innovation Policy and the Economy (Adam Jaffe, Joshua Lerner, & Scott Stern eds., 2001).

[11] *See, e.g.*, F.M. Scherer, Industrial Market Structure and Economic Performance 407–38 (2d. ed. 1980).

[12] *See id.*

[13] *See, e.g.*, Gleklen, *supra* note 3.

[14] *See* Kaiser Aetna v. U.S., 444 U.S. 164, 176 (1979) (the right to exclude others is "one of the most essential sticks in the bundle of rights that are commonly characterized as property").

erty laws provide a right to exclude does not mark them as special, but as standard instances of property law in general.[15]

Equally well established is that intellectual property rights, the same as other property rights, are limited. They are limited in duration, and other laws constrain them,[16] including the antitrust laws.[17] Just as monopolists under some circumstances have a limited duty to sell their non-intellectual property, there is no logical incoherence in finding that monopolists may also sometimes face a limited duty to deal their intellectual property.

The question then is: did Congress through its laws (and the courts through their interpretations) specifically exempt intellectual property owners from this well-established limitation on the property right to refuse dealing?

Firms with Intellectual Property Rights Are Subject to the Obligations of Antitrust Law Unless Explicitly Exempted. The Patent and Copyright acts do not provide general exemption from the antitrust laws.[18] The Federal Circuit in *Xerox* states: "Intellectual property rights do not confer a privilege to violate the antitrust laws." [19] As the D.C. Circuit recently wrote:

> Microsoft's primary copyright argument borders upon the frivolous. The company claims an absolute and unfettered right to use its intellectual property as it wishes: "If intellectual property rights have been lawfully acquired," it says, then "their subsequent exercise cannot give rise to antitrust liability." That is no more correct than the proposition that use of one's personal property, such as a baseball bat, cannot give rise to tort liability.[20]

Because intellectual property rights do not exempt all conduct from the antitrust laws, we must inquire whether unilateral refusals to deal are exempted without limitation.

Congress Did Not Exempt the Duty to Deal for Private or Intellectual Property. In general, a monopolist may have a duty to deal in its private property under some circumstances.[21] This point is not

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[15] For a thorough argument that intellectual property should be treated the same as other property under the antitrust laws, see A. Douglas Melamed & Ali Stoeppelwerth, *The* CSU *Case: Facts, Formalism and the Intersection of Antitrust and Intellectual Property Law*, 10 GEO. MASON L. REV. (2002) (forthcoming).

[16] *See, e.g.*, U.S. v. Microsoft Corp., 253 F.3d 34, 63 (D.C. Cir. 2001).

[17] *Xerox*, 203 F.3d at 1327.

[18] *See, e.g.*, U.S. v. Paramount Pictures, Inc., 334 U.S. 131, 144 (1948) ("For a copyright may no more be used than a patent to deter competition between rivals in the exploitation of their licenses."); Interstate Circuit, Inc. v. U.S., 306 U.S. 208, 230 (1939) ("An agreement illegal because it suppresses competition is not any less so because the competitive article is copyrighted."); Broadcast Music, Inc. v. CBS, 441 U.S. 1, 19 (1979) ("the copyright laws confer no rights on copyright owners to fix prices among themselves or otherwise to violate the antitrust laws."); U.S. v. Line Material Co., 333 U.S. 287, 308 (1948) ("It is equally well settled that the possession of a valid patent or patents does not give the patentee any exemption from the provisions of the Sherman Act beyond the limits of the patent monopoly.").

[19] *Xerox*, 203 F.3d at 1325. *See also* Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1362 (Fed. Cir. 1999) ("intellectual property 'does not confer upon it a privilege or immunity to violate the antitrust laws'" (quoting Intergraph Corp. v. Intel Corp., 3 F. Supp. 2d 1255 (N.D. Ala. 1998)).

[20] *Microsoft*, 253 F.3d at 63 (citations omitted).

