Sea Change or High Tide: 
Introduction to What’s Next at the Supreme Court

By any standard, the last two years have seen a remarkable resurgence of interest in antitrust on the part of the Supreme Court. In producing more antitrust decisions in these two terms than it had in the rest of the last decade, the Court has given both practitioners and scholars plenty to debate:

- In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the Court overturned the longstanding and much debated per se rule against minimum resale price maintenance agreements.
- In *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, the Court extended the standard of *Brooke Group* from predatory pricing to predatory bidding because the two practices are economically similar.
- In *Credit Suisse Securities (USA) LLC v. Billing*, the Court held that the securities laws prevent application of the antitrust laws to allegedly collusive conduct by underwriters involved in the IPO process.
- In *Bell Atlantic Corporation v. Twombly*, the Court held that a Sherman Act complaint must allege sufficient facts to create plausible grounds for inferring that an illegal agreement existed.
- In *Illinois Tool Works Inc. v. Independent Ink, Inc.*, the Court held that the mere fact that a tying product is patented does not support a presumption of market power in the patented product, and further held that in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product.
- In *Texaco Inc. v. Dagher*, the Court held that it is not per se illegal under Section 1 of the Sherman Act for a lawful, economically integrated joint venture to set the prices at which it sells its products.
- In *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*, the Court held that a manufacturer could not be liable for secondary-line price discrimination under the Robinson-Patman Act, absent proof that it discriminated between dealers contemporaneously competing to resell its product to the same retail customer.

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1 127 S. Ct. 2705 (2007).
Is this surfeit of new authority the start of an era in which the Court will show sustained interest in issues of antitrust or are we seeing only a temporary upswing before the Court moves on to other fields? More importantly, what is next, or should be next, for the Court?

Some of the best antitrust lawyers and leaders in the ABA Section of Antitrust Law take on these difficult questions, and in doing so, offer insight not only into where the Court is going, but also where it has come from.9

9 The articles in this symposium are revised and expanded versions of comments presented by the authors at an ABA Section of Antitrust Law program, Whistler, British Columbia, August 16, 2007.
Antitrust in the Supreme Court: What Lies Ahead

Joseph Angland

Over its last few terms, the Supreme Court, in decisions such as Leegin Creative Leather Products, Inc. v. PSKS, Inc. and Illinois Tool Works Inc. v. Independent Ink, Inc., has cleaned up much of the detritus of an earlier, less economically enlightened era of antitrust jurisprudence. At this point, I believe that the Court should, and perhaps will, focus on issues of more recent vintage.

To begin with, the Court should address bundled pricing. LePage’s Inc. v. 3M Co. was an analytic disaster. The problem was not that the court of appeals adopted the wrong test for appraising whether bundled pricing by a firm with monopoly power violated Section 2 of the Sherman Act, but that it found liability without articulating any meaningful test. It permitted a jury to deem pricing by a firm with monopoly power to be anticompetitive, even if price exceeded any relevant definition of cost, simply because such pricing injured a competitor. This focus on harm to a competitor rather than harm to competition is anathema to modern antitrust thinking. By effectively permitting a jury to condemn almost any bundled discounting by a firm with—or with a dangerous probability of obtaining—monopoly power, the decision fails to provide firms with meaningful guidance and it deters procompetitive discounting. Moreover, it creates a price umbrella under which less efficient firms can operate and thereby increases prices to the detriment of consumers.

It is not surprising that the decision had virtually no defenders. What was somewhat surprising was that the Federal Trade Commission and the Department of Justice, while acknowledging that the decision was wrong, requested that the Supreme Court not review it because more time was required for the lower courts and the academic literature to consider what test was best in such cases.

The issue has percolated long enough. Bundled pricing has been addressed extensively in the academic literature, it was the object of one of the major recommendations of the Antitrust Modernization Commission, and it has been considered by several lower courts. With the Ninth Circuit’s decision in Cascade Health Solutions v. PeaceHealth, we now have a stark conflict between the Third and Ninth Circuits. One can quarrel with whether the Ninth Circuit got it precisely

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1 127 S. Ct. 2705 (2007).
3 324 F.3d 141 (3d Cir. 2003) (en banc).
4 Id.
5 See id. at 156–57.
8 502 F.3d 895 (9th Cir. 2007).
correct in *Cascade*—e.g., whether recoupment should be required or whether average variable cost should always be the controlling cost standard. The key point, however is that *Cascade* adopted a coherent test with which dominant firms can endeavor to comply and pursuant to which competition, rather than a disgruntled competitor, is given priority. The Supreme Court should make clear that *LePage*’s non-test is simply wrong. Regardless of whether it fully embraces the test set forth in *Cascade*, adopts some variation of it, or simply acknowledges that the *Cascade* test is one acceptable standard, the Court should make clear that bundled pricing cannot give rise to a Section 2 violation absent some form of below-cost pricing under some type of price attribution rule.

On a related note, the Court should consider the price-squeeze issues raised by the Ninth Circuit’s recent decision in *linkLine Communications, Inc.* v. *SBC California, Inc.* linkLine would punish a dominant firm whose above-cost pricing to a downstream competitor makes it difficult to compete effectively in the downstream market. It is difficult to square *linkLine* with decisions, such as *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, and *Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co.*, which are solicitous of aggressive pricing and condemn it only when below-cost pricing results. It is not obvious why a different test should apply simply because the defendant is a supplier to the plaintiff and thereby determines a portion of the plaintiff’s costs. It is also difficult to square *linkLine* with *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, in that it appears that *linkLine* would find a price squeeze violation even where, under *Trinko*, the dominant firm could simply refuse to sell to the competitor at all. Such a result is puzzling, and the Court should resolve this apparent conflict. *linkLine* would also give the Court an opportunity to clarify the impact of a regulatory scheme on the antitrust analysis, a subject about which *Trinko* left some uncertainty and *Credit Suisse Securities (USA) LLC* v. *Billing* raised some eyebrows.

The Supreme Court also should weigh in on patent settlements. As it stands, we have a split not only among the circuits, but between the federal enforcement agencies as well, regarding the test that should be applied to so-called reverse payment settlements—i.e., settlements of patent infringement suits in which the party challenging the patent receives a substantial payment in exchange for agreeing to remain out of the market for some period of time. The Sixth Circuit condemned one such payment under a per se rule in *Louisiana Wholesale Drug Co.* v. *Hoechst Marion Roussel, Inc.* (*In re Cardizem CD Antitrust Litigation*), whereas the Eleventh Circuit applied the rule of reason to such a settlement in *Valley Drug Co.* v. *Geneva Pharmaceuticals, Inc.* and upheld another alleged reverse payment settlement in *Schering-Plough Corp.* v. *FTC*. The Second Circuit went even further in *Jofilove v. Barr Labs, Inc.* (*In re Tamoxifen Citrate Antitrust Litigation*), effectively holding that any settlement that was not more restrictive than the original

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9 See id. at 914–20.
10 503 F.3d 876 (9th Cir. 2007), petition for cert. filed, 76 U.S.L.W. 3226 (U.S. Oct. 17, 2007) (No. 07-512).
15 332 F.3d 896, 900 (6th Cir. 2003).
16 344 F.3d 1294, 1305 (11th Cir. 2003).
The Court should address whether the overlap between a factual claim in support of class certification and a factual claim on the merits bars the court from appraising the claim on the class certification motion.

