

## Ask the Ethics Experts

**Editor's Note:** In this issue of The Antitrust Source, we introduce a new feature: Ask the Ethics Experts. Our experts pose ethical questions that may occur in the context of antitrust practice and then answer them based on the rules of individual jurisdictions and the ABA's Model Rules of Professional Responsibility.

Our guest experts for this issue are Kathryn Fenton, a partner at Jones Day Reavis & Pogue in Washington, DC, and Allan Van Fleet, a partner in Vinson & Elkins L.L.P., in Houston, Texas. Kathy and Allan currently serve as Officers of the ABA Section of Antitrust Law—Kathy as Secretary and Allan as Section Delegate to the ABA House of Delegates. Allan is the former Chair of the Section's Ethics and Professionalism Committee.

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

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

### Billing Multiple Clients for Simultaneous Legal Service

**Q:** I have been asked to represent three unrelated companies in responding to an industry-wide CID issued by the Federal Trade Commission in connection with its retrospective review of hospital mergers. Each of the companies has consented to the simultaneous representation and to pay our firm's standard hourly rates. Initially, much of the work that would have been necessary to represent a single client can be used to benefit all three (e.g., reviewing FTC rules of procedures, negotiating certain general modifications of the CID, etc.). Given the traditional hourly billing arrangements in place here, can I bill each client for the total number of hours I spent on common activities, even though this would triple the time actually spent?

**A:** Ethics authorities unanimously have held that a lawyer who has agreed to charge a client for his or her services under an hourly billing arrangement may not bill more than one client for the same time. To do so would violate the ethical rules forbidding lawyer misrepresentation and charging excessive legal fees.

The principle that a lawyer may not bill more than one client for the same time expended on the same service has been articulated in numerous ethics opinions, including ABA Formal Ethics Opin. 93-379 (1993), and recently reiterated in Oregon State Bar Legal Ethics Committee Opin. 2002-170 (May 2002). The latter opinion considered the situation where a lawyer had four clients whose case were all set for a "call" before the trial court on the same day. The lawyer spent a total of one hour attending the call on behalf of all four clients and asked if each of the four clients could be billed for the entire hour.

The bar committee concluded that traditional hourly billing arrangements are violated if the lawyer bills the client for more time than the lawyer actually worked. A bill for more time than the lawyer actually worked constitutes a clearly excessive legal fee in violation of ABA Model Rule 1.5(a) and ABA Model Code DR 2-106(a). Moreover, the committee concluded “[b]illing more than one client for the same time expended on the same service also would constitute misrepresentation by nondisclosure” in violation of ABA Model Rule 8.4(c) and DR1-102(A)(3), which each make it professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

In reaching this conclusion, the Oregon Committee found that it made no difference that the lawyer could have billed each client for one hour if that client’s case had been the only one set for call that day. The opinion emphasized that a lawyer must bill clients on the basis of what actually occurred rather than on hypothetical facts. To the extent there are savings due to the lawyer’s ability to achieve efficiencies in the provision of legal services, the client, and not the lawyer, must benefit from those efficiencies. See, e.g., ABA Formal Ethics Opin. 93–379 (“economies . . . must inure to the benefit of the client, not give rise to the opportunity to bill a client phantom hours”). The same analysis has been applied to situations involving travel time billed to one client while simultaneously performing substantive work for another, or “recycling” existing work product originally developed for one client on behalf of another client who is billed the amount of time originally incurred to produce the product. *Id.*

**Sanctions.** The possible sanctions for violating these ethics rules can be severe. In egregious cases, disciplinary actions have been brought against attorneys who have engaged in this type of hours worked inflation or others forms of misbilling and have resulted in suspension or disbarment. See, e.g., *In re Miller*, 735 P.2d 591 (Or. 1987) (attorney disbarred for routinely adding an average of 5 to 15 hours to each billing statement); *In re Lane*, 642 N.W. 2d 296 (Iowa 2002) (attorney suspended for billing client 80 hours to write legal brief that was largely copied from employment law treatise). While the ethics opinions on this topic note that it is always possible to obtain the client’s agreement, with full disclosure, for additional compensation because of outstanding results or because the attorney was able to reuse existing work product on the client’s behalf, such “fee enhancement cannot be accomplished simply by presenting the client with a statement reflecting more billable hours than were actually expended.” ABA Formal Opin. 93–379.

Thus, if you only spent a total of six hours working on behalf of the three clients here, you are not entitled to bill eighteen hours. Only the time actually spent may be billed and it must be allocated among the three clients in a manner that fairly reflects the legal services provided to each.

### Contacting Represented Parties

**Q:** I am defending a company in an antitrust action filed in federal court. I’ve gotten word that the plaintiff’s lawyer has been talking to my client’s former employees and even some current employees. Can she do that ethically? It also appears that some DOJ types been asking questions of my client’s employees. Can they do that, or is it no-holds-barred on government snooping after 9/11? Also, my legal assistant has told me she’s been approached by one of the plaintiff’s employees, who wants to talk to our firm about the case. Since the employee made the approach, is it correct to assume that’s okay; would it be better if the legal assistant met the employee and did the debriefing?

**A:** You did not say in which state your case is filed or in which state the contacts were made. I will look mainly to the ABA's Model Rules of Professional Responsibility to answer your questions. You must remember, though, that state-adopted rules and case law govern lawyer conduct and that they differ from state to state. The Model Rules themselves are not law (although they are automatically adopted in the Virgin Islands and form part of the "national norms" of lawyer ethics that federal courts in the Fifth Circuit apply).

**Which State's Rules?** Variation in state ethics rules is increasingly important, as modern legal practice (particularly for antitrust lawyers) is increasingly multijurisdictional. The most recent amendments to the Model Rules, passed by the ABA House of Delegates at the August 2002 Annual Meeting, recognize the need for lawyers to act in jurisdictions other than the ones in which they are licensed, but also to subject themselves to the ethics rules of those other states.

Generally, litigation-related conduct is governed by the rules of the state in which the tribunal sits. (Model Rule 8.5(b)(1)). But before a case is filed, the Model Rules, as most recently amended in August, apply the ethics rules of the state in which the lawyer's conduct occurred or—if different—where the conduct has its predominant effect. (Model Rule 8.5(b)(2)). That would point us to the state in which the contacts are made. If the contacts were made, say, in an interstate telephone call, most likely a court or disciplinary body would look to the rules of the state where the contacted employees reside.

**General Rule Prohibiting Contact.** Model Rule 4.2 addresses contacts with a represented party: "In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order."

The purpose of the rule was clarified in amended comments the ABA adopted in February 2002:

This Rule contributes to the proper functioning of the legal system by protecting a person who has chosen to be represented by a lawyer in a matter against possible overreaching by other lawyers who are participating in the matter, interference by those lawyers with the client-lawyer relationship and the uncounselled disclosure of information relating to the representation.

**Current and Former Employees.** A lawyer for a corporation, of course, represents the organization, not its individual employees. For purposes of the no contact rule, however, the concept of a represented party embraces a "constituent who supervises, directs or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability." These employees may not be contacted, except with the consent of the party's lawyer. If a constituent is represented individually by her own lawyer, consent of that lawyer suffices.

As recently amended comment 7 clarifies, former employees are fair game: "Consent of the organization's lawyer is not required for communication with a former constituent."

In talking with former or current employees, the lawyer must take care not to violate the organization's rights, including the right to preserve the confidentiality of attorney-client communications to which the employee may have been privy.

**Government Lawyers.** One of the most controversial legal ethics issues over the last decade has been the U.S. Department of Justice's effort to exempt its lawyers from state ethics rules, particularly those prohibiting contact with a represented party. This began with the infamous Thornburgh Memorandum in 1989, codified in the Reno Regulations of 1994, which were criticized by the ABA and the courts and were invalidated by the McDade Amendment to the 1998 Omnibus Spending

Bill. An effort last session to reverse the congressional action failed. In the recently amended comment 5 to Rule 4.2, the ABA reaffirmed no blanket exception for government lawyers, but did not close the door completely:

Communications authorized by law may also include investigative activities of lawyers representing governmental entities, directly or through investigative agents, prior to the commencement of criminal or civil enforcement proceedings. When communicating with the accused in a criminal matter, a government lawyer must comply with this Rule in addition to honoring the constitutional rights of the accused. The fact that a communication does not violate a state or federal constitutional right is insufficient to establish that the communication is permissible under this Rule.

The ABA has noted that a lawyer may be advised to seek a court order determining whether a particular communication is authorized. Again, you must look to the rules and interpretations in individual jurisdictions. The Massachusetts Bar Association Committee on Professional Ethics recently concluded that the state's ethics rules do not govern the actions of a federal government lawyer, admitted in Massachusetts, in interviewing witnesses in another jurisdiction while preparing for litigation before a federal agency in that other jurisdiction. Rather, the rules of the federal agency tribunal must govern the conduct of all lawyers involved in the proceeding.

**Contact Initiated by the Represented Party.** In February 2002, the ABA House of Delegates adopted a new comment 3 to Rule 4.2 that a lawyer cannot talk to a represented party who contacts the lawyer: "The Rule applies even though the represented person initiates or consents to the communication. A lawyer must immediately terminate communication with a person if, after commencing communication, the lawyer learns that the person is one with whom communication is not permitted by this Rule."

**Contacts by Lawyer's Agents.** Finally, you may not evade the Rule by having your legal assistant or another representative make the contacts for you. This follows from Rule 8.4, which generally forbids a lawyer from violating the Model Rules through the conduct of others. The ABA recently amended comment 4 to Rule 4.2 to leave no doubt that "A lawyer may not make a communication prohibited by this Rule through the acts of another." ●

## Book Review:

# Innovative Insights About Innovation and Their Implications for Antitrust Policy

**William J. Baumol**

**The Free-Market Innovation Machine:  
Analyzing the Growth Miracle of Capitalism**

Princeton University Press ■ 2002

**Reviewed by Jeffery B. Fromm and Robert A. Skitol**

### Introduction

A recent *Business Week* commentary notes that “for more than a decade, technology companies in Silicon Valley and elsewhere have trumpeted employee stock options as the prime driver for innovation, entrepreneurship, and wealth creation.”<sup>1</sup> Now that stock options have lost much of their allure, the high-tech community needs a new “belief system” about what drives the innovation process. Professor William Baumol’s new book, *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism*, provides many fresh perspectives on this issue.

In a year of considerable hand-wringing over the darker sides of U.S.-style capitalism, Professor Baumol provides a distinctively upbeat message: the free-market system has demonstrated an ability “to produce a stream of applied innovations and a rate of growth in living standards far beyond anything that any other type of economy has ever been able to achieve for any protracted period” (p.viii). The fact that “[p]er capita income in the leading capitalist economies is growing at a rate that apparently permits something like an eightfold multiplication in a century” stands in stark contrast to a “wealthy eighteenth-century England” where “real per capita income had just about retained the level it had reached in third-century Rome” (p.20).

Professor Baumol paints a picture of the innovation process in markets driven by “innovative oligopolists” that challenges some longstanding antitrust doctrines and their application to oligopoly markets in the high-tech sector. Lawyers and economists alike will find the book stimulating and perceptive. It presents both microeconomic and macroeconomic insights of importance to many issues confronting antitrust policymakers.

### Baumol’s Themes

Baumol identifies three features of our economy that account for its extraordinary innovation output: the “fierce competition among many of the economy’s enterprises seeking to come up with the better new mousetrap or the better way to produce the old mousetrap,” the “routinization of

■ **Jeffery Fromm** retired in August 2002 as Senior Managing Counsel for Intellectual Property at Hewlett-Packard Company. **Robert Skitol** is a partner in the Washington, D.C. office of Drinker Biddle & Reath LLP.

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<sup>1</sup> Robert Hof, *This Reform Won’t Kill Silicon Valley*, *Bus. Wk.*, July 29, 2002, at 48.

the innovation process that reduces the firm's dependence upon fortunate happenstance," and the "competitive pressures to disseminate proprietary technology voluntarily . . . even to direct competitors" (p.20).

Baumol describes a present-day innovation paradigm that is quite different from the Schumpeterian model of extraordinary profit from innovation by lone entrepreneurs. While independent innovators continue to offer what may be considered the most revolutionary of new ideas, Baumol's focus is on "systematized, bureaucratized, and highly efficient sets of parallel activities" carried out within "innovative oligopolistic corporations" (p.ix). As he tells the story, these firms have transformed the innovation process from one "beset by fortuitous elements" into a "domain of memorandums, rigid cost controls, and standardized procedures which are the hallmarks of trained management" (p.36). The overall picture, in his view, is a "serendipitous relationship" between entrepreneurial and routinized innovation activity whose "results are arguably super-additive" (p.22).

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In Baumol's model, it is the intensity of competition among innovative oligopolists that determines both the level of innovation expenditure and its upward trajectory over time. Much like "an arms race among mutually suspicious nations," this model contains a "ratchet mechanism" causing periodic escalation, during which it becomes "necessary to run as rapidly as possible in order just to stand still" (p.43). Oligopoly is the necessary and natural market structure for this purpose. Monopoly will not do because, by definition, it is immune from competition; at the other extreme, small firms in unconcentrated markets lack not only the requisite resources but also "the stimulation of observed interdependence with their rivals," and "the spillover problem may well prove particularly severe in such an environment" (p.45).

To Baumol, the spillover factor is a major source of imperfection in the capitalist economic growth engine because a considerable share of the benefits of any given innovation will inevitably go to parties making no contribution to discovery or invention. However, spillover is a two-sided coin: it enables parties other than the innovator to appropriate value from the innovator's investments and thereby provides an important benefit to society in general. In Baumol's picture, an essential attribute to an innovation process that maximally advances societal welfare is the rapid dissemination of innovative output throughout the economy. It is oligopolists, he explains, that have strong incentives to facilitate dissemination through widespread licensing for profit, cross-licensing arrangements, joint R&D, technology consortia, and other forms of technology exchange. Just as competitive pressures have led to the routinization of innovation, competitive mechanisms drive the dissemination process as "part of the regular portion of the firm's *voluntary* activities" (p.75). While rapid dissemination can sometimes be "the enemy" of innovation by diminishing the returns from innovation investment, licensing and other forms of exchange can also enhance incentives for innovation by helping "to internalize the externalities of innovation activity, thereby reducing the spillover problem" (p.79). Thus, it is no longer necessary to view invention and technology transfer as activities that impede one another; rather, they may be seen as "mutually compatible" (p.83). In short, market mechanisms "make it profitable to engage simultaneously in the innovation 'arms race' and in the licensing of any new inventions obtained in the process" (p.83).

Baumol also discusses in some detail the implications of routinized innovation and the continuous sunk cost investments that it requires for pricing the products resulting from the innovation process. Cost-sinking is a "repeat game," and all of it must be regularly recouped. According to Baumol, competitors in technology-driven markets cannot compete on price alone and must compete primarily on innovation. In contrast to Adam Smith's world of atomistic markets and

marginal cost pricing, today's "innovation assembly line economy" drives firms to great size and drives markets into oligopoly structures. In these markets, sunk costs compelled by innovation arms races are "substantial, mandatory, and constantly repeated" (pp.162–63). Pricing well above marginal costs, and a considerable degree of price discrimination, become the norm because innovation outlays cannot be recouped without them. Finally, these markets tend to be "contestable" with firms as "price-takers" unable to impose prices that yield supracompetitive profits (*id.*).