[21] For example, in *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951), the Supreme Court affirmed a Section 2 violation when a newspaper refused to sell advertising space to customers that had also bought advertising time from a newly established radio station that competed with the newspaper. The right to freely choose customers with which it would deal "is neither absolute nor exempt from regulation." *Id. at 155*. *See also* U.S. v. Colgate & Co., 250 U.S. 300, 307 (1919) ("In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."); Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 601 (1985) ("[t]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified").

controversial.[22] As is the case for other private property owners, the core feature of intellectual property is the right to exclude others from making, using, or selling the property. But the right to exclude for property generally is limited. Under some circumstances, the courts have found that a firm with market power can have a duty to deal. Has Congress made it clear that intellectual property should be different from other property in this regard? As I argued above, there is no economic or policy reason to think that it did: unlike tangible property, ideas are not in their nature excludable, and the creation of intellectual property rights serves to bring them onto the same footing as tangible property. It is not stated in the Constitution nor in the Patent or Copyright Acts that intellectual property holders have greater rights to exclude than do other property holders.

To the contrary, my reading of this language, and of the debate over its legislative history, is that this language was not intended to grant intellectual property greater protection than other property from antitrust liability.

Supporters of the *Xerox* decision infer such an exemption from analysis of the legislative history of Section 271(d) of the 1988 amendments to the Patent Act. In particular, supporters read an exemption from the antitrust laws into the language that "No patent owner otherwise entitled to relief for infringement or contributory infringement shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of having . . . (4) refused to license or use any rights in the patent."[23]

To the contrary, my reading of this language, and of the debate over its legislative history, is that this language was not intended to grant intellectual property greater protection than other property from antitrust liability.[24]

There are several statements in the legislative history indicating that the purpose of Section 271(d) was "to put intellectual property rights on *an equal footing with other property* with respect to the license, sale and other agreements concerning the distribution of property rights."[25]

On its face, the language in Section 271(d) does not even address antitrust liability: the section concerns the affirmative defense of misuse against an infringement claim by the patent holder.[26] Some argue that the second clause in Section 271(d)'s phrase, "misuse or illegal extension of the patent right," must refer to antitrust liability. How could it make sense to exempt firms from a misuse defense by an infringer, but then subject the firm to antitrust liability?[27] The argument is flawed. An infringer would not have automatic recourse to an antitrust counterclaim any time there is a refusal to deal. In fact, there are very narrow circumstances under which any refusal to deal violates antitrust laws. In all other circumstances, the patent owner not only will not be liable under

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[22] *See, e.g.*, Jonathan Gleklen, *Antitrust Liability for Unilateral Refusals to License Intellectual Property:* Xerox *and its Critics*, ANTITRUST AND INTELLECTUAL PROPERTY Newsletter (ABA Section of Antitrust Law Intel. Prop. Committee), Spring 2001 ("A monopolist whose monopoly is based on tangible property may, in some circumstances, be compelled to share that property with others."

[23] 35 U.S.C. § 271(d)(4).

[24] Statutory construction and the analysis of legislative intent is not my area of expertise. Fortunately, the debate has been ably engaged elsewhere. For the opposing view, *see* Gleklen, *supra* note 3; Melamed & Stoeppelwerth, *supra* note 15.

[25] Senate Rep. No. 100-492 at 9 (1988) (emphasis added). *See also* Grid Sys. Corp. v. Texas Instruments Inc., 771 F. Supp. 1033, 1037 n.2 (N.D. Cal. 1991). The DOJ and FTC Antitrust Guidelines for the Licensing of Intellectual Property § 2 state, "for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property," *available at* http://www.usdoj.gov/atr/public/guidelines/ipguide.htm.

[26] *See Grid Systems*, 771 F. Supp. at 1037 n.2 ("On its face, section 271(d) relates only to the defense of patent misuse," and "TI argues that the legislative history merits a judicial extension of this statute into the area of anti-trust. Some legislators did favor such an exception. However, a full reading of the legislative record reveals that Congress rejected the extension despite this articulate support.") The U.S. Solicitor General, in his *Xerox* amicus brief asserts that Section 271(d) on its face does not address monopolization by refusal to deal. Brief for the United States as Amicus Curiae at n.6, *CSU, L.L.C. v. Xerox*, 121 S. Ct. 1077 (2001) (No. 00-62), *available at* http://www.usdoj.gov/osg/briefs/2000/2pet/6invit/2000-0062.pet.ami.inv.pdf.