These issues require answers. The split among the courts and between the agencies regarding the applicable standard creates risk for patent holders (and challengers) that undermine the incentives that the patent system is designed to provide. Whatever the ultimate test, patent holders and challengers will benefit from clarity in this now particularly muddy area.

Finally, unless the courts of appeals sort out the conflict that remains among them, I think the Supreme Court should address a procedural issue applicable to federal cases generally but of particular significance in antitrust cases: the standard to be applied when appraising a motion for class certification. More specifically, the Court should address whether the overlap between a factual claim in support of class certification and a factual claim on the merits bars the court from appraising the claim on the class certification motion. By invoking the mantra that “the merits are not in issue at the class certification stage,” many courts have created a virtual immunity from review for any claim at the class certification stage that might be an issue on the merits. For example, if a plaintiff attempted to show that common issues predominated by contending that there was a national market and thus the same market definition and monopoly power issues applied to all class members, some courts applying the standard would refrain from considering an argument that numerous local geographic markets were involved and thus there were actually individual rather than common issues regarding market definition and monopoly power. They would decline to consider the defendant’s argument, no matter how frivolous the argument in favor of a national market appeared to be, because market definition is part of the merits analysis.

This approach finds support in neither logic nor Supreme Court precedent. As several appellate courts have held in recent years, both sound judicial management and the language of the Federal Rules of Civil Procedure require that a court make a finding about whether the “predominance” test is satisfied, and the court thus should not blindly accept a plaintiff’s argument merely because it happens to overlap with a merits issue.¹⁹ Several of those courts have convincingly demonstrated that the Supreme Court’s admonition regarding the consideration of the merits at the class certification stage prohibits only the consideration of merits issues that are not relevant to the specific issues that Rule 23 requires courts to consider at that stage—e.g., predominance.²⁰

¹⁹ E.g., In re Initial Pub. Offering Sec. Litig., 471 F.3d 24 (2d Cir. 2006).
²⁰ E.g., id. at 41.
Unfortunately, while a wave of rationality has swept through the courts on this issue in the last few years, there are some apparent holdouts. For example, the First Circuit, in *Waste Management Holdings, Inc. v. Mowbray*,\(^{21}\) interpreted relevant Supreme Court precedent as prohibiting a district court from inquiring at the class certification stage into a merits-related issue, as the Ninth Circuit did in *Dukes v. Wal-Mart, Inc.*\(^{22}\) It may be that all the circuits will fall in line on this issue over the next year or so, but if they do not, the Supreme Court should take a case to make clear that a court may not duck its responsibilities under Rule 23 just because a plaintiff invokes the word “merits.”

Over the last few years, the Supreme Court has addressed several of the vestiges of earlier eras of antitrust, and in doing so it enhanced the coherency of antitrust law. One hopes that the Court’s interest in antitrust issues will persist and that it will address some or all of the issues discussed above.

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\(^{21}\) 208 F.3d 288 (1st Cir. 2000).

\(^{22}\) 474 F.3d 1214, 1227 (9th Cir. 2007).
Whither Antitrust in the Supreme Court?

Susan S. DeSanti

A consideration of “what next?” for the Supreme Court requires first a look at recent Supreme Court opinions, not only to identify the issues just put to rest, at least for the time being, but also to assess the Court’s attitude toward antitrust law. For the most part, the Court’s recent decisions describe antitrust as a costly and mistake-prone doctrine, to be applied (if at all) only by experts capable of a specialized evaluation of the competitive circumstances at issue.

Two decisions in the spring of 2007 illustrate the trend. In *Bell Atlantic Corp. v. Twombly*, Justice Souter’s majority opinion decried the enormous expense of discovery in antitrust cases, which judges have been unsuccessful in managing, according to the Court, and which can lead defendants to settle “even anemic cases” long before summary judgment motions are filed. For these reasons among others, the Court articulated a new and arguably higher standard for pleading, dismissing an antitrust complaint where plaintiffs had not “nudged their claims across the line from conceivable to plausible.”

In *Credit Suisse Securities (USA) LLC v. Billing*, Justice Breyer’s majority opinion stated that in certain securities contexts, “antitrust courts are likely to make unusually serious mistakes” (note the implication that antitrust courts *usually* make serious mistakes), such that “to allow an antitrust lawsuit [concerning conduct related to the marketing of new securities] would threaten serious harm to the efficient functioning of the securities markets.” Far better, the Court concluded, to leave these matters in the hands of the securities experts. The Court declared antitrust law impliedly repealed as “incompatible” with securities law in that context.

These opinions are not ringing endorsements of antitrust law application by federal courts or juries. Regardless of improvements in antitrust doctrine to consider economic complexities before finding liability, the Court finds antitrust still too mistake-prone in particular circumstances and certainly only more costly as a result of its increased complexity. This view suggests the Court will look for antitrust cases that offer the opportunity further to confine antitrust doctrine. Although the Court appears already to have done much of its pruning, opportunities still exist. And perhaps the Court is just in a “pruning” mood; as discussed further below, the Court’s recent patent decisions reflect an interest in restricting the application of patent law as well.

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2 Id. at 1967.
3 Id. at 1974.
5 Id. at 2396.
6 Id.
7 Id.
8 Id. at 2397.
From Implied Antitrust Immunity to State Action?