In Baumol's model, price and cost pressures determine firm size and market concentration. No firm that is to survive can operate inefficiently. Therefore, the scale of operations cannot fall short of cost-minimizing levels. Each firm is forced to produce close to its cost-minimizing volume of output, the number of firms in the market becomes the number required to meet total demand at minimum cost, and contestability drives prices to levels that just permit competitive returns. In short, innovation drives concentration to cost-minimization levels—and to firm sizes larger than was previously the case—but innovation does not create monopoly power. Baumol's focus is on the "inter-temporal pattern of final product prices that returns [the continuous investment in innovation] in a manner compatible with economic efficiency" (p.183).

Baumol offers several comments on the policy implications of his model. First, he states that "innovation is an activity in which inter-firm coordination, even among horizontal competitors, can bring substantial welfare benefits" (p.119). For this reason, the antitrust authorities should ordinarily refrain from challenging such collaborations and minimize uncertainty about their legality by "indicating as specifically as possible what types of coordination and of what degree" will not raise antitrust concerns (*id.*). Second, the inherent tradeoff between welfare contribution of spillover effects from dissemination and welfare gain forgone because of the resulting limitation of innovators' payoffs may be modified by, for example, increasing or decreasing patent protection. With his comments on the Japanese system, Baumol invites controversial thinking about some possible welfare-enhancing U.S. patent law reforms (p.144):

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Japanese patenting laws are far less favorable to inventors than are those in the United States and probably increase greatly the "spillovers" from Japanese innovation. No obvious and substantial decline in Japanese innovative activity appears to have resulted from this less protective atmosphere. Even more important, the paucity of protection appears to have strengthened the incentive to enter technology-sharing agreements with competitors and others. That, in turn, has insured that inventions are rapidly disseminated and put to use throughout the Japanese economy, enhancing Japanese productivity growth . . . .

Finally, Baumol's analysis of the interaction between sunk costs of innovation investments and final product pricing imperatives leads him to a "drastically revised view of the nature of monopoly power and the kinds of evidence that can legitimately be used to support or refute an accusation that a firm possesses monopoly power" (p.182). He explains, for example, that price discrimination, or the selling of a product at different prices to different customers based on their different demand elasticities, "can be expected to occur [and to occur frequently] in the pricing of products of innovation—not *despite* relative ease of entry [or other competitive forces] but *because of it*" (p.167). One must, therefore, be wary of precedents that would make innovating oligopolists targets for antitrust prosecution "simply because their prices are discriminatory, or are not close to marginal costs" (p.182). In short, pricing practices of the sort he describes should not be used as a basis for attack: "[S]uch a course can easily constitute a major handicap to the steadily growing expenditure on innovation by private industry, which is arguably the mainstay of the U.S. economy's unprecedented growth record" (p.182).

## Antitrust Implications

**Joint Venture and Merger Standards.** Baumol's analysis of both the intensity of innovation rivalry between oligopolists and the desirability of collaborations between them invites fresh thinking about joint venture and merger enforcement policies now in place. Under the 2000 FTC/DOJ Antitrust Guidelines for Collaborations Among Competitors,<sup>2</sup> collaborations affecting competition in an "innovation market" are ordinarily "safe" from antitrust concern only if "three or more independently controlled research efforts, in addition to those of the collaboration, possess the required specialized assets or characteristics and the incentive to engage in R&D that is a close substitute for the R&D activity of the collaboration" (§ 4.3). Thus, as is now generally understood by the antitrust community, a joint venture or merger reducing the number of innovation rivals in a given field from five to four is generally acceptable, while one that reduces the number from four to three (or less) raises red flags. Are three competing innovative oligopolists insufficient for the kind of arms race that Baumol describes? If oligopoly is the natural and desirable market structure for efficient innovation rivalry and maximum societal welfare, then what is the basis for drawing the line at a four-firm structure and applying presumptions against three-firm or even two-firm scenarios?

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Even more questionable under the Baumol model is the negative signal regarding consideration of innovation efficiencies in merger enforcement policy under the current version of the agencies' Merger Guidelines.<sup>3</sup> Under the Merger Guidelines, the agencies assert that the only efficiencies to be considered as offsets to potential anticompetitive effects are efficiencies "that have been verified and do not arise from anticompetitive reductions in output or service" (§ 4). Moreover, efficiencies that enable the merging firms to reduce marginal costs of production are "more likely" than others to warrant attention, and efficiencies "relating to research and development" are "generally less susceptible to verification and may be the result of anticompetitive output reductions" (*id.*). Is this thumb on the scale against innovation efficiency considerations consistent with the picture Baumol has drawn of innovation rivalry driving oligopolists to cost minimization, large size and scale required for efficient "sunk cost" investments? Indeed, if innovation rivalry and associated efficiency imperatives are now driving increased market concentration, then what is the basis for less receptivity to R&D efficiency arguments than to marginal-cost-of-production efficiency arguments in merger enforcement policy?

The agencies have, in practice, considered innovation efficiencies in the course of many high-technology merger investigations in recent years. They have, however, much more prominently focused on concerns over the loss of "diversity" in innovation strategies, the loss of smaller challengers with incentives to disrupt the technology status quo by concentrating on breakthrough developments, and other ways in which the reduction in the number of pre-merger rivals may adversely affect innovation output.<sup>4</sup> The Baumol analysis does not challenge the desirability of considering these potential negative effects in any given merger transaction. It does, however, provide support for those who believe the agencies should be more open to potential offsetting positive effects from greater scale in R&D activity.

<sup>2</sup> Reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,160 (2000), available at <http://www.ftc.gov/os/2000/04/ftcdoguidelines.pdf>.

<sup>3</sup> Reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (revised 1997), available at <http://www.ftc.gov/bc/docs/horizmer.htm>.

<sup>4</sup> See generally Constance Robinson, Leap-Frog and Other Forms of Innovation: Protecting the Future for Tech-Tech in Emerging Industries Through Merger Enforcement, Address Before ABA (June 10, 1999), available at <http://www.usdoj.gov/atr/public/speeches/2482.pdf>.



*Standard Setting and Patent Pools.* Baumol's analysis of the tradeoff between innovators' rewards and spillover benefits, in conjunction with his emphasis on the critical importance of "rapid dissemination" of innovation output through licensing and other technology exchange vehicles, bears directly on some of the most contentious issues that were aired at the FTC/DOJ Hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy in April 2002. Of particular relevance are (a) the debate over appropriate policies with regard to the licensing of patents required to implement technology standards, and (b) the debate over the patent pool rules necessary to create a proper balance between pool insiders and pool outsiders.

The FTC's *Dell Computer*<sup>5</sup> action six years ago, its now-pending *Rambus*<sup>6</sup> proceeding, and a growing array of similar private litigation,<sup>7</sup> highlight the manner in which anticompetitive "patent hold-up" or "patent ambush" situations can arise when standard-setting bodies vote on proposed standards without knowledge that patents may be infringed by the use of the standards they adopt. These actions open a virtual Pandora's Box of related issues regarding how to address and minimize exposure to post-adoption opportunistic conduct by holders of patents required for a standard's use. Standards organizations today typically go no further than to require a patent holder, promoting incorporation of its patent into a proposed standard, to make a generalized commitment to "reasonable" licensing availability to all interested parties. Actual license provisions are disclosed only after the standard is adopted, enabling the patent holder, at that point in time, to demand terms that can place rivals at considerable competitive disadvantage.

At the April 2002 IP Hearings, the suggestion was made that standards organizations consider new policies requiring or encouraging the disclosure of intended license terms prior to a vote on a proposed standard. Many parties, however, resist that course on the ground that it would expose the standards participants to a charge of per se illegal price-fixing. That is not, however, a credible objection either as a matter of existing law or sound policy.<sup>8</sup> Indeed, policies aimed at meaningfully ensuring reasonable licensing terms to all rivals—known in advance of adopting a standard critical to a new market—can only be innovation-enhancing and procompetitive in light of Baumol's analysis of societal benefits from dissemination activity. Consistent with his recommendation that the agencies should indicate "as specifically as possible what types of coordination" will not be challenged, the agencies should confirm their comfort with policies of this sort in their final report on the hearings. Baumol's analysis would, at a minimum, support the desirability of requiring the disclosure of intended licensing terms prior to voting on a proposed standard which would require a license for its implementation.

Patent pools are among the most important technology exchange mechanisms that effectuate rapid technology dissemination and spillover effects of the sort Baumol applauds. They were also the subject of spirited debate at one session of the FTC/DOJ hearings in April 2002. Before discussing the debated issues, however, one must note the broad common ground among all speakers in their acceptance of certain basic antitrust rules with respect to pooling operations that emanate from three DOJ Business Review Letters issued over the course of the past five years. These principles include limiting aggregations to patents determined through objective means to

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<sup>5</sup> *Dell Computer Corp.*, 121 F.T.C. 616 (1996).

<sup>6</sup> *Rambus Inc.*, FTC Docket No. 9302 (complaint issued June 19, 2002).

<sup>7</sup> See, e.g., *Intersil Corp. v. Proxim, Inc.*, Civil Action No. 01-266 (D. Del. filed Apr. 24, 2001).

<sup>8</sup> See Statement of Scott K. Peterson, FTC/DOJ Hearings, Apr. 18, 2002, at pp. 7–12, <http://www.ftc.gov/opp/intellect/020418scottkpeterson.pdf>; see also Gail F. Levine, *B2Bs, E-Commerce and the All-or-Nothing Deal*, 28 *RUTGERS COMPUTER & TECH. L.J.* 305–51 (2002).

be “essential” to employing the technology in question; assuring access to the assembled package to all interested parties on reasonable nondiscriminatory license terms; preserving opportunities for each licensor to negotiate licenses to its patents outside of the pool; protecting against dissemination of competitively sensitive proprietary information among the participants; and avoiding license conditions that impair future innovation incentives, such as unduly broad grant-back requirements and constraints on assertions of patent rights against licensors.<sup>9</sup>

Debate ensued over whether these rules suffice for antitrust purposes or whether refinements and additional protections for some affected interests would be desirable. One of the authors of this review suggested that pools should be encouraged to operate under policies and procedures that would create a more meaningful balance between the conflicting interests of insiders (the pool’s founding members owning the patents initially assembled) and outsiders (diverse groups of applicants for pool licenses including existing competitors of the insiders, later new entrants into the market that the insiders dominate, as well as universities and other parties that do not directly compete in that market). Among the suggestions were mechanisms for ensuring consideration of outsiders’ perspectives on appropriate adjustments to license terms and patent essentiality as a result of changing market conditions in the years after pool formation, availability of “partial” licenses for parties that do not need the entirety of the pool’s package license (thus “unbundling” needed from unneeded patents), and pool governance arrangements that ensure input into decision-making processes from individuals without financial interests in the pool’s revenue stream.<sup>10</sup>

Again, ironically, some of the resistance to those suggestions has come in the form of expressed concern over antitrust risk in any departure from (or addition to) rules already established in compliance with the existing DOJ Business Review Letters in this area. The fact is, however, that additional safeguards for outsiders’ interests (of the sort mentioned above) could only bolster the innovation-enhancing and competition-enhancing potential of these pools in ways consistent with the Baumol analysis of dissemination and spillover benefits. Thus, even if the failure to include provisions of this sort does not rise to the level of creating cognizable antitrust liability in and of itself, the agencies could appropriately encourage pools to consider employment of them by recognizing their potential to enhance procompetitive effects that offset acknowledged anticompetitive risks under the applicable antitrust rule of reason. Again, consistent with Baumol’s recommendation that the agencies should indicate “as specifically as possible what types of coordination” will not be challenged, the agencies could constructively address these proposals in their final report on the hearings.

**Exclusionary Conduct Standards.** Baumol makes a compelling case against any presumption that innovative oligopolists’ pricing above marginal cost levels and associated patterns of discriminatory pricing signify noncompetitive or market power conditions that enable or threaten exclusionary conduct. He does not, however, specifically address what have recently become far more contentious issues with regard to aggressive strategies of innovative monopolists or firms that plainly dominate their sectors in contrast to battling oligopolists: allegations that such firms are engaged in both price and non-price predation aimed at either raising entry barriers in the technology spaces they already dominate or extending their control into other complementary technology

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<sup>9</sup> DOJ Business Review Letter of June 26, 1997 (MPEG-2), <http://www.usdoj.gov/aatr/public/busreview/1170.htm>; DOJ Business Review Letter of Dec. 16, 1998 (DVD-ROM), <http://www.usdoj.gov/aatr/public/busreview/2121.htm>; DOJ Business Review Letter of June 10, 1999 (DVD-Video), <http://www.usdoj.gov/aatr/public/busreview/2485.htm>.

<sup>10</sup> See Statement of Jeffery B. Fromm, FTC/DOJ Hearings, Apr. 17, 2002, at pp. 3–8, <http://www.ftc.gov/opp/intellect/020417jefferyfromm.pdf>.

spaces. One has the sense that Baumol's analysis could contribute importantly to this area, but one can only speculate about it since he has not written that chapter.

The Baumol analysis of the importance of innovation dissemination, along with his analysis of strong market incentives to effectuate dissemination on a "voluntary" basis, raises a question as to the stance he would take on the single most controversial issue of our day with respect to the intersection between antitrust and intellectual property law regimes. The issue, in essence, is whether and under what circumstances should an IP owner's refusal to license its IP to smaller rivals be considered exclusionary conduct in violation of Section 2 of the Sherman Act.<sup>11</sup> Baumol's model would appear to argue against any rule of "compulsory" licensing, at least in the absence of clear evidence showing market imperfections that foreclose "optimal" dissemination incentives.

Baumol's analysis of continuous sunk-cost recoupment imperatives plainly counsels caution with regard to any judgment that prices of a firm in an innovation-intensive market are "too high," but Baumol does not address the more timely issue of when such a firm's prices may be considered "too low" from an antitrust standpoint. DOJ's Section 2 case against American Airlines,<sup>12</sup> now on appeal from a district court's summary judgment dismissal, presents that issue: a dominant airline stands accused of unlawful predation for sharp price cuts along with aggressive capacity expansion on routes with new entrants, even though the resulting prices were still far above marginal costs and (apparently) above opportunity costs as well. Appearing in that case as an expert witness for American Airlines, Baumol opposed a predation standard that would prohibit competitive pricing responses of the sort at issue. Indeed, any such standard would surely be detrimental to the main characters in his book: innovative oligopolists that need to recoup innovation investments and for that reason need considerable freedom to respond aggressively to competitive attacks on their customer bases.

There is now a mountain of literature, proliferating throughout the 1990s, delineating what has come to be called a "Post-Chicago School" of antitrust thinking with heavy emphasis on "strategic conduct" by dominant incumbents and "raising rivals' costs" (in lieu of below-cost pricing) as an effective predation strategy. This thinking was central to many of the Clinton Administration's antitrust enforcement initiatives,<sup>13</sup> but the extent to which the agencies during the current administration adhere to it remains to be seen.<sup>14</sup> Baumol's new book provides considerable fodder for both proponents and detractors of the Post-Chicago School.