[27] *See, e.g.*, Boyle et al., *supra* note 2; Gleklen, *supra* note 3.

antitrust, but can also sue for infringement with immunity to an affirmative defense that its refusal to deal constitutes unclean hands. In other words, the patent owner is always immune to a misuse claim, and usually—but not always—free from antitrust liability.

The Ninth Circuit Is Not Alone. Some authors suggest that the Ninth Circuit in its *Kodak* decision is alone in suggesting that antitrust law may impose a limited duty to deal on an IP owner. Although this question is certainly unsettled, it is not lopsided. Quite recently, in *U.S. v. Microsoft*, Judge Jackson wrote, "copyright law does not give Microsoft blanket authority to license (*or refuse to license*) its intellectual property as it sees fit."[28] The D.C. Circuit upheld his decision.[29]

There has also been seemingly endless debate about whether the Supreme Court's footnote 29 in *Kodak* applied only to its thinking about tying agreements, or more generally: "The Court has held many times that power gained through some natural and legal advantage such as a patent, copyright, or business acumen can give rise to liability if 'a seller exploits his dominant position in one market to expand his empire into the next?'"[30] Although this footnote appeared in its discussion of the tying claim in *Kodak*, the Ninth Circuit pointed out that the Court referred back to its more detailed arguments in this section when discussing monopolization.[31] Certainly, the language is not on its face restricted to tying agreements: the Court is concerned that a firm might leverage its market power gained from intellectual property into another empire. This appears to be the thinking in the full sentence the Court quoted from *Times-Picayune*: "But the essence of illegality in tying agreements is the wielding of monopolistic leverage; a seller exploits his dominant position in one market to expand his empire into the next."[32] In that 1953 decision the Court is not saying that *only* tying agreements give rise to illegal leverage, but that the essence of illegality is itself "the wielding of monopolistic leverage."

It may be useful at this point to recall the allegation against Xerox. CSU did not complain that Xerox was monopolizing the market for replacement parts by refusing to sell its patented parts. Likewise, Xerox did not claim that CSU wanted to license its intellectual property so that it could go into the business of selling competing parts. Rather, CSU complained that Xerox was leveraging its power over a few patented parts in order to monopolize the market for *service labor*.

The *Xerox* opinion states that "a patent may confer the right to exclude competition altogether in more than one antitrust market."[33] I do not disagree: it may. For example, a patent on a material may legitimately prevent others from making infringing rollers for copiers and from making nonstick cookware. By the same token it may not: just as a patent does not give the right to monopolize another market through a tie-in, it would be economically, legally, and logically coherent to determine that some refusals to deal should be prohibited if their effect is to obtain a monopoly in a market which does not itself directly flow from the patent. There is at the least a colorable argument that the market for service labor does not fall within the scope of patents on a few replacement parts.

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[28] U.S. v. Microsoft Corp., 1998 U.S. Dist. LEXIS 14231 at *48 (D.D.C. Sept. 14, 1998) (emphasis added).

[29] 253 F.3d 34, 63 (D.C. Cir. 2001).

[30] Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 479 n.29 (1992) (emphasis added) (quoting Times-Picayune Publ'g Co. v. U.S., 345 U.S. 594, 611 (1953)).

[31] *Kodak*, 125 F.3d 1195, 1216 (9th Cir. 1997). The Federal Circuit in *Xerox* dismissed this statement by the Supreme Court, stating that *Kodak* was a tying case when it was before the Supreme Court, and not commenting on the fact that there was also a monopolization claim. 203 F.3d at 1327.

[32] *Times-Picayune*, 345 U.S. 594, 611 (1953).

[33] 203 F.3d at 1327.