As noted above, in Credit Suisse, the Court held that antitrust law was impliedly repealed in the context of conduct related to marketing new securities that was subject to the securities regulatory regime.9 This result may have been presaged in Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP.10 There, the Court held that Verizon’s alleged breach of its duties under the 1996 Telecommunications Act to share its network with competitors did not state a claim under Section 2 of the Sherman Act.11 The 1996 Telecommunications Act contains an explicit savings clause through which Congress mandated that antitrust laws should continue to be applied, despite the regulatory scheme established by the Act.12 Prevented from implying antitrust immunity for conduct covered by the Act, the Court nevertheless took into account the “existence of a regulatory structure designed to deter and remedy anticompetitive harm” in deciding that Section 2 of the Sherman Act did not outlaw unilateral refusals to deal such as Verizon’s.13

Some—including the Antitrust Modernization Commission (AMC)—have argued that Trinko is best understood simply as a limit on refusal to deal claims under Section 2 of the Sherman Act, not as a decision in which the Court found a way to avoid application of the antitrust laws, despite the explicit savings clause in the 1996 Telecommunications Act.14 That interpretation becomes more questionable after Credit Suisse, a case in which the Court went through contortions to demonstrate that, where both securities and antitrust laws disapproved virtually identical conduct, application of antitrust law would be “practically incompatible” with application of securities law.15

In addition, Credit Suisse raises the question whether the Court similarly will take a more favorable view toward other doctrines that protect regulated activity from antitrust scrutiny. One of the recent cases brought by the Federal Trade Commission could provide a vehicle to answer that question, at least as to the state action doctrine. In FTC v. Equitable Resources, Inc., the Third Circuit is now considering whether a proposed merger of two local gas distribution companies in western Pennsylvania is immune from antitrust scrutiny under the state action doctrine.16 The FTC challenged the proposed transaction as a merger to monopoly.17 The parties claimed their conduct was protected by the state action doctrine.18 Under the Supreme Court’s decision in California Retail Liquor Dealers Association v. Midcal, private parties may take advantage of the state action doctrine only if their conduct is pursuant to a “clearly articulated and affirmatively expressed” state policy to displace competition, and the policy is “actively supervised” by the state.19

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9 Id.
11 Id. at 415–16.
12 Id. at 406.
13 Id. at 412.
17 Id. at 36.
The merging parties in *Equitable Resources* argued the transaction had been approved by the Pennsylvania Public Utility Commission (PPUC) under a “clearly articulated” state policy to displace competition,20 and the PPUC would “actively supervise” the merged entity’s rates, costs, earnings, terms of service, and service quality.21 The district court agreed,22 and the FTC appealed the district court’s decision to the Third Circuit.23

The FTC’s arguments in *Equitable Resources* parallel those made in the FTC Staff’s State Action Report.24 The FTC asserts that *Midcal* requires a showing that the state has authorized the specific type of anticompetitive conduct that has been challenged.25 In particular, according to the FTC, “The [district] court should have assessed whether the Pennsylvania legislature had clearly articulated any policy to displace the antitrust laws with respect to anticompetitive acquisitions by public utilities.”26 (The AMC similarly recommended that, for the state action doctrine to immunize conduct by entities that are not sovereign states, courts should require that those entities act pursuant to a clearly articulated state policy “deliberately intended to displace competition in the manner at issue.”27)

In *Equitable Resources*, the FTC further argues that the second part of the *Midcal* test—active state supervision—also requires a more targeted inquiry: whether the state will supervise the particular conduct likely to cause antitrust competitive injury.28 The FTC alleges the PPUC does not regulate the particular conduct likely to cause anticompetitive effects—that is, certain customers’ loss of discounts and high quality service.29

Whoever wins or loses in the Third Circuit, a petition for certiorari may be filed. The last time the FTC was before the Supreme Court on a state action issue, in *FTC v. Ticor Title Insurance Co.*,30 the agency succeeded in persuading the Court that alleged horizontal price fixing by defendant title insurance companies did not merit state action immunity, because active state supervision was absent.31 Among other things, the Court in *Ticor* noted that “state-action immunity is disfavored, much as are repeals by implication [of the antitrust laws].”32 After *Credit Suisse*, however, repeals by implication of the antitrust laws no longer seem disfavored; does state action immunity remain disfavored? Leaving aside the particular facts in *Equitable Resources*, the Court’s shift toward a more benign view of regulation and a more skeptical view of antitrust law suggests the FTC would likely have a more difficult time today persuading the Court to adopt the FTC’s position than it did in *Ticor*.

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20 Appellant Reply Brief, supra note 18, at 3.
21 Id. at 20.
23 Appellant Opening Brief, supra note 16.
26 Id.
27 AMC REPORT, supra note 14, at 24 (emphasis added).
29 Id. at 30–31.
31 Id. at 638.
32 *Ticor*, 504 U.S. at 636.
From Tying to Bundled Discounts?

In *Illinois Tool Works, Inc. v. Independent Ink*, the Court explained not only that one could not assume market power from the mere existence of a patent, but also that “[o]ver the years, this Court’s strong disapproval of tying agreements has substantially diminished.” The Court may consider this language a sufficient signal for the lower courts to develop tying law in the direction the Court wishes.

For bundled discounts, however, the current law is in conflict. In *LePage’s Inc. v. 3M Co.*, the Third Circuit held the bundled discounts at issue violated Section 2 of the Sherman Act. There, the plaintiff contested bundled rebates that the defendant offered when customers made purchases across a number of the defendant’s product lines. The Third Circuit described the “principal anticompetitive effect” of the rebates as their potential “to foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.” The Third Circuit’s decision has been widely criticized as focusing simply on harm to the single product competitor without considering whether the conduct in question constituted harm to competition.

The criticisms of *LePage’s* alerted the Ninth Circuit to the controversy, and the court therefore invited amicus briefs on the proper antitrust evaluation of the bundled discounts at issue in *Cascade Health Solutions v. PeaceHealth*. In that case, the Ninth Circuit ultimately adopted the first part of a three-part test for bundled discounts advocated by the AMC. The first part of that test requires a factfinder to allocate the full amount of the discounts given on the entire bundle to just the competitive product and determine whether the resulting price is below the defendant’s incremental cost to produce the product. If it is, then the Ninth Circuit would find the bundled discount to constitute exclusionary conduct under Section 2. Application of this test, however, would result in liability only if the bundled discounts had the potential to exclude a hypothetical equally efficient producer of the competitive product(s).

Thus, two courts of appeals have conflicting approaches to bundled discounts, and the stage is set for a Supreme Court ruling to choose the proper approach. The Ninth Circuit’s cost-based approach is more in line with the Court’s cost-based tests for predatory pricing, a type of exclusionary conduct that, like bundled discounts, may be defined as “pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing compe-

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34 Id. at 35 (2006).
35 324 F.3d 141 (3d Cir. 2003) (en banc).
36 Id. at 144–45.
37 Id. at 155.
38 E.g., AMC REPORT, supra note 14, at 97.
39 502 F.3d 895 (9th Cir. 2007).
40 Id. at 919 (citing AMC REPORT, supra note 14, at 99–100).
41 Id.
42 Id. The AMC would ask two further questions before a finding of liability could be reached: (1) whether the defendant is likely to recoup the short-term losses from offering the bundled discounts, and (2) whether the bundled discounts had or are likely to have an adverse effect on competition. AMC REPORT, supra note 14, at 99–100.
43 PeaceHealth, 502 F.3d at 919.
tition in the long run.” As the AMC acknowledged, however, the cost-based test the Commission proposed and the Ninth Circuit adopted could generate false negatives—that is, the standard “would permit bundled discounts that could exclude a less efficient competitor, even if the less efficient competitor had provided some constraint on pricing of the competitive product.” Nonetheless, the Court would likely agree with the Commission that the danger of such false negatives was outweighed by “the difficulties of identifying [circumstances in which a less efficient competitor had provided some constraint on pricing], the lack of predictability and administrability in any standard that would capture such instances, and the undesirability of a test that would protect less efficient competitors,” and would likely adopt the Ninth Circuit or another cost-based standard for the antitrust analysis of bundled discounts.