\* \* \* \* \*

This book review does nothing more than begin to outline areas where the Baumol model may be relevant to a wide array of difficult and complex antitrust issues confronting high-technology markets as they evolve in the years ahead. Our intent is to instigate deeper commentary by others in future issues of this publication. In the meantime, those eager for more policy prescriptions from Professor Baumol himself will be pleased to know that he is already well underway on his next book (with co-author Daniel Swanson) about antitrust for the new economy. ●

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<sup>11</sup> Compare *In re Independent Serv. Organization Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000) with *Image Technical Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997); see Robert Pitofsky, *Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property*, Remarks Before American Antitrust Institute (June 15, 2000).

<sup>12</sup> *United States v. AMR Corp.*, 140 F. Supp. 2d 1141 (D. Kan. 2001).

<sup>13</sup> See David Balto & Robert Pitofsky, *Antitrust and High-Tech Industries: The New Challenge*, 153 ANTITRUST BULL. 583 (1998).

<sup>14</sup> Note, on the one hand, Mr. James's approval of the appeal in the *American Airlines* case shortly after taking office and, on the other hand, his approval shortly thereafter of a consent decree in the *Microsoft* case.

## FTC/DOJ Organization Charts and Photos\*

**Editor's Note:** In the May issue of The Antitrust Source, we offered online versions of the U.S. Department of Justice Antitrust Division and Federal Trade Commission Bureau of Competition organization charts, reflecting restructuring changes to the Antitrust Division (<http://www.abanet.org/antitrust/source/may02/who.pdf>). Since publishing that chart, it has been the FTC's turn to offer some restructuring, announcing on August 28, 2002, the formation of a new Merger Litigation Task Force (<http://www.ftc.gov/opa/2002/08/mergerlitigation.htm>). In the spirit of fulfilling our mission of providing an "on-line connection to the latest and best information in the world of antitrust," The Antitrust Source is presenting revised versions of the previously published FTC and DOJ organization charts, reflecting these changes, and others, to the organizations.

As before, these charts are accompanied by links to publicly available speeches by certain agency heads that are available on the agencies' respective Web sites. These available links are listed here and are also provided within the photos and corresponding captions for these individuals on the photo pages. We encourage our readers to simply click the appropriate link to obtain access to these speeches.

### For the FTC, speeches are available for:

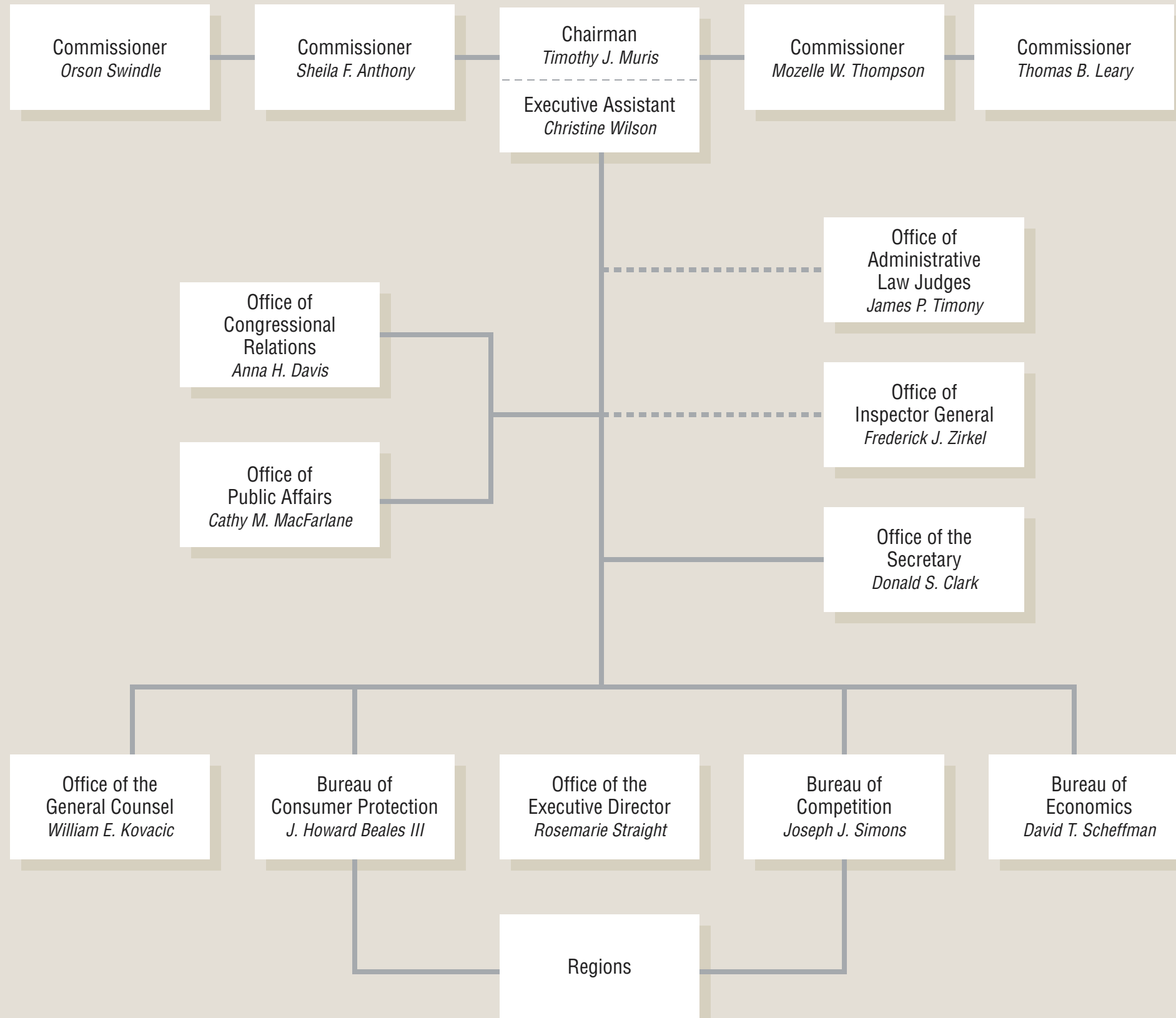
- **Timothy J. Muris**, Chairman: <http://www.ftc.gov/speeches/muris.htm>
- **Sheila F. Anthony**, Commissioner: <http://www.ftc.gov/speeches/anthony.htm>
- **Mozelle W. Thompson**, Commissioner: <http://www.ftc.gov/speeches/thomp1.htm>
- **Orson Swindle**, Commissioner: <http://www.ftc.gov/speeches/swindle.htm>
- **Thomas B. Leary**, Commissioner: <http://www.ftc.gov/speeches/leary.htm>
- **J. Howard Beales, III**, Director, Bureau of Consumer Protection: <http://www.ftc.gov/speeches/beales.htm>

### For the Antitrust Division, speeches are available for:

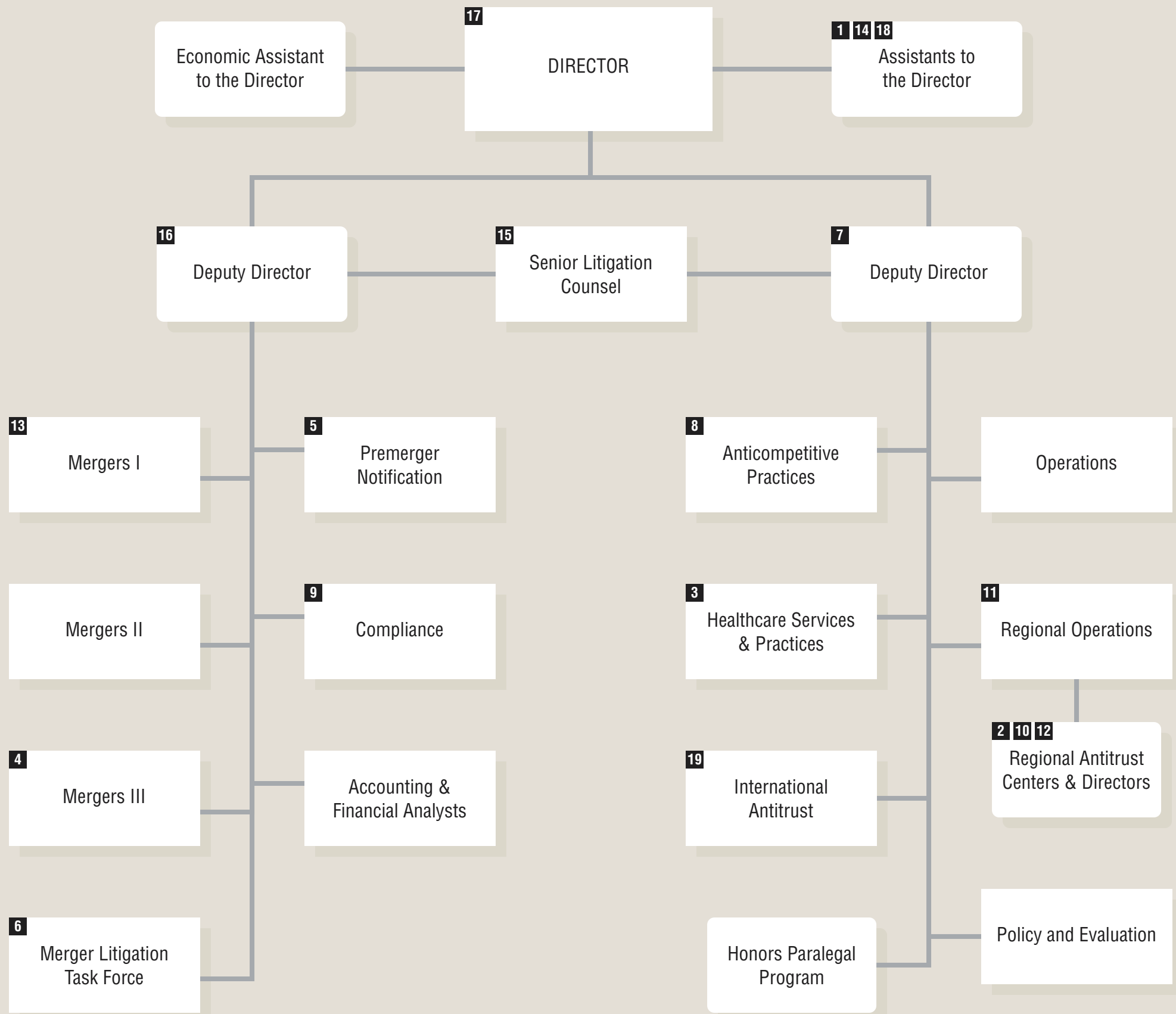
- **Charles A. James**, Assistant Attorney General: [http://www.usdoj.gov/atr/public/speeches/speech\\_james.htm](http://www.usdoj.gov/atr/public/speeches/speech_james.htm)
- **Deborah Platt Majoras**, Deputy Assistant Attorney General:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_majoras.htm](http://www.usdoj.gov/atr/public/speeches/speech_majoras.htm)
- **James M. Griffin**, Deputy Assistant Attorney General:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_griff.htm](http://www.usdoj.gov/atr/public/speeches/speech_griff.htm)
- **William J. Kolasky**, Deputy Assistant Attorney General:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_kolasky.htm](http://www.usdoj.gov/atr/public/speeches/speech_kolasky.htm)
- **Scott D. Hammond**, Director of Criminal Enforcement:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_hammond.htm](http://www.usdoj.gov/atr/public/speeches/speech_hammond.htm)
- **Constance K. Robinson**, Director of Operations:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_robinson.htm](http://www.usdoj.gov/atr/public/speeches/speech_robinson.htm)
- **Douglas Ross**, Special Counsel for Agriculture: [http://www.usdoj.gov/atr/public/speeches/speech\\_ross.htm](http://www.usdoj.gov/atr/public/speeches/speech_ross.htm)
- **Mark J. Botti**, Chief, Litigation I Section: [http://www.usdoj.gov/atr/public/speeches/speech\\_botti.htm](http://www.usdoj.gov/atr/public/speeches/speech_botti.htm)
- **Roger Fones**, Chief, Transportation, Energy and Agriculture Section:  
[http://www.usdoj.gov/atr/public/speeches/speech\\_fones.htm](http://www.usdoj.gov/atr/public/speeches/speech_fones.htm)
- **Robert Kramer**, Chief, Litigation II Section: [http://www.usdoj.gov/atr/public/speeches/speech\\_kramer.htm](http://www.usdoj.gov/atr/public/speeches/speech_kramer.htm)

\* These charts and photo pages can be printed out on letter-size, landscape format, at 67%.

F E D E R A L T R A D E C O M M I S S I O N



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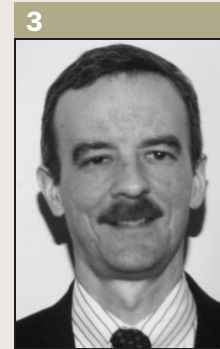
F T C B U R E A U O F C O M P E T I T I O N



**1**  
**Alden F. Abbott**  
*Assistant Director,  
Policy and  
Evaluation*



**2**  
**Barbara Anthony**  
*Director, North  
Eastern Regional  
Office*



**3**  
**Jeff Brennan**  
*Assistant Director,  
Healthcare  
Services and  
Products*



**4**  
**Phillip Broyles**  
*Assistant Director,  
Mergers III*



**5**  
**Marian Bruno**  
*Assistant Director,  
Premerger  
Notification*



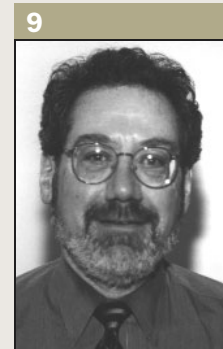
**6**  
**Michael Cowie**  
*Assistant Director,  
Merger Litigation  
Task Force*



**7**  
**Susan Creighton**  
*Deputy Director*



**8**  
**Richard B. Dagen**  
*Assistant Director,  
Anticompetitive  
Practices*



**9**  
**Daniel P. Ducore**  
*Assistant Director,  
Compliance*



**10**  
**Charles A. Harwood**  
*Director, North  
Western Regional  
Office*



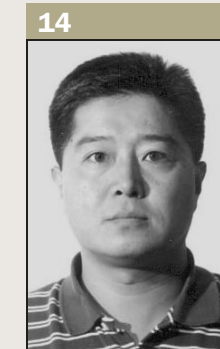
**11**  
**D. Bruce Hoffman**  
*Associate Director,  
Regional  
Operations*