The *Xerox* Rule Will Easily Be Exploited and Will Provide a Safe Harbor for Illegal Conduct

Supporters of the *Xerox* decision characterize the rule of law as antitrust immunity for *unilateral* refusals to deal. However, it is important to realize that the conduct in question was also a *conditional* refusal to deal. Xerox sold parts to purchasers who wanted them for copiers they owned. That is, Xerox conditioned its refusal: a purchaser could not obtain parts *if* it was going to install those parts in a copier owned by another party.

To the extent that they are economically equivalent conduct in their impact on competition, conditional refusals to deal should not be treated differently from tying agreements.

The Xerox policy was not contractually a tie-in: it did not refuse to sell parts to purchasers unless the purchaser also purchased service labor from Xerox. Purchasers were allowed to buy parts and then hire ISOs to install them. However, this was not economically feasible for most copier owners, and thus the conditioned refusal had exactly the same consequences as a tie: service labor competition from ISOs was excluded. Ordering parts when a copier broke down took days, and most customers could not afford to maintain a sufficient inventory of parts (each machine used thousands of different parts). Thus, the conditioned refusal was very specific in its terms and impact: customers were permitted to purchase parts for their own machines, but they were not permitted to hire a third party to serve as their agent in purchasing parts. This was enough to exclude competition in the service labor market.[34]

Thus, *Xerox* supporters claim that firms should be able to unilaterally impose *conditional* refusals to deal, even as they acknowledge that tie-in agreements that have the same economic consequences on competition can be illegal. It is hard to see any logic supporting this formalistic distinction. As I have shown above, it is not supported by economic logic. Nor does it appear to be consistent with the Supreme Court's statements in *Times-Picayune* and *Kodak* that "the essence of illegality in tying agreements is the wielding of monopolistic leverage." To the extent that they are economically equivalent conduct in their impact on competition, conditional refusals to deal should not be treated differently from tying agreements. Indeed, claiming a distinction between the two is especially far-fetched because most tying agreements are unilaterally imposed on consumers as take-it-or-leave-it offers. Indeed, the Supreme Court stated in *Jefferson Parish* that "forcing" is the identifying characteristic of an illegal tying arrangement.[35]

It's bad enough that there is no sense in this formalistic distinction when the economic consequences are identical. Worse, the *Xerox* rule promises to lead to substantial mischief. If an intellectual property right to refuse to deal is absolute and immune to antitrust, then for all intents and purposes all non-intellectual property owners are likely to find that they have an absolute immunity to antitrust when they unilaterally refuse to deal in the future. Hardly any significant commer-

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[34] The situation is not idiosyncratic. Consider the more generic hypothetical, from Eugene Crew, Microsoft's Copyright Defense, *in* INTELLECTUAL PROPERTY ANTITRUST 2000 (Practicing Law Institute June-July 2000): Xerox refuses to sell patented parts to Y unless Y agrees not to compete with Xerox in the service market, and Y agrees: Xerox would have no immunity from Section 1 prohibition of tying. *Cf.* U.S. v. Loews, 371 U.S. 38, 46 (1962). What if Y refuses to agree and Xerox then refuses to license Y? Y is thereby excluded from the service market, resulting in precisely the same harm to competition that results from Y's acceptance of Xerox's license offer. *See, e.g.*, Thompson v. Metropolitan Multi-List, Inc., 934 F.2d 1566, 1572 (11th Cir. 1991). Mr. Gleklen agrees that a "failed tie" is illegal. *See* Gleklen, *supra* note 22.

[35] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984). The courts have recognized that conduct that is not strictly a tying agreement nonetheless should be treated as a tie when its economic effects are equivalent. *See, e.g.*, Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 463 (1938) (pure unilateral conduct penalizing those who used a patented process without unpatented materials (through infringement litigation) was the "practical equivalent" of an illegitimate tie). *See also* Virtual Maint., Inc. v. Prime Computer, Inc., 11 F.3d 660 (6th Cir. 1993) (offering service labor separately from a copyrighted software program only at an economically prohibitive price was an illegal tie).