**Further Pruning Patent Law?**

In April of this year, in *KSR International Co. v. Teleflex, Inc.*, the Court issued a unanimous decision on “obviousness” under patent law, the most important decision on this issue in four decades. The Court addressed when a patent application should be rejected, or an existing patent should be invalidated, because the underlying subject matter is “obvious,” a term of art in patent law. Under the Patent Act, a patent may not issue where “the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.” The Supreme Court found that the Court of Appeals for the Federal Circuit had adopted and applied too rigid a test for obviousness, resulting in an erroneous ruling that upheld the patent in question as non-obvious.

The Court remanded the case and reminded the Federal Circuit to take another look at Supreme Court precedent on “obviousness.” In addition, the Court stated: “[T]he results of ordinary innovation are not the subject of exclusive rights under the patent laws. Were it otherwise patents might stifle, rather than promote, the progress of useful arts,” which the Constitution specifies that patents should promote. As the FTC noted in its 2003 report, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, patents on obvious subject matter can preclude innovation that competition might otherwise have encouraged. The Court’s ruling in *KSR* now leaves greater room for competition to encourage “ordinary innovation.”

Showing a continued interest in patent law, the Supreme Court this fall granted certiorari in *Quanta Computer, Inc. v. LG Electronics, Inc.*, another case that will test the scope of the exclusive rights granted under the patent laws. That case involves whether and, if so, when, a patentee may bring an infringement suit to enforce restrictions on a patented article after an authorized sale. LG had granted Intel a license to make and sell specialized components using certain LG

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46 *AMC Report*, supra note 14, at 100.
47 See id.
50 *KSR*, 127 S. Ct. at 1739.
51 Id. at 1746.
patents. The license agreement, however, specifically disclaimed any express or implied license for acts of infringement that might occur when a third party to which Intel sold its LG-patented products combined them with other, non-Intel components; indeed, the license required Intel to notify purchasers of this limitation.\footnote{LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1368 (Fed. Cir. 2006).}

Under Supreme Court cases, the patent exhaustion doctrine, also known as the first-sale doctrine, prohibits a patentee who sells a machine embodying the invention (either directly or through an authorized licensee) from bringing a patent infringement suit against the purchasers for using the machine for its only reasonable use or for reselling the machine to others. In \textit{LG Electronics}, the district court held, among other things, that LG could not enforce certain of its patent claims against Quanta, a manufacturer that had combined LG-patented Intel products with non-Intel products, because those claims were “exhausted” by the license that LG had granted Intel to sell products embodying LG’s patents.\footnote{LG Elecs., Inc. v. Asustek Computer, Inc., 248 F. Supp. 2d 912, 917–18 (N.D. Cal. 2003).} In reaching its decision, the district court emphasized that the relevant licensed Intel components were essential to LG’s patented invention and had no reasonable use that did not practice LG’s patents.\footnote{Id.} The Federal Circuit reversed the district court’s holding on this point, on the ground that the patent-exhaustion doctrine does not apply to “an expressly conditional sale”—that is, a sale that is subject to an express limitation on the right to use or to resell the patented invention.\footnote{\textit{Bizcom Electronics}, 453 F.3d at 1370.}

The Solicitor General recommended that the Court grant certiorari to review the Federal Circuit’s decision, arguing that the Federal Circuit’s expansion of the circumstances in which a patentee may use a patent infringement suit (as opposed to a suit for breach of contract) to enforce restrictions on a patented article after an authorized sale “is difficult to reconcile with the reasoning of this Court’s cases.”\footnote{Brief for the United States as Amicus Curiae at 17, Quanta Computer, Inc. v. LG Electronics, Inc., No. 06-937 (U.S. Aug. 24, 2007), available at http://www.usdoj.gov/atr/cases/f225500/225544.htm.} Among other things, the Solicitor General noted, “The Federal Circuit’s approach also has the potential to erode downstream competition by permitting patentees to avoid antitrust scrutiny of restrictions on the use and resale of products embodying their inventions—restrictions that would be enforceable as a matter of patent law in the Federal Circuit.”\footnote{Id. at 18.} This would contrast with current practice, under which a patentee may negotiate contractual restrictions with downstream purchasers but the patentee does not automatically have the right to apply such restrictions as a matter of patent law.

This case provides yet another opportunity for the Court to limit the Federal Circuit’s expansive interpretation of the scope of patents and thus to facilitate competition. To allow a patentee automatically to apply any condition on all downstream purchases of the patented product would add uncertainty to those purchases at best, and could impose anticompetitive restrictions to competition involving the patented product \textit{as a matter of patent law} at worst. Given the Court’s recent patent decisions, such as \textit{KSR}, there is reason to believe that the Court understands the competition implications of the Federal Circuit’s approach to the doctrine of patent exhaustion and has granted certiorari in \textit{LG Electronics} to undo the Federal Circuit’s method of avoiding the application of that doctrine. Overruling the Federal Circuit on this issue would be the best outcome for competition and consumers.\footnote{Id. at 18.}
The Supreme Court’s Antitrust Future: New Directions or Revisiting Old Cases?

Pamela Jones Harbour

Predicting future Supreme Court actions in any area of the law is, at best, an uncertain exercise. Antitrust law, given its breadth and scope, is even less certain. Doctrine in one area may move little, if at all. Doctrine in other areas may develop quickly. And sometimes, Court-related predictions tell us as much about the prognosticator’s aspirations for antitrust law as they do about the Court’s. A few truths about the current Court, however, make possible some generalizations.

The Court’s Pro-Business Bias Will Generally Continue

The Court is now undeniably “conservative” in a way that would be comfortable to the Reagan Administration. Five Republican appointees—Chief Justice John Roberts, joined by Associate Justices Anthony Kennedy, Antonin Scalia, Clarence Thomas, and Samuel Alito—anchor a solidly conservative and pro-business majority for this Court.

As a result, I suspect a greater number of cases coming before the Court will present issues of substantial importance to the American business community. We are likely to continue to see the Court defer to American businesses by granting more freedom from what they characterize as burdensome lawsuits. That relief will sometimes take the form of changes in legal standards themselves. At other times, it may be the product of procedural rulings, such as more stringent application of statutes of limitation, heightened pleading and proof standards, or greater evidentiary deference.