**12**  
**Jeffrey A. Klurfeld**  
*Director, Western  
Regional Office*



**13**  
**Ann B. Malester**  
*Assistant Director,  
Mergers I*



**14**  
**Chul Pak**  
*Assistant to the  
Director*



**15**  
**J. Robert Robertson**  
*Senior Litigation  
Counsel*



**16**  
**M. Sean Royall**  
*Deputy Director*



**17**  
**Joseph J. Simons**  
*Director, Bureau of  
Competition*

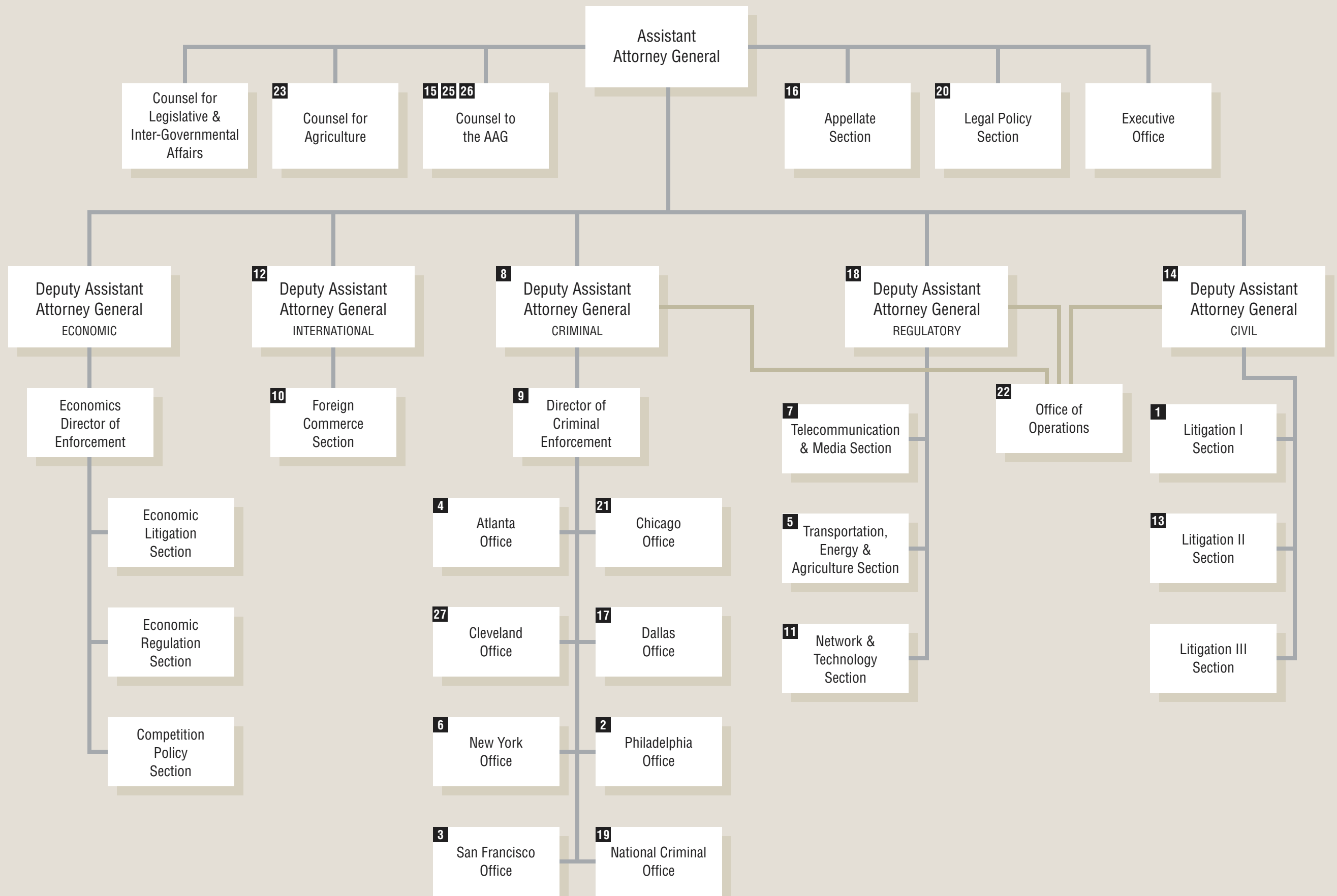


**18**  
**Jerome Swindell**  
*Assistant to the  
Director*



**19**  
**Randolph W. Tritell**  
*Assistant Director,  
International  
Antitrust*

DOJ ANTITRUST DIVISION





D O J A N T I T R U S T D I V I S I O N



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Chief, Litigation I  
Section



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Robert E. Connolly  
Chief, Philadelphia  
Field Office



**3**  
Christopher S. Crook  
Chief, San Francisco  
Field Office



**4**  
Nezida S. Davis  
Chief, Atlanta  
Field Office



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Roger W. Fones  
Chief, Transportation,  
Energy & Agriculture  
Section



**6**  
Ralph T. Giordano  
Chief, New York  
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Nancy M. Goodman  
Chief,  
Telecommunications  
and Media Section



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DAAG, Criminal  
Enforcement



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Scott D. Hammond  
Director of Criminal  
Enforcement



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Chief, Networks  
and Technology  
Section



**12**  
William J. Kolasky, Jr.  
DAAG, International



**13**  
Robert J. Kramer II  
Chief, Litigation II  
Section



**14**  
Deborah P. Majoras  
Deputy Assistant  
Attorney General,  
Civil



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John M. Mitnick  
Counsel to the AAG



**16**  
Cathy G. O'Sullivan  
Chief, Appellate  
Section



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Alan Albert Pason  
Chief, Dallas Field  
Office



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DAAG, Regulated  
Industries



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Lisa M. Phelan  
Chief, National  
Criminal Enforcement  
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Section



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Chief, Chicago Field  
Office



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Constance K.  
Robinson  
Director of  
Operations



**23**  
Douglas Ross  
Special Counsel  
for Agriculture



**24**  
James R. Wade  
Chief, Litigation III



**25**  
David P. Wales Jr.  
Counsel to the AAG



**26**  
Margaret A. Ward  
Counsel to the AAG



**27**  
Scott M. Watson  
Chief, Cleveland  
Field Office

# Developments in Professional Conduct

## New Federal Rules of Professional Responsibility: How Will Antitrust Lawyers be Affected?

**Layne E. Kruse**

Section 307 of the Sarbanes-Oxley Act of 2002,<sup>1</sup> signed by President Bush on July 30, 2002, requires the Securities and Exchange Commission to promulgate rules within 180 days of its enactment setting “minimum standards of professional conduct” for attorneys. When the new rules are issued in January 2003, they may have an impact on all attorneys who advise public companies. Senator Michael Enzi (R-Wyo.), a co-sponsor of the legislation, explained that “it is clear we need some hard and fast rules, and not just an arcane honor code rarely adhered to, so the necessary measure of client duty is placed in the hearts and minds of the legal profession.”<sup>2</sup> The ABA lobbied against this provision, and indeed, critics have argued that it will lead to the federalization of the legal practice. This article answers key questions about the statute, and in particular, whether it will have an impact on antitrust lawyers.

### What Specific Duties Are Required Under § 307?

Section 307, which is entitled “Rules of Professional Responsibility for Attorneys,” requires an attorney to “report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof to the chief legal counsel or chief executive officer.” If these officers do not “appropriately respond,” the attorney must report the evidence to the audit committee, to another committee consisting entirely of outside directors, or to the full board. As explained by the chief sponsor of the provision, Senator John Edwards (D-N.C.), when attorneys “see something occurring or about to occur that violates the law . . . they must act as an advocate for the shareholders, for the company itself, for the investors.”<sup>3</sup> However, Senator Edwards emphasized that it applied only to “material” violations. “That means no reporting is required for piddling violations or violations that don’t amount to anything. The obligation to report is triggered only by violations that are material violations that a reasonable investor would want to know about.”<sup>4</sup>

■  
**Layne E. Kruse** is  
Chair, ABA Section of  
Antitrust Law, Ethics  
and Professional  
Responsibility  
Committee, and a  
partner, Fulbright &  
Jaworski L.L.P.,  
Houston, Texas.

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<sup>1</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>2</sup> 148 CONG. REC. S6524 at S6555 (daily ed. July 10, 2002) (Sen. Enzi).

<sup>3</sup> *Id.* at S6552 (Sen. Edwards); *id.* at S6554 (Sen. Enzi) (“lawyers are expected to represent the corporation in the best interests of the shareholders”). Sen. Edwards, a former plaintiffs’ personal injury attorney, also explained: “[L]awyers’ obligation should be to the Board of Directors—not to the CEOs, who they play squash with every week.” WALL ST. J., July 25, 2002, at B1. *See also* 148 CONG. REC. S6524 at S6551 (daily ed. July 10, 2002) (Sen. Edwards).

<sup>4</sup> *Id.* at S6552 (Sen. Edwards).

### Will the New Rules Apply to All Attorneys Who Advise Public Companies?

The initial question for antitrust lawyers is whether the statute and new rules will apply “minimum standards” to all lawyers who advise public companies. Section 307 directs the Commission “in the public interest and for the protection of investors,” to set forth “minimum standards of professional conduct for attorneys appearing and practicing before the commission in any way in the representation of issuers.” Thus, the rules will clearly apply to lawyers who actually practice before the SEC, whether they work as corporate counsel or with law firms. Senator Enzi indicated that it was aimed at lawyers who prepare the SEC filings. He explained that this provision would require the SEC to enact standards for “attorneys appearing and practicing before the Commission; not all attorneys, just attorneys appearing and practicing before the Commission; that is, those who are dealing with documents that deal with companies listed by the Securities and Exchange Commission.”<sup>5</sup>

“[W]e need some hard  
and fast rules, and not  
just an arcane honor  
code. . . .”

—SEN. ENZI

For law firms, however, that advise public companies on numerous issues, including antitrust problems, as well as disclosures under the securities laws, interpreting Section 307 as applying to attorneys who practice only before the SEC may have little practical impact. The key question is whether knowledge of any attorney in a law firm can be imputed to other attorneys in the same firm that practice before the SEC. The new rules may clarify this issue, but given that knowledge within a firm is often imputed, the knowledge of the law firm, as a whole, including knowledge of “evidence” of antitrust violations or violations of other laws may determine what needs to be reported to upper corporate management.

### What Is the Origin of Section 307?

Senator Edwards added the language of Section 307 as an amendment to the corporate governance bill. It was co-sponsored by Senator Enzi and Senator Jon Corzine (D-N.J.)<sup>6</sup> As acknowledged in the *Congressional Record*, however, the impetus for Section 307 arose from a “bipartisan” group of forty law professors, who had originally proposed to the SEC in January 2002 that new rules be created for lawyer conduct. After the SEC declined to issue the new rules, Congress decided to act.<sup>7</sup> The provision that finally passed in Congress, however, has language even broader than the law professors’ proposal, which had sought a rule on reporting only actual “knowledge” of fraud.

### How Does Section 307 Compare to the ABA Model Rule 1.13?

The fact that an attorney has disclosure obligations to upper management within a corporation is not new. ABA Model Rule of Professional Conduct 1.13, which explains the duty of lawyers to an organizational client,<sup>8</sup> is premised on whether a lawyer “knows” that an officer or employee “is

<sup>5</sup> *Id.* at S6555 (Sen. Enzi).

<sup>6</sup> WALL ST. J., July 25, 2002, at B1.

<sup>7</sup> 148 CONG. REC. S6524 at S6552 (daily ed. July 10, 2002) (Sen. Edwards); *id.* at S6552 (Sen. Enzi); *id.* at S6557 (Sen. Sarbanes).

<sup>8</sup> Model Rule 1.13 has been codified in most states and is titled “Organization As a Client.” Rule 1.13 adopts the “entity theory,” as opposed to the “group theory” of representation. Under the entity theory, the entity or organization is the client, not the individual members or officers of the organization, unless there is a specific undertaking to represent them. The group theory is based on the idea that an attorney represents several clients jointly and each constituent of the organization is a “client” with concurrent representation. THE RESTATEMENT ON THE LAW GOVERNING LAWYERS, REPRESENTING AN ORGANIZATION AS CLIENT § 96, adopts a similar “entity” representation theory. *See* 2 GEOFFREY HAZARD & WILLIAM HODES, THE LAW OF LAWYERING at 17-4 through 17-5 (3d ed. Supp. 2002).

engaged in action” or “intends to act” in “violation of law.” Model Rule 1.13(b). The Rule then requires the lawyer to “proceed as reasonably necessary in the best interest of the organization without involving unreasonable risk of disrupting the organization and of revealing information relating to the representation to persons outside the organization.” Rule 1.13 (b) also requires that a lawyer take “reasonable remedial actions whenever the lawyer learns” that an officer, employee, or other person “has committed, or intends to commit a violation of a legal obligation or a violation of law which reasonably might be imputed to the organization” and the “violation is likely to result in substantial injury to the organization” and the violation is related to a matter within the scope of the lawyer’s representation of the company. Rule 1.13 even explains that one remedial measure is reference “to a higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization, as determined by applicable law.”

Rule 1.13, like Section 307, does not identify the appropriate remedial action. Senator Edwards acknowledged that under Section 307:

We have not specified how a CEO or a general counsel should act to rectify the violation. That is because the truth is that the appropriate response to cure the problem will vary dramatically, depending on the circumstances. The CEO can do a short investigation, for example, and figure out that no violation occurred, then the obligation stops there. But if there is a serious violation of the law, the appropriate response is clear: The CEO has to act promptly to remedy the violation. If he doesn’t, the lawyer has to go to the board. It is that simple.<sup>9</sup>

Key differences, nevertheless, exist between the ABA Model Rule 1.13 and Section 307. As previously indicated, Rule 1.13 is limited to knowledge that an employee has committed or intends to commit a violation of law. In contrast, the new statute requires action based on mere knowledge of “evidence of a material violation.” Model Rule 1.13 also gives lawyers more discretion on how to handle evidence of wrongdoing, as long as they believe they were acting in the company’s best interest.<sup>10</sup> Rule 1.13 has been described as having a “pro-client” orientation. The lawyer is directed to “minimize” the risk of disrupting the normal work of the organization and to “minimize” the risk of revealing confidential information to others. “Rule 1.13(b) is no charter for whistleblowers.”<sup>11</sup> Rule 1.13 gives an attorney the right to take into consideration “the seriousness of the violation and its consequences, the scope and nature of the lawyer’s representation, the responsibility in the organization and the apparent motivation of the person involved . . . and any other relevant considerations.” In other words, in contrast to Section 307, the Model Rule provides considerable discretion to the lawyer. The new statute’s sponsors want “hard and fast” rules.

### **Do Attorneys Report on Antitrust Violations?**

For antitrust lawyers, the main question is whether Section 307 is limited to “evidence” of a violation of “securities laws.” The language was specifically broadened from the law professors’ proposal to the SEC to encompass other types of conduct. Section 307 refers to a “breach of fiduciary duty or similar violation.” The antitrust laws, of course, are not “securities” laws, as defined

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<sup>9</sup> 148 CONG. REC. S6524 at S6552 (daily ed. July 10, 2002) (Sen. Edwards).

<sup>10</sup> See *id.* at S6555 (Sen. Enzi).

<sup>11</sup> 2 HAZARD & HODES, *supra* note 8, at 17–32; see 148 CONG. REC. S6524 at S6552 (daily ed. July 10, 2002) (Sen. Edwards). Similarly, in the *Restatement*, there is concern about a measured response by counsel based on numerous considerations. RESTATEMENT ON THE LAW GOVERNING LAWYERS § 96, comment f.

under the federal securities statutes. But does the term “similar violation” include antitrust or environmental or any type of violation? Will the new SEC rules provide guidance on this question? As reported in the press, Senator Edwards wanted the law to require lawyers to report “state law violations of fiduciary duty or similar violations, in addition to federal securities laws violations.” He added the broad language knowing that “these state law violations are not criminal, as could be the case with securities laws violations that are under investigation.”<sup>12</sup> ABA Model Rule 1.13(b), moreover, is not limited to a certain type of violation. It applies to “a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization . . . .”<sup>13</sup> Whether Section 307 applies to almost any type of “violation” remains to be seen in the rulemaking before the SEC, but it appears that the sponsors of Section 307 did not intend to limit the scope of the statute, as long as the conduct injures the corporation.