[36] *See* Transcript, May 1, 2002 FTC-DOJ Hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy," at 71–73, *available at* http://www.ftc.gov/opp/intellect/020501xscript.pdf.

cial property sufficiently unique that its owner might leverage it to anticompetitive effect is devoid of components of intellectual property that could be protected by patent or copyright. Further, it would be a trivial matter for firms, on advice of counsel, to modify their designs in order to incorporate protected components. I have elsewhere referred to this as the "stupid washer" problem: a firm could patent the design of a washer, then integrate that washer as a component of its otherwise unprotected parts, assemblies, machines, etc.[36] The same could be done with a patented algorithm inserted in a firm's software programs.

[I]n the future, firms will take advantage of this formalistic distinction to endow their non-intellectual property with an intellectual property component before they refuse to deal, thereby designing themselves into a safe harbor.

Jonathan Gleklen (and others) argue that the "stupid washer" is not a problem under *Xerox* because it amounts to a tie, and the court in *Xerox* agrees that tie-ins conditioned on patented property are not exempt from antitrust scrutiny.[37] It is possible that some naked attempts to hide behind *Xerox* immunity would be ruled a tie, and thus not exempt.[38] However, courts do not generally question product design decisions, and if a component is integrated into the design and manufacture of a product, it is unlikely the courts would declare that integration to be a tie-in.[39] As an example, I believe some of the patents in *Xerox* applied to components of parts, not to entire assemblies.

Lest my concern seem alarmist, it is instructive to note that many of the most significant refusal to deal cases in the past involved, or could easily have involved, protected intellectual property. Under the *Xerox* rule, many of these may have been wrongly decided. Should AT&T have been allowed to refuse to deal with MCI if its interfaces were patented? Its market power was due to its ubiquitous local network, not interfaces.[40] What if Aspen had a patented gear mechanism in its ski lifts?[41] Suppose Otter Tail Power had patents on parts in its electric transformers (which it refused to use to wheel power)?[42] It seems clear that in the future, firms will take advantage of this formalistic distinction to endow their non-intellectual property with an intellectual property component before they refuse to deal, thereby designing themselves into a safe harbor.

Conclusion

Congress has endowed owners of ideas a legal right to exclude that puts intellectual property on the same footing as other property. As with all such rights, it is limited. Economic analysis of the social welfare purposes behind intellectual property law does not support antitrust immunity for unilateral refusals to deal, nor does prior law or legislative history.

It is true that limits on the extent of an intellectual property right will, to some extent, reduce the expected return to the property right, which in turn may reduce the incentive for some firms to innovate. But this effect is true of any limitation on intellectual property rights, and it is well established

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[37] Gleklen, *supra* note 3.

[38] I do not expect, for example, that we need to worry about Patterson's example that a firm might package an unprotected part in a box that is printed with copyrighted text, Mark R. Patterson, *When Is Property Intellectual? The Leveraging Problem*, 73 S. Cal. L. Rev. 1133 (2000)).

[39] *See, e.g.*, U.S. v. Microsoft Corp., 147 F.3d 935, 949–50 (D.C. Cir. 1998) ("In antitrust law, from which this whole proceeding springs, the courts have recognized the limits of their institutional competence and have on that ground rejected theories of 'technological tying.' A court's evaluation of a claim of integration must be narrow and deferential."). This was the decision concerning the applicability of an earlier consent decree on Microsoft's decision to allegedly integrate its Internet Explorer Web browser product into its Windows operating system product. Indeed, in *B. Braun Med. Inc. v. Abbott Labs*, 124 F.3d 1419 (Fed. Cir. 1997), the court held that the patentee had the right to exclude competition in both the market for patented valves and the market for extension sets incorporating patented valves.

[40] MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132–33 (7th Cir. 1983).