Still I concur with the view that “[r]ecent breakthrough victories for business in tort, antitrust, and other areas of the law can’t be explained totally by the Court’s overall conservative majority.” And another anomaly: it has been reported that a specialized segment of the Supreme Court bar now represents an increasing proportion of the cases accepted for argument, which may also be affecting the outcome of those cases. I will leave it to others to try to figure out whether the Court is taking more cases from those firms because of their strong advocacy skills, or because the clients who can afford their services happen to have interests that coincide with the economic preferences of the Court.

Reluctance to Take on New Cases Until Lower Courts Can Digest Its Recent Decisions

The Supreme Court has weighed in on several important issues in its last few terms. To name only a few, it heightened pleading standards under Section 1 of the Sherman Act in Bell Atlantic Corp. v. Twombly. It enun-

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2 Id.
associated a legal standard for monopsony predation in Weyerhaeuser.\(^5\) It addressed resort to American antitrust law remedies by foreign nationals regarding transactions in foreign markets in Empagran.\(^6\) The Court examined a novel issue under the Robinson-Patman Act\(^7\) when it reviewed the bidding conduct at issue in Reeder-Simco.\(^8\) The Court also dealt with the intersection between antitrust law and other federal regulatory regimes in Credit Suisse\(^9\) and Trinko.\(^10\) Finally, at the end of last term, the Court authorized its own experiment with vertical minimum price fixing when it abandoned per se illegality for that conduct in the Leegin case.\(^11\)

It would not be surprising if the Court were to stop and take a breath. That would give the lower courts an opportunity to digest the Court’s recent output. Such a pause will give the lower courts time to begin integrating these new teachings into doctrine in a wide variety of cases. The Court may prefer to watch and wait, and see what develops out of its recent cases, before doing more. Accordingly, I predict that the Court will not take as many antitrust cases in its next couple of terms as it did in recent years.

This prediction is consistent with what the Court did regarding the issue of “but-for” jurisdiction in Empagran.\(^12\) But-for jurisdiction refers to the plaintiffs’ argument that vitamins, the price-fixed goods at issue, were fungible commodity products selling in international markets. Fixing the prices of vitamins in the United States was a necessary condition to fixing them in foreign markets. Accordingly, injury in foreign market transactions could not occur unless prices in the United States had been fixed. Plaintiffs claimed that this interdependence linked foreign injury to domestic conduct in the United States sufficient to create jurisdiction for that injury in US courts. The Court easily could have dealt with the plaintiffs’ “but-for” jurisdiction argument itself as the issue had been briefed by the parties, but still chose to remand that issue to the court of appeals.\(^13\)

The Importance of the Government’s Amicus Role—the Schering Case

Even in light of the foregoing factors, the hardest thing to predict about the Supreme Court’s future antitrust agenda is which areas of antitrust law it will actually choose to address. This used to be simplified because the Expediting Act\(^14\) allowed automatic direct appeals to the Court of civil antitrust cases brought by the Antitrust Division of the U.S. Department of Justice. Since the Expediting Act was amended in 1974\(^15\) to eliminate that right of automatic appeal, the number of antitrust cases accepted by the Court each term has dwindled substantially; the disputes have been predominantly between private parties; and the cases finding their way to the Court no longer reflect the enforcement agenda of the current Administration in the way they once might have done. We can no longer simply look at the federal government’s case selection, then sit back

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\(^13\) Id. at 175.

\(^14\) Act of Feb. 11, 1903, ch. 544, § 1, 32 Stat. 823.

and sagely pronounce which of those cases are likely to make their way to the Court over time.

That said, it is still true that the government influences the Court's antitrust docket through positions taken as amicus curiae, although that influence is neither as direct nor as predictable as direct appeals were. In deciding what private cases to accept for review, the Solicitor General, via amicus filings, still has an important influence on the antitrust cases the Court accepts for review. The Court often seeks the advice of the Solicitor General and frequently follows that advice.

The Federal Trade Commission tried, albeit unsuccessfully, to lengthen the Court's antitrust docket when it sought review of the Eleventh Circuit's decision in the *Schering* case. The case involved so-called reverse or exclusion payments in the context of a patent dispute settlement. The Commission's appeal asked the Court to determine whether the Commission had applied the proper legal standard in its evaluation of the propriety of payments by a patent holder to a party challenging the validity of the patent, whereby the patent challenger has agreed to delay its entry into the market for a period of time in consideration of the payments. The Commission, in its administrative opinion, found that Schering's payments to the challengers were improper, but the Eleventh Circuit disagreed. After seeking and receiving the contrary views of the Solicitor General, the Court declined to review the case.

I worry that patent settlements might become a convenient pretext for other, broader assaults on competition. Unless the Court provides some definitive guidance, there is a very real likelihood that creative counsel will be able to use patent "settlements" as camouflage for a host of consumer-unfriendly outcomes.

**Collateral Fallout from the *Leegin* Decision**

Another case that may influence the direction of what's next for the Supreme Court is *Leegin*. To say that I think a majority of the Court made a mistake in *Leegin* would be an understatement. I do not, however, want to address the obvious *Leegin* topics, such as the proper legal standard for minimum vertical price fixing, allocations of burden of proof, and the absence of empirical support for the *Leegin* outcome. Rather, I want to focus on two collateral issues that may now arise with the demise of a per se rule of illegality for minimum vertical price fixing: First, *Leegin* potentially revitalizes the state action and Twenty-First Amendment defenses to price fixing that had been rejected in the *Midcal* case; and second, *Leegin* seems to remove any foundation for

16 Schering-Plough Corp. v. FTC, 402 F.3d 1056 (11th Cir. 2005), cert. denied, 126 S. Ct. 2929 (2006).
17 *Id.* at 1076.
Justice Holmes’s exemption of major league baseball from the reach of the antitrust laws. These issues might not have been in the Court’s crosshairs when it issued the Leegin decision but their revival may be the unexpected fallout of the ruling.

The Scope of the State Action and Twenty-First Amendment Defenses in Liquor Pricing. In simplified form, the California wine regulations at issue in Midcal required each wine producer to file schedules with the state setting the prices at which wine merchants or wholesalers would offer its wines for sale to retailers. The Court observed that wine producers were setting these prices “according to their own economic interests . . . [and] the state’s role is restricted to enforcing the prices specified by the producers.” The lower court had enjoined enforcement of the regulations, and the Court was asked to decide whether that injunctive relief was proper.

The Midcal Court began its analysis by asking “[t]he threshold question . . . whether California’s plan for wine pricing violates the Sherman Act.” In 1980, the answer to that question was a clear “yes”—based on the rule of per se illegality established by the Court’s 1911 Dr. Miles decision and its progeny. But today, under the unstructured rule of reason test announced in Leegin, it is not clear that the answer to this question would be the same. The Leegin majority showed deference to the pricing discretion of manufacturers; the California regulatory system at issue in Midcal showed the same deference by leaving the producer’s pricing discretion wholly unencumbered. Indeed, the Midcal Court described California’s role as being limited to the provision of a relatively cost-free enforcement mechanism—which, presumably, was efficient.