### How Will the SEC Enforce the New Rules?

As a practical matter, the greatest impact of Section 307 may be the fact that the SEC will now be enforcing rules on lawyer conduct regarding public companies, whereas before, states were primarily responsible for attorney disciplinary action. Senator Enzi’s condemnation of the state bars was clear: “[T]he State Bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced. Most States also do not have the ability to investigate attorney violations involved with the complex circumstances of audit procedures within giant corporations.”<sup>14</sup> To justify the statute, Senator Enzi, who is an accountant, also argued that the burden imposed on lawyers is far less than that placed on auditors, who have obligations to report to the SEC.<sup>15</sup> SEC Chairman Harvey Pitt echoed these points after the legislation passed. He told the ABA Annual Meeting on August 12, 2002, that the law was aimed at alerting lawyers “representing public companies” that they have “responsibilities requiring government definition.” In particular, Pitt explained he was disappointed about the lax response to cases of possible lawyer misconduct that the SEC had referred to state bars. The new law will give the SEC new powers to police lawyers. Not only will lawyers be subject to review and regulation by state bars, but now the SEC may take an active role in the regulation of conduct by lawyers that advise public companies.<sup>16</sup>

Another question is whether the statute will have an impact on third-party claims against attorneys. The sponsors of Section 307 made repeated statements during the debate that the statute was not meant to create a private right of action. Senator Edwards explained that “[n]othing in this bill gives anybody a right to file a private lawsuit against anybody. The only people who can enforce this amendment are the people at the SEC.”<sup>17</sup> Likewise, Senator Enzi said that the amendment “does not create a right of action by third parties. The Fourth Circuit has made such a ruling con-

“State bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation.”

—SEN. ENZI

<sup>12</sup> 34 Sec. Reg. & L. Rep. (BNA), July 29, 2002, at 1227.

<sup>13</sup> Nor does Section 96 of the *Restatement* limit the type of violation. According to Comment f, the *Restatement* applies to “an act or failure to act . . . that, although perhaps intended to serve an interest of the organization, will foreseeably cause injury to the client, such as exposing the organization to criminal or civil liability.”

<sup>14</sup> 148 CONG. REC. S6524 at S6555 (daily ed. July 10, 2002) (Sen. Enzi).

<sup>15</sup> *Id.*

<sup>16</sup> Harvey Pitt, SEC Chairman, Remarks Before Annual Meeting of ABA Business Law Section (Aug. 12, 2002), available at <http://www.sec.gov/news/speech>.

<sup>17</sup> 148 CONG. REC. S6524 at S6552 (daily ed. July 10, 2002) (Sen. Edwards).

cerning the code of conduct applied by the IRS Rules.”<sup>18</sup> However, Senator Enzi argued that it may impact the liability of attorneys for securities fraud violations: “The SEC has already found that attorneys who fail to take steps to prevent their clients from violating federal securities law are guilty of aiding and abetting. This amendment will put attorneys on the right course. By reporting violations to the board of directors, they can avoid being found guilty of aiding and abetting their client.”<sup>19</sup> Section 307, moreover, may bolster arguments that lawyers have committed malpractice by not disclosing wrongful conduct as soon as possible to the CEO or to the board. Now that a federal statute clarifies the duties of lawyers on a federal scale, lawyers may have to evaluate their conduct as related to all public companies. Section 307 may set a higher conduct standard for attorneys advising public companies.

Another area of concern is the attorney-client privilege. Sponsors of the statute emphasized that Section 307 would not violate the attorney-client privilege because the client is still the board of directors and shareholders, not the CEO.<sup>20</sup> Senator Edwards explained that “there is no obligation to report anything outside the client, the corporation.”<sup>21</sup> Senator Enzi, in particular, pointed out that the provision “does not empower the SEC to cause attorneys to breach their attorney/client privilege. Instead, as is the case now, attorneys and clients can assert this privilege in court.”<sup>22</sup>

The new Rules are due in January 2003. The SEC has not yet announced a schedule for comments and proposals for rulemaking. Any attorney, however, who advises a public corporation should carefully examine each proposal. ●

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<sup>18</sup> *Id.* at S6555 (Sen. Enzi).

<sup>19</sup> *Id.*

<sup>20</sup> 34 Sec. Reg. & L. Rep. (BNA), July 29, 2002, at 1227.

<sup>21</sup> 148 CONG. REC. S6524, S6557 (daily ed. July 10, 2002) (Sen. Edwards).

<sup>22</sup> *Id.* at S6555 (Sen. Enzi).

# The FTC's Use of Disgorgement in Antitrust Actions Threatens to Undermine the Efficient Enforcement of Federal Antitrust Law

David K. Park and Richard Wolfram

In the last few years, the Federal Trade Commission has on several occasions sought disgorgement in antitrust actions.<sup>1</sup> To obtain such relief, the FTC has asserted authority under FTC Act Section 13(b), which, in express terms, permits the FTC merely to obtain injunctive relief.<sup>2</sup>

Previously, the FTC had for some time used Section 13(b) to obtain disgorgement in consumer fraud cases. Although two or three cases do not necessarily make a trend, stepped-up efforts by the FTC to seek monetary relief in antitrust cases are notable: The agency was vested by Congress with equitable powers to *enjoin* acts or transactions violating the FTC Act's proscription of unfair competition, and this has been its traditional enforcement role. Although the FTC's recent expansion of its traditional equitable enforcement role through its use of Section 13(b) to obtain disgorgement in antitrust cases may be an expedient means to wrest ill-gotten gains from wrongdoers, this effort strains the plain meaning of Section 13(b). More significantly, the FTC's expanded application of Section 13(b) conflicts with the *Illinois Brick* "direct purchaser rule" and its underlying policy rationale of minimizing the risk of duplicative remedies, reducing the complexity of damages determinations, and promoting efficient enforcement in illegal overcharge cases by giving standing only to direct purchasers to seek damages. The effect of this development should not be underestimated: it constitutes a significant change in the federal enforcement scheme in any antitrust case in which the FTC seeks disgorgement.

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*The authors, members of the New York Bar, work or have worked at firms that have represented defendants in antitrust disgorgement actions discussed in this article.*

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<sup>1</sup> As an equitable remedy for wrongful conduct, disgorgement wrests ill-gotten gains from the wrongdoer. It is intended to deny the wrongdoer his or her unjust enrichment and to serve as a deterrent against similar conduct in the future. In a multi-level chain of distribution, for instance, where each wholesaler/distributor may not only pass through an overcharge from the initial manufacturer but also add its own extra margin, disgorgement would equal only the amount of the alleged overcharge imposed on the first wholesaler/distributor by the manufacturer.

In contrast, restitution for an ultimate consumer, for instance, is the total amount of monetary harm (out-of-pocket loss) suffered by that consumer. Restitution thus restores that consumer to the status quo ante and is equal to the difference between the price the consumer paid before the illegal conduct and the (higher) price it paid after the illegal conduct began—and regardless of how much of the total monetary harm is attributable to the manufacturer or to downstream distributors before the product reaches the ultimate consumer.

<sup>2</sup> 15 U.S.C. § 53(b).

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### Legislative and Case Law History

The FTC is authorized under Section 5 of the FTC Act<sup>3</sup> to issue “cease and desist” orders to enjoin unfair methods of competition. Section 13(b) of the Act authorizes the FTC to seek and obtain injunctions from federal district courts. There is no indication, however, that Congress ever intended Section 13(b) to be used to obtain monetary relief; instead, its use as authorization to seek and obtain disgorgement in antitrust cases is a creation only of the Commission itself and the courts.<sup>4</sup> The FTC’s use of Section 13(b) to obtain disgorgement in antitrust cases is just the latest step in a gradual expansion of the Commission’s enforcement powers under the FTC Act from injunctive to monetary relief, beginning with consumer protection cases involving deceptive and fraudulent conduct and most recently including antitrust rule of reason cases.

In 1969, the FTC asserted that its Section 5 cease and desist authority gave it the power to order the payment of refunds to consumers injured by a defendant’s unfair or deceptive acts or practices. *Curtis Publishing Co.*, 78 F.T.C. 1472 (1970)), *aff’d on other grounds*, 78 F.T.C. 1472 (1971).

In 1974, in another consumer fraud case, a Ninth Circuit panel held that the FTC’s remedial authority did not include the power to order restitution to defrauded merchants and franchisees. *Heater v. FTC*, 503 F.2d 321, 326–27 (9th Cir. 1974). The court noted that “statements, of courts, commentators, and congress throughout those years [the 60 years the FTC Act had been on the books] uniformly reflect an understanding that the Commission is without the power [to order restitution] it seeks to exercise.” *Id.* at 326.

In the 1970s two pieces of legislation enhanced the FTC’s remedial powers: (1) the Trans-Alaska Pipeline Act and (2) the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, both of which amended the FTC Act. In 1973, the Trans-Alaska Pipeline Act added Section 13(b). Section 13 empowers the FTC, whenever it believes that someone “is violating or is about to violate” any of the laws enforced by the FTC, to sue in district court to enjoin such activity pending issuance of an FTC complaint and final resolution of that action. It also authorizes the FTC to seek preliminary injunctions in court, without first having to complete an administrative hearing and obtain a cease and desist order.

Two years later, Magnuson-Moss added FTCA Section 19, which expressly authorizes the FTC to seek remedial monetary relief, but only in cases involving fraudulent or deceptive conduct.

Over time, finding the requirements imposed by Section 19 difficult to meet, the FTC changed tactics and argued that the proviso in Section 13(b) permitting a court to award a “permanent injunction” in “proper cases” is by itself sufficient to allow the FTC to seek remedial monetary relief, or any other form of equitable relief, from a court. The FTC further asserted that it could seek such

<sup>3</sup> Section 5 states, in part:

Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition. . . in or affecting commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing. . . . If upon such hearing the Commission shall be of the opinion that the method of competition . . . is prohibited . . . it shall issue . . . an order requiring such person, partnership, or corporation to cease and desist from using such method of competition. . . .

15 U.S.C. § 45(b) (emphasis added).

Congress made no provision for the FTC to seek damages or remedial monetary relief under the FTC Act. Congress also chose not to provide for any type of private right of action under the FTC Act.

<sup>4</sup> See generally Peter C. Ward, *Restitution for Consumers Under the Federal Trade Commission Act: Good Intentions or Congressional Intentions?* 41 Am. U. L. Rev. 1139 (1992).



relief for any violation of the FTC Act (i.e., not limited to cases specified in Section 19).<sup>5</sup>

The Commission prevailed with this argument. In *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107 (9th Cir. 1982), it argued that because Section 13(b) “gives the court authority to grant a permanent injunction, it also by implication gives the court authority to afford all necessary ancillary [equitable] relief, including rescission of contracts and restitution.” *Id.* at 1112. The court agreed, citing a now much-relied upon statement by the Supreme Court in *Porter v. Warner*<sup>6</sup> about the scope of a federal court’s equitable jurisdiction, and holding that “Congress, when it gave the district court authority to grant a permanent injunction against violations of any provisions of law enforced by the Commission, also gave the district court authority to grant any ancillary relief necessary to accomplish complete justice because it did not limit that traditional equitable power explicitly or by necessary and inescapable inference.” *Id.* at 1111. As a result, the court found, “Congress thereby gave the district court power to order rescission of contracts, and Section 13(b) provides a basis for an order freezing assets.”<sup>7</sup> *Id.*

Since the *Singer* decision, courts consistently have held that Section 13(b)’s grant of authority to issue permanent injunctions to enjoin unfair or deceptive acts or practices that violate Section 5(a) of the FTC Act, impliedly also gives district courts authority to order any other equitable remedy, including redress in the form of disgorgement of illicit profits or restitution on behalf of persons who have been harmed thereby.<sup>8</sup>

The FTC has built on the *Singer* decision, winning a series of cases under Section 13(b) that have resulted in the provision becoming essentially open-ended and empowering the FTC to seek remedial monetary relief, or any other form of equitable relief, from the courts, even though such power is not expressly granted to the Commission under any part of the FTC Act.

The broad interpretation of Section 13(b) that has gained traction since *Singer* appears to nullify the limitations on the FTC’s ability to seek consumer redress that Congress imposed under FTC Act Section 19.<sup>9</sup> If the court in *Singer* was correct that Congress intended to give courts authori-

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<sup>5</sup> In *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711 (5th Cir. 1982), the Fifth Circuit allowed the FTC to put a hold on assets temporarily, pursuant to Section 13(b)’s provision for preliminary injunctions, to protect the ability of the FTC to later seek a permanent injunction pursuant to Section 13(b) and/or restitution pursuant to Section 19, if it prevailed in the pending administrative proceeding. *Id.* at 720–21. The court observed that “the evident intent of these 1975 amendments was to add significant new weapons to the Commission’s enforcement arsenal in order to make more meaningful and complete consumer relief possible.” *Id.* at 720. This comment shows that Section 13(b) authorized the court to maintain the status quo in anticipation of the FTC obtaining restitution pursuant to Section 19. The court’s statement that “the complete resolution of [this] matter will require a two-step process” indicates that in its view, Section 19 was the only source of potential consumer redress. *Id.*

<sup>6</sup> *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946) (“Unless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction . . . Moreover, the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. “Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court’s jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. . . .”) (emphasis added).

<sup>7</sup> The Ninth Circuit panel that decided *Singer* was different from the panel that decided *Heater v. FTC*.

<sup>8</sup> See, e.g., *FTC v. Febre*, 128 F.3d 530, 534 (7th Cir. 1997) (“the power to grant ancillary relief [pursuant to Section 13(b)] includes the power to order repayment of money for consumer redress as restitution or recession”); *FTC v. Gem Merchandising Corp.*, 87 F.3d 466, 470 (11th Cir. 1996) (“Section 13(b) permits a district court to order a defendant to disgorge illegally obtained funds”); *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir. 1994) (the authority granted by Section 13(b) “includes the power to order restitution”); *FTC v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1316 (8th Cir. 1991) (affirming award of monetary equivalent of rescission pursuant to Section 13(b)). In addition to these and many other consumer fraud cases, the FTC has also extended its Section 13(b) remedial powers into the realm of unfair competition.

<sup>9</sup> See *Ward*, *supra* note 4, at 1189–95.

ty to impose all equitable remedies for all violations of the FTC Act with Section 13(b), which was passed in 1973, it makes no sense, as a matter of statutory construction, for Congress two years later to have enacted Section 19, a provision that gives courts the same equitable power as under Section 13(b) but only with respect to a subset of cases. The logical conclusion is that Congress never intended Section 13(b) as an authorization to the FTC to seek and obtain disgorgement or restitution, either for consumer fraud cases or antitrust cases.