[41] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

[42] Otter Tail Power Co. v. United States, 410 U.S. 366 (1973).

that there are limits, as with any property right. Congress wants to endow inventors with some amount of protection, but not unlimited protection (and even limited the duration of the right to exclude). When the limitation is imposed in order to limit unwarranted accumulation of monopoly power, we cannot even be sure that such a limitation will reduce the total incentives to innovate, because the accumulation of monopoly power can itself reduce innovation.

I do not dispute that the right to exclude others from the use of the intellectual property is a core aspect of a patent grant. What I argue is that it is not essential or proper that it be an unlimited right, and that in some limited circumstances refusals to deal should be prohibited. We should be especially concerned about conditional refusals to deal, because they can have exactly the same economic consequences as tie-in agreements, which the Federal Circuit agreed are not exempt from antitrust scrutiny.

Indeed, the *Xerox* immunity rule can be easily expanded into a safe harbor for conduct previously found illegal. It may well be that this is precisely the outcome that supporters of *Xerox* prefer: that unilateral refusals to deal be immune from antitrust liability for all property, not just intellectual. Even if that is not the argument offered, that is the likely consequence of *Xerox*. ●

Paper Trail: Working Papers and Recent Scholarship

***This edition of the Paper Trail** summarizes the papers presented on June 10, 2002, by past and present senior agency leadership (mostly economists) on the occasion of the 20th anniversary of the 1982 Merger Guidelines. These papers were presented following brief but interesting opening remarks by Assistant Attorney General Charles James, who likened the development of the Guidelines to John Coltrane's composition of* Giant Steps *that revolutionized modern jazz. (Kudos to the AAG for helping to dispel the illusion that antitrusters are only interested in green eye-shade topics.) In addition, we summarize two recent and interesting papers raising questions about the scope of network effects. As always, suggestions for papers to include in the Paper Trail are encouraged. Email those suggestions to John Woodbury, jrw@crai.com, or to William Page, page@law.ufl.edu.*

20th Anniversary of the 1982 Merger Guidelines: The Contribution of the Merger Guidelines to the Evolution of Antitrust Doctrine (June 10, 2002), http://www.usdoj.gov/atr/hmerger.htm.

Oliver E. Williamson, The Merger Guidelines of the US Department of Justice. In this collection, the short paper by Oliver Williamson reminds the antitrust community that the roots of the 1982 and after Guidelines are found in earlier days, in particular when Don Turner upgraded the status of economic analysis within the Antitrust Division in the mid- and late 1960s. These must certainly have been heady intellectual times, with the likes of Williamson, Turner, and Posner all steering antitrust enforcement towards waters more friendly to economic analysis.

William Kolasky and Andrew Dick, The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers. Where the Williamson paper ends—describing the potential importance of efficiencies in merger analysis—is where the paper by William Kolasky and Andrew Dick begins. The Kolasky-Dick paper describes the 1968–1997 transformation of the Guidelines' approach to efficiency claims, from being only an exceptional defense to potential anticompetitive harm to being integrated as part of the Guidelines' competitive effects analysis. Interestingly, the paper suggests that the 1997 revisions do not obviously support only a consumer welfare approach in evaluating efficiency claims. (This is the view that the efficiencies must be such as to result in lower prices to consumers; because fixed cost savings are not likely to result in lower prices within the Guidelines' time horizon, such savings, in this view, do not "count.") Instead (citing note 37 in the 1997 revision to the 1992 Guidelines), the authors suggest that the "real" Guidelines' approach should be considered a hybrid of the total welfare approach (which would count fixed cost savings) and the consumer welfare approach. In addition to suggesting that the efficiencies analyses play an important role in merger analysis at the agencies, the paper also describes how the courts have "increasingly" accepted the idea that efficiencies can be used offensively. Yet, it's not hard to recall the D.C. Circuit's characterization of the efficiency analysis in the *Baby Food* case as "novel." *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001). Perhaps Kolasky and Dick are sending practitioners a signal that it's safe to use efficiency arguments before the agencies if they conform to the 1997 revisions.