It is difficult to fathom why the Court would want to inhibit an efficiently implemented exercise of pricing discretion of a type to which it already has demonstrated a willingness to grant substantial deference. Further, no author with whom I am familiar has ever believed the rule of reason to be plaintiff-friendly. That, in turn, makes it unlikely that many plaintiffs will be able to challenge successfully a vertical minimum price fixing regulatory system. In other words, in the post-Leegin era, it will be a rare case indeed in which a plaintiff will be able to answer the Midcal Court’s threshold question in the affirmative. And if one cannot make it past the threshold question of Midcal, the classic two-pronged analysis for state action becomes irrelevant.

The provisions of the Twenty-First Amendment did not protect the California regulatory system from antitrust liability in Midcal. It is, however, fairly arguable post-Leegin that the Twenty-First Amendment would now save California’s regulations from antitrust attack, even if state action still did not.

The Twenty-First Amendment repealed prohibition and vested the states with significant regulatory discretion. The Midcal Court, however, did not demarcate a bright-line test to draw the line between state and federal powers to regulate liquor prices. Rather, the Court’s test for reconciling “competing state and federal interests” required “careful scrutiny of those concerns in a ‘con-

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23 Midcal, 445 U.S. at 101.
24 Id. at 102.
27 Id. at 2718.
29 Id. at 114.
30 Id. at 110.
crete case.”31 In the “concrete case” of *Midcal*, the Court found that California’s interests in producer-controlled vertical minimum price fixing was “less substantial than the national policy in favor of competition,” as defined by *Dr. Miles*’s per se prohibition of vertical minimum price fixing.32

Today, however, if one were to attempt to balance California’s regulatory system against the national policy in favor of competition as it is defined by *Leequin*, one might reach a different result. A court would be hard-pressed to find that California’s policy of promoting resale price maintenance—at prices set in accordance with the producers’ unbridled economic discretion—would be outweighed by the *Leequin* Court’s policy of promoting resale prices set in accordance with the producers’ economic discretion as “disciplined” by the rule of reason.

Two years after its decision in *Midcal*, the Court faced the question of whether the Sherman Act preempted another California liquor regulation when it decided *Rice v. Norman Williams*.33 The Court found that a rule of reason standard would apply to determine Sherman Act liability for complying with California’s regulation prohibiting an importer from bringing a distiller’s brands into California without having been designated to do so by the distiller.34 The Court held that preemption of a state regulation by the Sherman Act could only occur when the state regulation compelled an actor to engage in conduct that was per se unlawful under the Sherman Act because “[a]nalysis under the rule of reason requires an examination of the circumstances underlying a particular economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws.”

*Rice* decided a different, albeit related, question than the Twenty-First Amendment question presented in *Midcal*, but *Rice* is nonetheless instructive for Twenty-First Amendment analysis. When balancing federal versus state sovereign interests, the balance materially shifts in favor of the states when the rule of reason, rather than a per se standard, is applied. As state regulators and the industries they regulate begin to appreciate the implications of *Leequin*, we may see a new round of state action and constitutional issues percolating up to the Court.

**Can the Antitrust Exemption for Baseball Survive *Leequin***? If *Leequin* taught us nothing else, it tells us that we should classify as “endangered species” old cases based on rationales that allegedly cannot be reconciled with modern antitrust analysis. Justice Holmes’s 1922 decision in *Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs*35 is just such a case.36

Holmes distinguished travel between cities to play games from the local exhibition of the games, and found baseball to be “purely state affairs;” the movement between cities was too incidental to bring local exhibitions within the jurisdictional reach of the Sherman Act.37 A year later in the *Keith Vaudeville* case, however, Holmes found that local exhibitions of vaudeville acts might involve incidentals (presumably, travel between theaters) that would rise “to a magnitude that

31 Id. (citing Hostetter v. Idlewild Liquor Corp., 377 U.S. 324, 332 (1964)).
32 Id. at 113.
34 Id. at 662.
35 259 U.S. 200 (1922).
requires [them] to be considered independently.” 38 Since then, the Court has twice reaffirmed Federal Baseball on the basis of stare decisis,39 while declining to extend the rule to local exhibitions of vaudeville,40 professional boxing,41 professional football,42 or professional basketball.43 While the Court has described the baseball exemption as an “aberration,”44 thus far the Court has left it to Congress to deal with, if at all.

The analytical logic of the Leegin decision should lead to the demise of the baseball exemption. Even the Court itself criticizes the baseball rule. It is, therefore, not necessary here to recite the voluminous criticisms of the exemption that exist in the literature. It is an old decision based on conceptions of interstate commerce that are today, at best, quaint. If the Court has as loose a regard for the reliance interests of baseball club owners as it had for discount merchant investors in Leegin,45 stare decisis should not constrain the Court. Plaintiffs in Leegin could make a stronger case for Congressional reliance46 than could baseball owners.

Finally, the very nature of the baseball product has changed since 1922. Local exhibition in 1922 was limited by the visual acuity of each person within sight of the game. Justice Holmes does not mention in Federal Baseball whether telegraph, telephone, or radio redistribution of accounts of the games was available at the time. But the intervening advent of radio and television broadcasting of baseball games, both interstate and international in character, has placed the product within the reach of the vast majority of its viewers only through the use of various instrumentalities of interstate commerce. Given that, it is simply absurd to retain the notion that the incidental effects of baseball on commerce are outweighed by the local nature of the exhibition. Unless the Court is willing to say that investments in professional baseball are socially or economically superior to investments in discount retailing, it is difficult to articulate a principled distinction that could save the baseball exemption from the inescapable logic of Leegin. There is, thus, at least some hope for societal good from the Leegin decision.

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At the end of the day, only time will tell whether we will see a new flood of state action cases or a successful assault on the baseball exemption. Stay tuned . . .

40 Hart, 262 U.S. at 273–74.
44 Flood, 407 U.S. at 282–84.
46 Id. at 2723–24 (Kennedy, J.), 2732 (Breyer, J., dissenting).
What Should Be Next at the Supreme Court?

Jonathan M. Jacobson

In asking “What’s next at the Supreme Court,” we can focus on what we think will be next or on what should be next. This note addresses a few topics where the law is unclear, and where illumination from on high could be beneficial, namely: (1) the per se rule for tying; (2) the appropriate standard for bundling; (3) standards for class certification; and (4) class action waivers and other provisions ancillary to arbitration clauses. The degree to which the Court’s guidance would be helpful, however, is somewhat unclear given the apparently hostile approach to antitrust enforcement that seems to emanate from some of the Court’s more recent decisions. Consumers might be better off if some of these important unresolved issues remain open a bit longer.