### The FTC Seeks, and Ultimately Recovers, Disgorgement for Indirect Purchasers in Antitrust Actions

Although the FTC has sought and obtained remedial monetary relief pursuant to Section 13(b) in a number of consumer protection cases (involving fraudulent or deceptive conduct) since *Singer* was decided in 1982, it did not bring its first antitrust-based Section 13(b) cases until 1992.

In 1992, the FTC filed three substantively-related actions in federal court against the three leading manufacturers of infant formula, alleging a per se conspiracy to fix rebate bids and unilateral anticompetitive conduct, and seeking restitution under Section 13(b). The FTC obtained restitution from two of the three defendants, Mead Johnson & Co. and American Home Products, pursuant to consent decrees.<sup>10</sup> The third defendant, Abbott Laboratories, defeated the FTC at trial.<sup>11</sup> Because of the outcomes of these cases, no court decided what type of remedial monetary relief would be appropriate in the context of an antitrust violation of Section 5(a) of the FTC Act. The district court in *Abbott* did, however, address the FTC's request for remedial monetary relief as a threshold matter, rejecting the argument that it should rule as a matter of law that the FTC lacked the authority under Section 13(b) to obtain remedial monetary relief. Rather, the court said, "[w]hether or not the Court should issue a permanent injunction and/or restitution must await trial."<sup>12</sup>

The disgorgement issue was next raised most significantly in the collection of cases filed, beginning in 1998, by the FTC, a number of states, and various private plaintiffs against Mylan Laboratories,<sup>13</sup> the second-largest generic drug manufacturer in the United States.<sup>14</sup> A settlement of the FTC and states' suits, finalized in early 2002, provides for the distribution of some \$100 million to indirect purchasers.<sup>15</sup> In a separate settlement, Mylan agreed to pay \$35 million plus \$4 million in attorneys fees to settle class action suits by certain private plaintiffs suing under state law. The FTC said that Mylan's total payment of approximately \$147 million pursuant to the two settle-

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<sup>10</sup> *FTC v. Mead Johnson & Co.*, Civ. No. 92-1366 (D.D.C. June 11, 1992) (consent decree); *FTC v. American Home Prods.*, Civ. No. 92-1367 (D.D.C. June 11, 1992) (consent decree).

<sup>11</sup> *FTC v. Abbott Labs.*, Civ. A. No. 92-1364, 1992 WL 335442, \*2 (D.D.C. Oct. 13, 1992), *dismissed on other grounds*, 853 F. Supp. 526 (D.D.C. 1994).

<sup>12</sup> *Id.*

<sup>13</sup> *FTC v. Mylan Labs., Inc.*, 98CV03114, FTC File No. X990015 (D.D.C. filed Dec. 22, 1998), Order and Stipulated Permanent Injunction (Feb. 9, 2002).

<sup>14</sup> To the best of the authors' knowledge, the only other antitrust complaint seeking disgorgement or restitution filed by the FTC prior to *Mylan* was *FTC v. College of Physicians-Surgeons of Puerto Rico* (D.P.R. filed Oct. 2, 1997). In that case, the College of Physician-Surgeons and three physician groups agreed to settle charges that they violated Section 5 of the FTC Act by engaging, in part, in a group boycott. The complaint sought restitution, in part; the defendants agreed to pay \$300,000 to the Department of Health of the Government of Puerto Rico. Final Order and Stipulated Permanent Injunction (Oct. 2, 1997), available at <http://www.ftc.gov/os/1997/9710/prphyord.htm>.

<sup>15</sup> Specifically, the settlement agreement provided, in part, that Mylan would pay disgorgement in the amount of \$71,782,017 to satisfy the consumer claims in the states' lawsuit and \$28,217,983 to satisfy the states' agency claims. In re Lorazepam & Clorazepate Antitrust Litigation, 289 F.3d 98, 100 (D.C. Cir. 2002).

ment agreements equaled roughly all of the profits earned from the conduct challenged by the Commission.<sup>16</sup>

The FTC action pitted the asserted power of the Commission to obtain remedial monetary relief under Section 13(b) against the rule from *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), which grants standing to direct purchasers and denies standing to indirect purchasers for damages under federal antitrust law. The rule is intended to promote efficient enforcement of federal antitrust law through private treble damages actions by precluding multiple suits—e.g., by direct and indirect purchasers. The outcome in *Mylan* appears to undercut that policy goal.

The plaintiffs in the various suits all made substantially similar allegations: that Mylan had engaged in illegal restraint of trade, monopolization, attempted monopolization, and conspiracy to monopolize by entering into certain exclusive licensing agreements for the supply of essential raw materials (known as active pharmaceutical ingredients, or APIs) necessary for the manufacture of lorazepam and clorazepate, two generic, widely prescribed anti-anxiety drugs manufactured and sold by the company. The plaintiffs contended that Mylan, by obtaining long-term exclusive licenses from its API supplier, prevented Mylan's actual or potential competitors from gaining access to the APIs, which they needed to manufacture their own generic lorazepam and clorazepate, and that Mylan was thereby also able to significantly raise prices.<sup>17</sup> After obtaining these exclusive licensing rights, Mylan allegedly raised the price of its clorazepate tablets by approximately 1,900 to 3,200 percent, and raised the price of its lorazepam tablets by approximately 1,900 to 2,600 percent, on sales to state Medicaid programs, wholesalers, retail pharmacy chains and other customers.

The FTC sought, inter alia, restitution and disgorgement in an amount exceeding \$120 million plus interest. The defendants had argued that the court lacked subject matter jurisdiction under Section 13(b) either because the statute does not authorize the Commission to seek a permanent injunction or does not permit disgorgement or any other form of monetary relief. The court ruled that the FTC was entitled to seek a permanent injunction and disgorgement under Section 13(b) and suggested that it was also entitled to seek restitution under Section 13(b).<sup>18</sup> The court reasoned that although Section 13(b) does not explicitly authorize the FTC to seek monetary remedies, "monetary relief is a natural extension of the remedial powers authorized under Section 13(b)."<sup>19</sup> For support, the court, like other courts before it opining on the FTC's powers under Section 13(b), cited *Porter v. Warner Holding Co.*<sup>20</sup> The Court in *Porter* said: "Unless a statute in so many words or by a necessary and inescapable inference restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied."<sup>21</sup> In *Mylan*, Judge Hogan noted that "five courts of appeals and numerous district courts have permitted the FTC to pursue monetary relief under Section 13(b) . . . and that at least one court has upheld the FTC's ability to seek disgorgement in

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<sup>16</sup> FTC Press Release (Nov. 29, 2000), available at <http://www.ftc.gov/opa/2000/11/mylanfin.htm>.

<sup>17</sup> The plaintiffs also named the foreign supplier of these raw materials, the supplier's parent company, and its U.S. distributor as defendants.

<sup>18</sup> *FTC v. Mylan Labs., Inc.*, 62 F. Supp. 2d 25 (D.D.C. 1999).

<sup>19</sup> *Id.* at 36.

<sup>20</sup> 328 U.S. 395 (1946). In *Porter*, the Supreme Court upheld a district court's authority to refund illegal rent overcharges pursuant to Section 205(a) of the Emergency Price Control Act of 1942, which expressly granted only the power to enjoin illegal practices.

<sup>21</sup> *Id.* at 398.

the courts.”<sup>22</sup> Thus, because the “defendant cite[d] no relevant case law that prohibits the FTC from seeking disgorgement or any other form of equitable ancillary relief”<sup>23</sup>—i.e., in the absence of negative authority—the court ruled that the FTC had the authority to obtain disgorgement.

The plaintiff states sued in their *parens patriae* capacity, under Sections 1 and 2 of the Sherman Act and their respective state competition laws, on behalf of each state’s general economy and as injured purchasers or reimbursers under state Medicaid and other programs.<sup>24</sup> For relief, the states sought, *inter alia*, disgorgement and restitution. The court denied the states’ claim for restitution/d disgorgement under Section 16 of the Clayton Act.<sup>25</sup> The court reasoned that because private plaintiffs could already pursue damages under Section 4, and because the states could have sought damages under Section 4c of the Clayton Act, “permitting disgorgement under Section 16 would provide yet another route to defendants’ allegedly ill-gotten gains, and would therefore heighten the possibility that defendants in antitrust actions could be exposed to multiple liability.”<sup>26</sup> Characterizing the states’ argument as an attempt to circumvent the *Illinois Brick* prohibition of standing for indirect purchasers, the court granted defendants’ motion to dismiss insofar as the states sought disgorgement and/or restitution under Section 16.

Sixteen of the plaintiff states moved for reconsideration of the court’s ruling on the grounds, in part, that the court had mistakenly dismissed various states’ claims for equitable monetary relief. The court had dismissed a number of state restitution claims on the basis that because (a) the law of those states prompts courts to look to federal law in interpreting their unfair competition and consumer protection statutes, (b) the state statutes had to be construed with a view to the Clayton Act, and (c) the Clayton Act does not authorize restitution in light of *Illinois Brick*, then—(d) the states therefore could not state a claim for equitable monetary relief. As the court acknowledged on the motion for reconsideration, however, the Clayton Act is not the sole source or reference for states’ competition and consumer protection statutes: some states’ statutes prompt their courts to interpret those statutes in light of Section 5(a)(1) of the FTC Act rather than the Clayton Act.<sup>27</sup> Because the court had already held that the FTC could pursue equitable remedies such as disgorgement, based on Section 13(b) of the FTC Act, on the motion for reconsideration it held that states now found by the court to interpret their competition and consumer protection statutes in light of the FTC Act could state equitable claims for monetary relief.

The court reviewed the relevant statutes of the moving states and on most, but not all, of the motions upheld the claims of the states for equitable monetary relief on behalf of indirect pur-

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<sup>22</sup> 62 F. Supp. 2d at 37 (citing, in support of the first proposition, *FTC v. Febre*, 128 F.3d 530, 534 (7th Cir. 1997); *FTC v. Gem Merchandising*, 87 F.3d 466, 470 (11th Cir. 1996); *FTC v. Pantron*, 33 F.3d 1088, 1102 (9th Cir. 1994); *FTC v. Security Rare Coin*, 931 F.2d 1312 (8th Cir. 1991); *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711 (5th Cir. 1982); and *R.A. Walker & Assocs.*, 1991 U.S. Dist. LEXIS 14114 (D.D.C. July 26, 1991); and citing, for the second proposition, *Gem Merchandising*, 87 F.3d at 470). For Judge Hogan, the fact that the court was now being asked to exercise in an antitrust case a power previously applied only in consumer protection cases, in no way constituted a limitation on the court, especially in light of *Porter*.

<sup>23</sup> 62 F. Supp. 2d at 37.

<sup>24</sup> *Alaska v. Mylan Labs., Inc.*, No. 98CV03115 (D.D.C. filed Dec. 22, 1998).

<sup>25</sup> 62 F. Supp. 2d 25 (D.D.C. 1999) (*sub nom.* *Connecticut v. Mylan Labs., Inc.*). Section 16 states that “[a]ny person, firm, corporation, or association shall be entitled to sue for and have injunctive relief . . . against threatened loss or damage by a violation of the antitrust laws . . . when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity.” 15 U.S.C. § 26.

<sup>26</sup> 62 F. Supp. 2d at 41.

<sup>27</sup> Section 5(a)(1) of the FTC Act provides: “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful.”

chasers. For instance, in the case of Alaska, the court found that the state's Unfair Trade Practices and Consumer Protection Act provides that "in interpreting [the Act] due consideration and great weight should be given the interpretation of 15 U.S.C. Section 45(a)(1) (Section 5(a)(1) of the Federal Trade Commission Act."<sup>28</sup> This result rests on a two-step logic: first, *Illinois Brick* held only that indirect purchasers lack standing to sue for monetary relief under the Clayton Act; the Court did not hold—or much less even address—whether they lacked standing to sue for monetary recovery on antitrust claims under federal laws other than the Clayton Act. Second, under *ARC America*,<sup>29</sup> *Illinois Brick* does not preempt the states' right to enact and enforce their own antitrust laws, including laws specifically granting a state the right to sue on behalf of indirect purchasers.

It could be argued that the *Illinois Brick* exclusion of federal antitrust claims by indirect purchasers for overcharges was made with reference only to the Clayton Act because at the time of that ruling, there was little or no precedent for, or contemplation of, monetary recovery by the government under any other federal antitrust provision, such as Section 13(b) of the FTC Act. Under this reasoning, the Supreme Court's rationale, if not its explicit words, would have required extending the prohibition on any recovery on behalf of indirect purchasers to claims under the FTC Act, in addition to the prohibition of indirect claims under the Clayton Act. However, under a literal interpretation of *Illinois Brick* (which limited itself to the Clayton Act), and as Judge Hogan interpreted it in *Mylan*, the FTC was entitled to equitable monetary relief under FTC Act Section 13(b)—relief that in effect would be on behalf of indirect purchasers, even if the FTC did not explicitly so characterize it. This literal interpretation of *Illinois Brick*, leaving open the possibility of recovery by the FTC on behalf of indirect purchasers under the FTC Act, thus opened the way, under the teaching of *ARC America*, to similar recovery by those states with competition laws based on the FTC Act.

The remaining various federal actions were coordinated as *In re Lorazepam & Clorazepate Antitrust Litigation* (discussed further below), and are ongoing in the District of Columbia.<sup>30</sup>

The latest FTC action seeking disgorgement pursuant to Section 13(b) in an antitrust case is *FTC v. The Hearst Trust*.<sup>31</sup> In *Hearst*, the FTC alleged that the defendants illegally monopolized a relevant market comprised of integratable drug data files (i.e., electronic data bases containing comprehensive information about prescription and non-prescription medicines). The complaint asserted that Hearst failed to substantially comply with the HSR rules by failing to submit or identify certain competitively sensitive documents that were required to have been submitted in response to Item 4(c) of the Premerger Notification Rules. It further asserted that a proper, timely disclosure of these documents would have prompted the Commission to seek to block the acquisition, whereas in fact the consummated acquisition enabled defendants to achieve a monopoly or near-monopoly in the relevant market. Consequently, the FTC asserted that defendants had violated Section 7 of the Clayton Act and Section 5 of the FTC Act.

As relief, the FTC sought divestiture of the company that had just been acquired and disgorgement of profits. Neither remedy had been sought previously in connection with a consummated acquisition. Pursuant to a proposed settlement of the case, the defendants agreed to divest the recently acquired company and to disgorge \$19 million in profits, among other obliga-

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<sup>28</sup> 99 F. Supp. 2d 1, 9 (D.D.C. 1999) (citing Alaska Stat. § 45.50.545).

<sup>29</sup> *California v. ARC America Corp.*, 490 U.S. 93 (1989).

<sup>30</sup> MDL-1290 (TFH/JMF) (D.D.C.).