Gregory J. Werden, The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm. A brief paper by Gregory Werden details the intellectual antecedents to the hypothetical monopolist paradigm and how that paradigm became the "organizing principle" for merger analysis before the agencies. In addition, Werden documents the paradigm's almost wildfire-like spread (in antitrust time) to foreign antitrust agencies, as well as the now-conventional use of critical loss/critical elasticity analysis for market definition purposes, an analysis that derived from the hypothetical monopolist paradigm.

David Scheffman, Malcolm Coate and Louis Silvia, 20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective. A longer paper by David Scheffman, Malcom Coate, and Louis Silvia takes a broader look at the legacy of the 1982–1997 Guidelines at the FTC in particular and how the application of the Guidelines has been refined through the use of critical loss analysis, econometric demand estimation, bidding models, "natural" experiments or event analyses, MVS implementation, and unilateral effects models. For each of these, the paper cites investigations and cases that relied on one or more of these approaches. In discussing the role of concentration in merger analysis, the paper offers some interesting factoids. It notes that in a sample of 113 enforcement actions (i.e., either settlements or complaints) between 1983–2000, the lowest HHI in these actions increased from 1566 in 1983–84 to 2545 in 1985–86 "and remained well over 2000 for the remainder of the time period." For 107 closed investigations during the same period, the highest HHIs "generally exceeded 4000 throughout the sample." While discussing the role of efficiencies, the paper does not cite any evidence that any apparently Guidelines-conforming efficiency analysis played a key role in FTC investigations. No surprise there.

Jonathan B. Baker, Responding to Developments in Economics and the Courts: Entry in the Merger Guidelines. Finally, in a shorter paper, Jonathan Baker provides a concise and informative history of the role of entry in Guidelines' merger analysis. The paper discusses the significance of the distinction between uncommitted and committed entrants and the evolution of the "likely, timely, and sufficient" test. The paper closes with an important observation that the 5 percent MVS test is indeed arbitrary, with no Guidelines guidance on how to adjust that threshold to particular market circumstances.

—JRW

Stan J. Liebowitz, Network Meltdown: A Legacy of Bad Economics (April 19, 2002)
http://papers.ssrn.com/paper.taf?abstract_id=309879.
Liebowitz is a long-time critic of the network externalities and increasing returns literature. In this paper, excerpted from a forthcoming book, he argues that the dot.com bubble formed because entrepreneurs accepted the economists' extravagant claims that Internet markets are characterized by "lock-in" and a strong "first mover advantage." Liebowitz shows that, as a theoretical matter, these effects have a much narrower applicability than many believed. He argues for caution in accepting claims of paradigm shifts that upset the settled truths of traditional microeconomics, concluding that "[t]he laws of supply and demand are not so fragile as to be overcome by anything so small as a new method of communicating with one another." Much of the paper is familiar—Liebowitz trots out his famous debunking of the myth of the QWERTY keyboard—but the paper does include an entertaining collection of quotations from economists during the heyday

of the dot.coms. For example: "Earnings are a decision variable, not a requirement. . . . If everyone thinks you're doing fine without earnings, why have them?"

—WHP

Venkatesh Shankar & Barry Bayus, Network Effects and Competition: An Empirical Analysis of the Home Video Game Industry (January 2002)
http://papers.ssrn.com/paper.taf?abstract_id=296534.

This is another paper that challenges claims about the strength of lock-in resulting from gaining the larger installed base. The authors examine the role of network effects in competition between incompatible technologies, focusing on Sega and Nintendo. The study examines not only the size of the competing networks, but their strength—that is, "the marginal impact of a unit increase in network size on demand." In other words, networks of a given size can have asymmetric network effects depending upon their relative strength. Strength depends on a variety of sociological factors that foster brand loyalty; firms that have strong networks can exploit that strength as a resource in competition with other networks. Nintendo's network (installed base) was smaller than Sega's but stronger because it was composed of younger teenagers who were fiercely loyal. By marketing to that base, Nintendo was able to outpace the sales of Sega, even though it had a smaller installed base and even though it waited to introduce its new generations of products until after its competitors had done so. ●

—WHP