Tying
The per se rule for tying, if it even exists at all today, is clearly doomed. In Illinois Tool Works, Inc. v. Independent Ink, Inc., the Supreme Court pointedly recognized that tying arrangements are not invariably anticompetitive—as per se analysis requires. The Court also noted the potential efficiencies associated with tying, and acknowledged expressly that, “over the years . . . this Court’s strong disapproval of tying arrangements has substantially diminished.” Yet notwithstanding Illinois Tool, courts still refer to tying as, at least potentially, a per se offense. And many cases are progressing through the courts on that basis. In the wake of Leegin Creative Leather Products, Inc. v. PSKS, Inc., tying is the only vertical restraint in which per se analysis has not been eliminated conclusively. It is a virtual certainty that the Court will finally inter the per se tying rule at the next opportunity, and doing so soon should be regarded as among the Court’s highest antitrust priorities.

Bundling
There is now a sharp conflict in the circuits as to the appropriate standard for evaluating bundled pricing arrangements under Section 2 of the Sherman Act. The Third Circuit’s 2003 decision in LePage’s, Inc. v. 3M, created significant controversy by apparently holding that a multi-product firm’s bundled pricing may be found to violate Section 2 on the basis of nothing more than an adverse impact on single-product rivals. Certiorari was sought in that case, but the Solicitor General (following Supreme Court invitation of his views) counseled that the issue had not been developed sufficiently in the lower courts, and the writ was denied. Since then, there have been several cases decided in the district courts— with conflicting results.

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2 Id. at 35.
3 See, e.g., Park v. Thomson Corp., 2007-1 Trade Cas. (CCH) ¶ 75,552 (S.D.N.Y. 2007).
5 324 F.3d 141 (3d Cir. 2003) (en banc).
7 See Jonathan M. Jacobson, Exploring the Antitrust Modernization Commission’s Proposed Test for Bundled Pricing, ANTITRUST, Summer 2007, at 23, 23 n.2 (citing cases).
The most significant recent development was the Ninth Circuit’s September 2007 decision in *Cascade Health Solutions v. PeaceHealth.* The *PeaceHealth* court expressly rejected *LePage’s* and adopted instead a variant of the test proposed by the Antitrust Modernization Commission, Professor Herbert Hovenkamp, and others. Under the *PeaceHealth* court’s standard, bundled pricing may violate Section 2 if it has the requisite adverse effect on competition and if, “after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below its average variable cost of producing them.”

In analyzing the appropriate test for bundling arrangements, there are basically four approaches (although each has a multiplicity of nuances and variants). One is the *LePage’s* approach. Another is a simple rule of reason, or consumer welfare effects, analysis. A third couples rule of reason analysis with a discount attribution screen, as proposed by numerous commentators and adopted in *PeaceHealth.* A fourth approach, urged largely by telecom firms, is one that would condemn bundled pricing only in circumstances where the total price charged for all the products in the bundle is below the incremental cost of the total bundle.

The bundling issue is one that arises constantly in counseling clients, and the uncertainty in the law arising out of the *LePage’s-PeaceHealth* conflict makes counseling—and resulting business behavior—quite difficult. The issue, moreover, has now been the subject of extensive analysis—several cases, numerous articles, hearings before the Antitrust Modernization Commission, and hearings before the Federal Trade Commission and Department of Justice. There is no longer any reason to deny certiorari if and when an appropriate case comes along.

**Class Certification**

There are important intercircuit conflicts on a number of questions that arise in virtually every class certification antitrust case. One is the extent to which the *Eisen* case requires the court to accept the complaint’s allegations as true in making the class certification decision. *Eisen* established that a court considering class certification may not “conduct a preliminary inquiry into the merits of a suit.” Some courts have interpreted that mandate broadly, effectively treating a motion for class certification like a motion to dismiss under Rule 12(b)(6). Other courts, including most of the more recent cases, have held otherwise, ruling that a plaintiff seeking class certification must prove, with evidence, any contested elements under Rule 23, whether or not those elements overlap with an issue going to the merits—and that *Eisen* means only that a court should not evaluate the merits to determine whether a case is “worthy” of certification. But cases adhering to at least some version of the older view persist, and the conflict is a serious practical problem.

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8 503 F.3d 895 (9th Cir. 2007).
9 Id. at 920.
10 A number of commentators, including this writer, have been sharply critical of this total cost versus total revenues approach because it applies the same test that would have been applicable in a predatory pricing challenge whether multiple products were bundled or not and, thus, makes the bundling aspect of the conduct irrelevant.
12 Id. at 177.
13 See, e.g., *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006).
Another important circuit conflict has arisen just recently from the September 2007 decision of the Second Circuit in *Cordes & Co. Financial Services, Inc. v. A.G. Edwards & Sons, Inc.*\(^{15}\) Prior to *Cordes*, the courts had held uniformly that, because impact (or fact of injury) is an element of every private cause of action under the antitrust laws, a class action could not be certified if impact could not be established through common proof.\(^{16}\) *Cordes*, however, says that common impact is just one component of the predominance inquiry under Rule 23(b)(3), and a class can be certified if common issues predominate even if common impact cannot be shown. Perhaps that might be true in theory, in cases with a class that barely passes the numerosity requirement; but in a typical antitrust case, with thousands of putative class members, the concept borders on the ridiculous. *Cordes* conflicts in this respect with all prior circuit court decisions to address the issue, and is already beginning to work mischief in cases pending in the Second Circuit. Until the error is corrected, one can only hope that district courts will recognize that finding predominance in an antitrust case without common impact is nothing more than a theoretical possibility with no counterpart in the real world.

*Cordes* also holds that it may be appropriate for a district court, in the exercise of its discretion, to certify an “issue class” under Rule 23(c)(4)—i.e., the issue whether there was an antitrust violation—even if common issues do not predominate and neither a damages class nor an equitable relief class can be certified under Rules 23(b)(3) and 23(b)(2). That holding, the court recognized, conflicts with the Fifth Circuit’s contrary decision in *Castano v. American Tobacco Co*.\(^{17}\) It seems hard to imagine how certifying an issue class in an antitrust case could accomplish any good. Again, the *Cordes* decision is already causing mischief in the lower courts.

The Supreme Court has addressed general class certification standards infrequently. The Court has never analyzed certification in antitrust contexts in any detail. The result is that there are now serious conflicts in the lower courts on issues that arise in almost every case. It now seems time for the Supreme Court to step in.