<sup>31</sup> *FTC v. The Hearst Trust*, Civ. No. 1:01CV00734 (D.D.C. filed Apr. 4, 2001), available at <http://www.ftc.gov/os/2001/04/hearstcmp.htm>.

tions.<sup>32</sup> The Commission vote approving the agreement was 5–0, with Commissioners Thomas B. Leary (dissenting in part) and Orson Swindle (concurring) noting that the \$19 million the Commission obtained in disgorgement was to be turned over to private plaintiffs’ counsel and included in (i.e., offset against) the \$26 million settlement that private plaintiffs had negotiated with the defendants. In the face of the negotiated set-off, both Leary and Swindle suggested that the Commission might have obtained greater total relief if it had collected substantial civil penalties instead of disgorgement, and Leary added that he viewed disgorgement here as “unnecessary, it not affirmatively harmful.”<sup>33</sup>

### The FTC’s Pursuit of Disgorgement in Antitrust Actions Violates the Supreme Court’s Policy Against Duplicative Litigation and Damages

*The FTC’s pursuit of antitrust disgorgement actions under Section 13(b) threatens to undermine the efficient enforcement of federal antitrust law.*

The FTC’s pursuit of antitrust disgorgement actions under Section 13(b) threatens to undermine the efficient enforcement of federal antitrust law. First, the strained reading of Section 13(b) in support of such actions runs counter to the plain meaning of the statute and to the relevant legislative history; second, such actions undermine the Supreme Court’s policy against duplicative litigation and damages; and third, the FTC’s proposed cure for these ills—set-off—is inherently unreliable because its use and application are discretionary with the courts and it short-changes direct purchasers.

**Statutory Interpretation.** As a matter of statutory interpretation, interpreting Section 13(b) to enable the FTC to seek monetary relief in antitrust cases results in a dramatic change and expansion of the essentially restrictive power that Congress voted to give to the FTC with respect to antitrust enforcement.

As previously noted, the construction of Section 13(b) that enables the FTC to seek monetary relief for any violation of Section 5 is so broad that it contradicts and nullifies Section 19, which Congress passed two years after it passed Section 13(b).

In *Mylan*, three Commissioners, writing as part of the majority in a 4–1 vote to accept the proposed settlement, issued a statement spelling out the principal points supporting the use of Section 13(b) to seek disgorgement in this case (Majority Statement).<sup>34</sup> They argued that the FTC’s authority to seek disgorgement in an antitrust case is based on clear Supreme Court precedent—*Porter v. Warner Holding Co.* Based on this, the Commissioners in the majority assert, federal courts have the power to order disgorgement or restitution because Section 13(b) expressly authorizes the issuance of the equitable remedy of injunctive relief, and nothing in Section 13(b), explicitly or by necessary and inescapable inference, deprives a court of the full range of its inherent equitable authority.

Reliance on *Porter* is misplaced, however, because it does not take into account more recent, contrary Supreme Court law. In *Meghrig v. KFC Western, Inc.*, 516 U.S. 479 (1996), the Supreme Court takes a substantially narrower approach to statutory construction than it did fifty years earlier, in *Porter*. *KFC Western* instructs courts to no longer presume that once Congress expressly invokes a specific equitable power, Congress automatically intends to confer on the courts all other

<sup>32</sup> Order and Stipulated Permanent Injunction (Dec. 14, 2001), available at <http://www.ftc.gov/opa/2001/12/hearst.htm>.

<sup>33</sup> FTC v. The Hearst Trust, FTC File No. 991-0323 (Dec. 14, 2001) (Leary, Cmm’r, concurring in part and dissenting in part), available at <http://www.ftc.gov/os/2001/12/learystate.htm>.

<sup>34</sup> FTC v. Mylan Labs., Inc., FTC File No. X990015 (Nov. 29, 2000) (Statement of Chairman Robert Pitofsky and Commissioners Sheila F. Anthony and Mozelle W. Thompson), available at <http://www.ftc.gov/os/2000/11/mylanpitofskystatement.htm>.

equitable powers as well, particularly when there is an elaborate enforcement scheme. *KFC Western* confirms that courts should assume at the outset that Congress meant to limit Section 13(b) to injunctive relief only, especially in light of the elaborate enforcement scheme at issue here. Courts should infer additional, unarticulated remedies only upon a finding that Congress did, in fact, intend Section 13(b) to invoke this Court's other equitable powers, and that doing so would not disturb and undermine the policies of the FTC Act and the antitrust remedial scheme as a whole.

***Seeking Disgorgement in Antitrust Cases Conflicts with the Rationale Articulated in Illinois Brick Against Duplicative Remedies.*** In *Illinois Brick*, the Supreme Court held that direct purchasers are deemed to be injured to the full extent of the overcharge paid by them and thus that only they—and not indirect purchasers—have standing to seek recovery for overcharges under federal antitrust law. Yet, in *Mylan*, a potential for multiple, duplicative recoveries (i.e., greater than treble damages) arose from the receipt of settlement funds by indirect purchasers and their third-party reimbursers, combined with a possible recovery by direct purchaser class action plaintiffs in *In re Lorazepam & Clorazepate Antitrust Litigation*<sup>35</sup> from the same defendants. The stage thus was set for a possible multiple recovery against the defendants for the same violation of federal antitrust law—a result that *Illinois Brick* sought to preclude.

*Illinois Brick* concerned a claim by a plaintiff indirect purchaser that it suffered antitrust injury when the direct purchaser passed on overcharges instituted by the defendant manufacturer (i.e., offensive pass-on).<sup>36</sup> The Court spelled out three major reasons for rejecting the argument that the unavailability of defensive pass-on (established in *Hanover Shoe*<sup>37</sup>) should not necessarily preclude the use of offensive pass-on by plaintiffs seeking treble damages against that defendant: (1) a serious risk of multiple liability, (2) the evidentiary complexity of damages determinations, and (3) the need for an efficient antitrust enforcer.

First, the Court characterized multiple liability for defendants as unwarranted, and concluded that “overlapping recoveries are certain to result from the two law-suits unless the indirect purchaser is unable to establish any pass-on whatsoever. . . . [and that] we are unwilling to open the door to duplicative recoveries.”<sup>38</sup> Also, the Court rejected the position taken by some lower courts that procedures for apportioning damages adequately mitigate the risk of duplicative recoveries. Various procedural devices, it noted, such as the Multidistrict Litigation Act and statutory interpleader, have been relied upon to bring indirect and direct purchasers together in one action in order to apportion damages among them and thereby reduce the risk of duplicative recovery. But the Court dismissed these devices as unable to protect against multiple liability where the direct purchasers have already recovered by obtaining a judgment or by settling, as is often the case. In rejecting set-off, the Court was clear that awarding duplicative damages is not an acceptable

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<sup>35</sup> 289 F.3d 98 (D.C. Cir. 2002).

<sup>36</sup> In *Illinois Brick*, the chain of distribution worked as follows: the defendant manufactured concrete blocks which it sold to masonry contractors, who used them to build masonry structures. These structures were then incorporated into buildings by general contractors. They in turn submitted bids for the buildings to the plaintiff governmental entities. These entities were thus indirect purchasers of the concrete block. They sued for treble damages under Section 4, alleging that a price-fixing conspiracy among the concrete block manufacturers resulted in the governmental entities having to pay \$3 million more than they would have had to pay absent the conspiracy. Essential to their claim was the argument that the masonry and general contractors passed on all or at least part of the overcharge to the governmental entities.

<sup>37</sup> In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), the Supreme Court rejected as a matter of law the defense that indirect purchasers, rather than direct purchasers, might seek to recover damages under Section 4.

<sup>38</sup> 431 U.S. at 730–31 (internal citation omitted).

price to pay for insuring that an injured party will be compensated. And as for the argument that “it is better for the defendant to pay sixfold or more damages than for an injured party to go uncompensated [i.e., that] a little slop over on the shoulders of the wrongdoers . . . is acceptable),” the Court said that “[w]e do not find this risk acceptable.”<sup>39</sup>

Second, the Court said, the principal basis of the *Hanover Shoe* decision was the prohibitive complexity of a damages determination in an overcharge pass-on case, because the evidentiary complexities and uncertainties involved in the defensive use of pass-on against a direct purchaser are multiplied in the offensive use of pass-on by a plaintiff several steps removed from the defendant in the chain of distribution.<sup>40</sup>

Third, the Court said, as between direct and indirect purchasers, direct purchasers are more efficient ‘antitrust enforcers’. *Hanover Shoe*, it said, “rest[ed] on the judgment that the antitrust laws will be more effectively enforced by concentrating the full recovery for the overcharge in the direct purchasers rather than by allowing every plaintiff potentially affected by the overcharge to sue only for the amount it could show was absorbed by it.”<sup>41</sup>

The Majority Statement in *Mylan* asserted that an FTC action for disgorgement, such as *Mylan*, does not undercut any policy articulated in *Illinois Brick* against multiple recovery and, indeed, that the Supreme Court did not even articulate such a policy in that case or subsequently. According to this view, the Court in *Illinois Brick* and *ARC America* was not concerned that a defendant’s liability might exceed treble damages, but that multiple recoveries might be obtained under the same statute, which would violate the legislative intent of the Clayton Act. This logic is based on the recognition of dual sovereigns for antitrust enforcement—federal and state—as reflected in the Court’s statement in *ARC America* that “[s]tate laws [permitting indirect purchaser recoveries] are consistent with the broad purposes of the federal antitrust laws.”<sup>42</sup> Thus, the Majority Statement concluded, “[a]ccording to the Court’s logic [in *ARC America*], the possibility that a defendant’s total liability might exceed treble damages therefore does not constitute justification for denying relief under other statutes.”

In a separate statement, Commissioner Leary dissented from the financial terms of the settlement.<sup>43</sup> He warned that the *Mylan* cases could have a “particularly serious spillover effect” by conflicting with the rationale behind *Hanover Shoe* and *Illinois Brick*—that is, by increasing rather than decreasing both the risk of multiple damages and the likelihood of complex determinations of damages (for indirect purchasers), and by repudiating the view that direct purchasers are the most efficient antitrust enforcers.

The reasoning of the Majority Statement is misguided. It is of course true that disgorgement under a federal statute other than Section 4 of the Clayton Act, such as Section 13(b) of the FTC Act, does not literally conflict with *Illinois Brick* and *Hanover Shoe*, which involved an interpretation only of Section 4 of the Clayton Act (there being no other federal statute providing for antitrust damages, according to then-prevailing precedent). The absence of literal conflict ostensibly lies in the fact that FTC Act Section 13(b) and Clayton Act Section 4 are two different statutes. Thus,

<sup>39</sup> *Id.* at 731 n.11.

<sup>40</sup> *Id.* at 732.

<sup>41</sup> *Id.* at 734–35 (citations omitted).

<sup>42</sup> 490 U.S. at 102.

<sup>43</sup> *FTC v. Mylan Pharms., Inc.*, FTC File No. X990015 (Nov. 29, 2000) (Leary, Cmm’r, dissenting in part and concurring in part) (Leary Statement), available at <http://www.ftc.gov/os/2000/11/mylanlearystatement.htm>.

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it is true that relief under Section 4 does not literally duplicate relief under Section 13(b). But this elevates form over substance, for, as Commissioner Leary stated in *Mylan*, “it can hardly be claimed that restitution to indirect purchasers under an alternative federal statute is consistent with the broad policy objectives of *Illinois Brick*, which also involved a federal statute.”<sup>44</sup>

The logic for the non-applicability of *Illinois Brick*'s policy (against duplicative remedies) to the remedy of disgorgement in *Mylan* purportedly derives from *California v. ARC America Corp.*, which held that *Illinois Brick* does not preclude indirect purchaser recoveries under state—as contrasted with federal—statutes. But *ARC America* did not address the issue of any distinctions among federal laws; rather, it was simply based on the principle of federalism, which is careful to distinguish between the authority of the federal—as contrasted with state—sovereigns, and there is no such corresponding distinction between application of the FTC Act and application of the Clayton Act, which are both enforced by the same sovereign. Reliance on *ARC America* for the proposition that monetary relief is available to indirect purchasers for antitrust injury under Section 13(b) of the FTC Act is therefore misplaced, for *ARC America* would, if anything, counsel that the Sherman and Clayton Acts should be construed consistently with the FTC Act, as many other courts have done, as a matter of substantive law.

It should also be noted that although the majority in *Mylan* stated that the complexity of a damages proceeding awarding restitution to indirect purchasers is not brought into play by a disgorgement action such as this, because here the only calculation necessary was the measurement of *Mylan*'s unjust enrichment, the fact remains that the FTC also sought restitution in its complaint, and restitution most certainly would require the very kind of complex calculation that the decision in *Illinois Brick* intended to preclude.

**Set-Off Is Discretionary with the Courts; Short-Changes Direct Purchasers.** In the FTC's view, as articulated in the Majority Statement in *Mylan*, set-off can, as a practical matter, mitigate any risk of multiple recovery in excess of treble damages: courts have routinely coordinated remedies in government disgorgement actions and private damage actions, and are readily able to surmount the potential problem of duplicative recovery. The FTC cites a number of securities cases involving set-off to illustrate the point.<sup>45</sup> In each case, either amounts obtained by private litigants were set off against amounts obtained by the SEC, or the court at least said such set-off was permissible. Also, in each case, the money obtained by the SEC was deemed to have been obtained on behalf of the persons who sued or with standing to sue in the related, private litigation. In other words, set-off operated to reduce the total amount of money from the two separate actions that the defendant would otherwise have to pay to the same persons.

According to this view, set-off similarly could mitigate any duplicative remedies obtained by the FTC through Section 13(b) disgorgement and by direct purchasers under Section 4; and set-off thus could help save FTC disgorgement in antitrust actions from undercutting the policies of *Hanover Shoe* and *Illinois Brick*.

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<sup>44</sup> *Id.*

<sup>45</sup> The majority cited *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996) (upholding award of disgorgement to agency with set-off of amounts paid to private litigants in prior settlement); *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307 (2d Cir.) (establishing escrow fund “[t]o protect [the defendants] from double liability”); *McGhee v. Joutras*, No. 94 C 7052, 1995 U.S. Dist. LEXIS 2040, at \*1–3 (N.D. Ill. Feb. 14, 1995) (holding that private litigant's damages would be reduced by any amounts the litigant receives from disgorged funds paid to the SEC); *SEC v. Penn Central Co.*, 425 F. Supp. 593, 599 (E.D. Pa. 1976) (“In the event that we deem disgorgement [to the SEC] appropriate, defendants will have the opportunity to prove that they have already relinquished their ill-gotten gains [in a private damages action].) It should be noted, however, that none of the cases cited by the Majority Statement concerned treble damages.

This argument is flawed because it places too much reliance on set-off generally and also ignores significant differences in how set-off would work in the antitrust context. First, set-off is not automatic but instead is discretionary with the court. The use of set-off to mitigate duplicative recoveries by the FTC (through disgorgement) and by direct purchasers therefore cannot be guaranteed. Thus, reliance on it to justify FTC disgorgement contemporaneously with the possibility of recovery by direct purchasers may be misplaced.

Second, even assuming a court did apply set-off in an antitrust case, such as *FTC v. Mylan*, set-off would operate not between amounts received by the same parties, as in the SEC cases, but between the amount received by the FTC in the settlement fund on behalf of indirect purchasers and any amount ultimately received by direct purchasers. This distinction is significant, and the question therefore arises whether set-off would operate as efficiently and equitably in these circumstances. Suppose, for instance, that the SEC wins a \$15 million judgment and private litigants subsequently win judgment for \$20 million. The court, exercising its discretion, would typically set off the \$15 million against the \$20 million, leaving the private litigants with \$5 million and the SEC with \$15 million to distribute to this same class of consumers. The private litigants would be deprived only of the windfall of an additional \$15 million.

On the other hand, suppose (a) the FTC obtained judgment against Mylan for \$15 million and direct purchasers subsequently won judgment for treble damages in the total amount of \$45 million (i.e., \$15 million single damages). A district court, exercising its discretion, would likely set off the FTC judgment amount against the direct purchasers' treble damages; thus, the direct purchasers would receive \$30 million (while the FTC receives \$15 million for indirect purchasers). Thus, the direct purchasers will receive less than the total they otherwise would have received pursuant to their judgment. Or, suppose (b) the direct purchasers first obtained \$45 million in treble damages and the FTC then won judgment for \$15 million in disgorgement on behalf of indirect purchasers. After set-off, the FTC would receive nothing, while the direct purchasers keep their \$45 million. Conversely, suppose (c) the FTC obtained \$45 million and then the direct purchasers won a judgment for \$15 million (or less); after trebling, set-off would leave the direct purchasers with no monetary recovery. This last scenario, leaving the direct purchasers with no monetary recovery, directly contradicts *Illinois Brick's* holding that only direct purchasers may recover and that they may recover treble damages.

As these direct and indirect purchaser set-off examples involving two distinct parties illustrate, there would be a powerful incentive to be the first party to obtain judgment. Although duplicative recoveries may thus be mitigated in each of these scenarios, as in cases involving the same plaintiffs, it is certain that here, with two different levels of plaintiff competing for the same pot of money, set-off would trigger races to obtain recovery (because the judgment of the second party to obtain recovery will be set off against the judgment amount obtained by the first party). Furthermore, as noted above, whether set-off will be used at all, or, if so, how it would work arithmetically, is discretionary with the court. Thus, a defendant, in calculating its litigation and settlement strategy, cannot reliably predict how set-off would work; the same of course is also true for private plaintiffs. Indeed, these are some of the principal reasons why the Supreme Court in *Illinois Brick* rejected set-off as a solution to the problem of duplicative recoveries.<sup>46</sup>

***The FTC's Policy Leaves It with a Free Hand to Determine Whether Given Conduct Is "Egregious."*** One of the FTC's strongest positions in the debate over disgorgement is the simple, equitable argument

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<sup>46</sup> 431 U.S. at 731 n.11.

that parties that have engaged in egregious conduct in violation of Section 5 of the FTC Act and/or other antitrust statutes, should not be allowed to keep their ill-gotten gains, and that disgorgement is the best, most precise tool to wrest such gains from them.<sup>47</sup>

But this argument is self-referential: stating that the FTC will seek disgorgement only in cases of “egregious” conduct, when the Commission’s case against Mylan was, after all, brought under the rule of reason and not the rule of per se illegality, begs the question of how a defendant can know in advance that its conduct is “egregious” and may thus be subject to the exceptional remedy of disgorgement. Per se conduct is subject to a bright-line rule; on the other hand, conduct that may be justified on the grounds of business efficiencies, by definition, is not subject to a bright-line rule and for that reason should be much less amenable to being characterized as “egregious.” Thus, by allowing the FTC to pursue antitrust-based cases under the rule of reason pursuant to Section 13(b), courts subject to remedial monetary relief conduct which a defendant might reasonably believe to be legal. Entrusting the FTC to limit itself to seeking disgorgement only in cases of “egregious” conduct leaves the determination of what constitutes “egregious” entirely in the hands of the FTC itself, once a court has determined that the Commission indeed has the right to seek disgorgement under Section 13(b) in an antitrust case.<sup>48</sup>

***The Ongoing Litigation in In re Lorazepam & Clorazepate Antitrust Litigation Illustrates the Uncertainty Surrounding the Use of Disgorgement.*** This action raises the question of how to apply the Supreme Court’s ruling in *Illinois Brick* to private actions brought under Section 4 of the Clayton Act that challenge conduct for which the FTC has already recovered substantial monetary relief under federal antitrust law. Indeed, the pending class action by alleged direct purchasers raises the real possibility of the kind of duplicative recovery feared by Commissioner Leary in *Mylan*. Also, with the possibility of monetary recovery by the alleged direct purchasers, the symmetrical rejection of the pass-on theory—that is, for both defendants and plaintiffs—would be repudiated, with only plaintiffs, but not defendants, permitted to use it.

Judge Hogan, denying a motion to dismiss on standing grounds, acknowledged the possibility of duplicative recoveries in these circumstances to be an “ostensibly colorable concern” but nonetheless found “that such risks, unlike the risk identified in *Illinois Brick*, . . . are insufficient to defeat standing for the putative direct purchasers.”<sup>49</sup> As justification, the court distinguished this situation, where the risk of duplicative recovery arises from the use of both Section 13(b) and Section 4, from the situation in *Illinois Brick*, where different plaintiffs were both seeking recovery under Section 4.

Like Judge Hogan, the majority Commissioners in the FTC case against Mylan also distinguished between the use of two different federal statutes versus the use of one federal statute by two levels of plaintiffs seeking monetary recovery. But this is a distinction without a difference. First, *Illinois Brick* did not involve—and therefore did not address—the use of two different federal statutes. Second, the possibility of duplicative recoveries is aggravated whether the potential for multi-layered recovery for a single federal antitrust violation stems from only one remedial statutory provision or two. As the defendants argue in their petition for leave to appeal,

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<sup>47</sup> See Majority Statement (“The Commission should cautiously exercise its prosecutorial discretion to seek disgorgement in all cases. Such relief is best reserved for cases, like this one, in which the defendants have engaged in particularly egregious conduct.”).

<sup>48</sup> See, e.g., Leary Statement (“[I]t is essential that we somehow communicate our views on the appropriate parameters of the Section 13(b) remedy generally for antitrust cases. At the very least, we might indicate that the remedy will not be sought in cases where the violation is unclear and where private damage remedies are available and being pursued.”).

<sup>49</sup> *In re Lorazepam & Clorazepate Antitrust Litigation*, 202 F.R.D. 12, 20 (D.D.C. 2002).

Indeed, the potential for overlapping recoveries on behalf of direct and ultimate purchasers becomes a near certainty each time the FTC seeks monetary relief (restitution/disgorgement) under Section 13(b) for the benefit of consumers and “direct purchasers” sue for damages under Section 4. Inevitably, there will be “conflicting claims to a common fund, the amount of the alleged overcharge, thereby creating the danger of multiple liability for the fund.”<sup>50</sup>

Judge Hogan added that “[i]f necessary, the court can utilize apportionment to avoid duplicative recovery at a later stage in this lawsuit.” Opinion at 16. But as in the Majority Statement in *Mylan*, the passing mention of set-off fails to acknowledge substantial inefficiencies and arguable inequities that may well result from set-off between different levels of purchasers.

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Set-off here may indeed “solve” the risk of duplicative recovery in the strict sense of reducing the overall assessment against the defendant, but whereas set-off in the SEC and similar cases works to reduce a windfall, here set-off would reduce the amount that a given party would otherwise be entitled to, and the race would merely go to the swift. As defendants’ petition for leave to appeal puts it, “[r]ecover for a plaintiff under the Clayton Act [would thus become] contingent on the time and amount of recovery made on behalf of another plaintiff under the FTC Act and vice versa. . . . [T]he use of set-off could promote wasteful races to judgment, as competing groups of plaintiffs each seek to be the first to recover in order to avoid a judgment reduction by virtue of set-off.” Petition at 13–14.

The use of set-off might, paradoxically, ultimately weaken the FTC’s enforcement powers. No defendant would agree to settle any claims under Section 13(b) prior to reaching a settlement with all potential plaintiffs, for fear of being assessed duplicative damages later. Such an outcome would in turn increase the incentives for a private defendant to litigate any action brought under Section 13(b) to the fullest extent possible—an undesirable policy goal. Finally, as noted above, the use of set-off to mitigate duplicative recoveries contradicts the Supreme Court’s rejection in *Illinois Brick* of such procedural fixes.<sup>51</sup>

## Conclusion

The tension between the FTC’s use of disgorgement in antitrust actions and *Illinois Brick* is acute. Direct purchasers and defendants who ignore the practical implications of this enforcement trend do so at their peril. ●

<sup>50</sup> *In re Lorazepam & Clorazepate Antitrust Litigation*, Defendants’ Joint Petition for Review under FRCP 23(f) (July 12, 2001) (citing *Associated Gen’l Contractors v. California State Council of Carpenters*, 459 U.S. 519, 544 (1983)).

<sup>51</sup> *See Illinois Brick*, 431 U.S. at 731 n.11.

## Paper Trail: Working Papers and Recent Scholarship

*This issue of the Paper Trail focuses on the articles and comments published in the recent symposium issue of the George Washington Law Review. As will be evident from the summaries below, the Law Review has gathered the very timely and often provocative thoughts of leading participants in the debate on the topics covered in this symposium on antitrust remedies.*

This month, (albeit with a December 2001 cover date), the *George Washington Law Review* published a lengthy symposium issue entitled *Pyrrhic Victories? Reexamining the Effectiveness of Antitrust Remedies in Restoring Competition and Deterring Misconduct*. The issue includes fourteen principal articles and five comments divided among five broad topics: criminal penalties, the use of paid informants in criminal cases, treble damage actions, merger remedies, state enforcement, and injunctive remedies for monopolization.

**Criminal Enforcement.** Criminal enforcement is the focus of four articles in the first two panels. Donald Baker's piece, *The Use of Criminal Law Remedies to Deter and Punish Cartels and Bid-Rigging*, reviews the history of criminal enforcement in the United States against both corporate and individual defendants, highlighting the enormous increase in fines and jail time imposed in the few years since the adoption of the 1991 Sentencing Guidelines. Baker contrasts the present U.S. regime with that of the EU and Canada, whose only large fines appear to have occurred in cases that followed on successful American prosecutions. He argues that the effectiveness of the U.S. system flows in large part from its unique emphasis on individual, in addition to corporate liability. Donald Klawiter's article, *After the Deluge: The Powerful Effect of Substantial Criminal Fines, Imprisonment, and Other Penalties in the Age of International Cartel Enforcement*, goes over much the same ground, arguing that "blockbuster" fines and the DOJ's leniency program have been effective in enhancing deterrence. Gary Spratling's article, *Detection and Deterrence: Rewarding Informants for Reporting Violations*, similarly focuses on the recent upsurge in massive fines and the expansion of the DOJ's amnesty program. Spratling argues that the amnesty program and the threat of huge fines have combined to increase the risk of detection of cartels by provoking cartel members to defect. He also suggests that detection is more likely now because of improved investigative techniques and international cooperation in enforcement.

Two articles take very different approaches to the cartel problem. In *Antitrust, Agency, and Amnesty: An Economic Analysis of the Criminal Enforcement of the Antitrust Laws Against Corporations*, Bruce Kobayashi questions the recent enthusiasm for megafines and amnesty. He examines the same history of criminal enforcement as do Baker, Klawiter, and Spratling, but diverges from their approaches by applying the standard of optimal deterrence. He argues that arbitrarily large fines may be less than optimal if firms and individuals make costly expenditures or avoid productive activities because of fear of being held liable. He offers an interesting game-theoretic analysis of the incentives created by the DOJ's leniency program, suggesting that some of the incentives it creates may be perverse. William Kovacic suggests an alternative to criminal

enforcement. In *Private Monitoring and Antitrust Enforcement: Paying Informants to Reveal Cartels*, he proposes the use of qui tam actions, modeled on the Civil False Claims Act, to detect and prosecute cartels.

**Private Treble Damage Actions.** Two of the articles in the symposium deal with private treble damage actions. In *Who Suffered Antitrust Injury in the Microsoft Case?*, John Lopatka and William Page discuss a variety of obstacles that consumers, computer manufactures, and competitors will face in proving that Microsoft's offenses caused them antitrust injury. For example, the article examines the difficulties the findings of fact pose for proving that Microsoft's conduct resulted in an overcharge over the price that would have prevailed but for the violations. Competitors also, including Netscape, will face difficulties disentangling the effects of Microsoft's offenses from those of its legitimate competitive activity. Robert Lande and James Langefeld provide an interesting response, *The Perfect Caper? Private Damages and the Microsoft Case*, in which they suggest several possible avenues by which private plaintiffs might prove damages. Andrew Gavil's article, *Federal Judicial Power and the Challenges of Multijurisdictional Direct and Indirect Purchaser Antitrust Litigation*, addresses the case management problems posed by the diffusion of private direct and indirect purchaser litigation among state and federal courts. He proposes a legislative solution that would allow easier removal and consolidation of indirect purchaser suits.

**Merger Remedies.** Three of the symposium papers address negotiated remedies in merger enforcement, particularly since the FTC's 1996 Divestiture Report. In *Solving Competition Problems in Merger Control: The Requirements for an Effective Divestiture Remedy*, William Baer and Ronald Redcay examine the divestiture policies of the enforcement agencies. They particularly examine the FTC's preference for "up-front" (already-located) acceptable buyers, for "as is" sales of an entire business, and for the inclusion of contingent requirements for divestiture of "crown jewel" assets as an incentive for completion of divestiture programs. Joe Sims and Michael McFalls argue, in their highly provocative piece, *Negotiated Merger Remedies: How Well Do They Solve Competition Problems?*, that the HSR framework for negotiation of remedies to address perceived competitive problems in proposed mergers often does not produce optimal remedial packages. For example, the authors suggest that the agencies threaten to sue in circumstances in which the courts would not provide relief, and thus induce firms to agree to costly remedial measures for speculative competitive risks. Sims and McFalls also criticize some of the features of divestiture practice that Baer and Redcay discuss. A sample sentence: "In recent years, the 'can we help' school of antitrust has been running the agencies, making a series of decisions on intervention that are justified only by speculative fears about what might or could possibly happen in the future, and then generating remedies that seek to protect against those possibilities through bilateral (but highly unequal) negotiations." David Balto's article, *Lessons from the Clinton Administration: The Evolving Approach to Merger Remedies*, discusses many of the same issues, but includes illuminating case studies of specific transactions.

In his comment on the articles on merger remedies, William Blumenthal suggests a burden-shifting approach to "regulatory" merger enforcement that would address some of the criticisms of the process. Molly Boast, in contrast, offers a spirited (not to say angry) and uncompromising defense of the FTC's "sophisticated, refined, and flexible" approach to remedies.

**State Enforcement.** In a free-standing article, *Delivering Remedies: The Role of the States in Antitrust Enforcement*, Harry First responds to Richard Posner's proposal in a recent essay, *Antitrust and the New Economy*, 68 *Antitrust L.J.* 925 (2001), to essentially abolish state antitrust enforcement.

**Microsoft.** Finally, in *Do Easy Cases Make Bad Law? Antitrust Innovations and Missed Opportunities* in *United States v. Microsoft*, Timothy Brennan argues that whether or not Microsoft violated the antitrust laws, the Post-Chicago theories used to support the case reflect a recycling of discredited, non-economic pre-Chicago antitrust. He argues (in a lengthy parsing of the case) that the theories, evidence, and remedies in the case do not correspond with one another. He suggests some alternative strategies that might better have supported the case and the remedies. Richard Pierce offers a comment, arguing that despite the merits of Post-Chicago economics as theory, it does not offer a useful guide to antitrust courts. ●

WILLIAM H. PAGE