**Ancillary Arbitration Clause Provisions**

The enforceability of arbitration clauses in antitrust cases has been settled for more than twenty years. More recently, provisions ancillary to arbitration in standardized agreements—such as class action waivers—have come up for review, with occasionally conflicting results. Last year, in *Kristian v. Comcast Corp.*\(^{18}\) the First Circuit struck down a consumer contract provision excluding class actions (or class arbitrations) and the trebling of damages. The court reasoned that both provisions interfered unduly with the plaintiffs’ ability to vindicate their rights under the Sherman Act. In contrast, the Fourth Circuit, in *In re Cotton Yarn Antitrust Litigation*\(^{19}\), recently sustained a clause with a one-year statute of limitations that, at least potentially, could curb the period of recoverable damages significantly. And numerous courts of appeals have upheld class actions waivers in other statutory contexts.\(^{20}\) At some point, the enforceability of these ancillary provisions will have to be taken up by the Court.

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\(^{15}\) 502 F.3d 91 (2d Cir. 2007).

\(^{16}\) See, e.g., *Blades v. Monsanto Co.*, 400 F.3d 562 (8th Cir. 2005).

\(^{17}\) 84 F.3d 734, 745 n.21 (5th Cir. 1996).

\(^{18}\) 446 F.3d 25 (1st Cir. 2006).

\(^{19}\) No. 05-2392, 2007 WL 2965586 (4th Cir. Oct. 12, 2007).

Latest Portents—Decisions of the October Term 2006

The problem with suggesting types of cases the Supreme Court should take is that they might agree—and then get things deeply wrong. The Court’s most recent term included decisions that are, at the very least, debatable, and that continue what might be viewed as disturbing trend of hostility to antitrust enforcement. Continuation (or, worse, acceleration) of that trend would bode ill for antitrust enforcement and, accordingly, for U.S. consumers.

Some of the Court’s recent decisions were entirely uncontroversial. *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*,21 like *Dagher* and *Independent Ink* the year before, was easy and plainly correct. *Twombly* was much more debatable in terms of its reasoning, but the Second Circuit’s holding that conscious parallelism was sufficient to defeat a motion to dismiss obviously had to be reversed. The overruling of *Conley v. Gibson*22 was a good deal more surprising, but the Court’s articulation of a plausibility standard makes a lot of sense. The effects of *Twombly* will take many years to play out, but a reasonable guess is that the decision’s effects will be incremental, not radical, and that the principal impact will be the positive one of weeding out cases that do not belong in court in any event. The one really disturbing aspect of *Twombly*, echoed and amplified in *Credit Suisse Securities (USA) LLC v. Billing*,23 is the implication that antitrust litigation itself is bad, a point addressed below.

The decision that caught the most attention and that has generated the most controversy to date is, of course, *Leegin*.24 It is contrary to normal principles of statutory interpretation for the Court to discard a construction embraced by dozens of its own precedents in a context where Congress has clearly endorsed and relied on the Court’s prior precedent for decades. But it is equally true that the underpinnings of the *Dr. Miles* rule had eroded dramatically over the years through the *Colgate* doctrine, especially as revived in *Monsanto*, and through the limitation in *Sharp* of per se condemnation only to agreements on specific prices or price levels.25 And as the Ping amicus brief pointed out so effectively,26 the *Dr. Miles* rule had led to the creation of vast and inefficient compliance structures in many companies. My own preference in *Leegin* would have been for a decision that applied the characterization analysis of *Broadcast Music, Inc. v. CBS, Inc.*27 to vertical price agreements so that only “naked” resale price restraints with no plausible efficiency justifications would be condemned per se. But that point was not argued, and the decision came out otherwise. In any event, it is hard to say that *Leegin* alone signals the end of effective antitrust enforcement. Many will applaud its outcome, and the decision’s long-term impact on consumer welfare will not be known for many years.

The truly problematic decision is *Billing*. The decision cut back sharply, to the point of practical overruling, decades of implied immunity cases—allowing immunity to be implied on the basis of potential inconsistency (perhaps from no more than the presence of regulation) rather than the

24 127 S. Ct. 2705.
“plain repugnancy” the Court’s prior (and often unanimous) decisions had required. 28 Three years earlier, in Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 29 the Court had suggested that regulation was preferable to antitrust in determining market outcomes:

Antitrust analysis must always be attuned to the particular structure and circumstances of the industry at issue. Part of that attention to economic context is an awareness of the significance of regulation. . . . One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny. . . . The regulatory framework that exists in this case demonstrates how, in certain circumstances, “regulation significantly diminishes the likelihood of major antitrust harm.” 30

The most troubling aspect of Billing is that it makes clear that Trinko’s analysis was no aberration. Thus, in Billing, the Court said that, even though both the securities laws and the antitrust laws prohibit the challenged conduct, “to permit antitrust actions such as the present one still threatens serious securities-related harm.” 31 The Court added that, because of SEC enforcement, “any enforcement-related need for an antitrust lawsuit is unusually small.” 32 In Trinko, the Court pointedly noted what it called the “considerable disadvantages” of antitrust, and commented that the “cost of false positives” must be weighed “against the slight benefits of antitrust intervention.” 33 Likewise, in Billing, the Court cited as grounds for implied immunity the “fear [of securities firms] that anticompetitive conduct could lead to an antitrust lawsuit and the risk of treble damages,” 34 a fear that could be applicable to any firm in any industry, regulated or not, and one which Congress affirmatively sought to instill to encourage compliance with the law. Billing, especially coming on the heels of Trinko, seems to suggest that the Court is affirmatively hostile to antitrust.

All four decisions this year—Weyerhaeuser, Twombly, Billing, and Leegin—were wins for the defense. That in itself is not unusual or in any way problematic. But it is well to keep in mind that there has not been a “plaintiff antitrust law win” in the Supreme Court since 1993 in Hartford Fire Insurance Company v. California. 35 That statistic is unique in antitrust history. We had the era of Chief Justice Peckham, and later the Depression era that gave us Appalachian Coals, Inc. v. United States, 36 but there has never before been a period in which antitrust enforcement has received such persistently negative treatment in the Supreme Court. Nor, at least since the Holmes dissent in Northern Securities, have we seen affirmative expressions of actual hostility to antitrust. The combination of Billing and Trinko in that respect seems chilling.

Given all of the Court’s recent decisions, maybe it is just as well that the important unresolved issues addressed at the outset of this note stay unresolved, at least for now. Perhaps the best outcome that we can reasonably hope for in most cases is the well-known phrase “certiorari denied.”

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30 Id. at 411–12 (quoting earlier precedent).
31 127 S. Ct. at 2394.
32 Id. at 2386.
33 540 U.S. at 412–14.
34 127 S. Ct. at 2396.
36 288 U.S. 344 (1933).
Can Water Run Uphill?  
Predictions About Future Antitrust Appeals

J. Robert Robertson

It is nearly impossible to predict the types of antitrust cases that might be heard by the Supreme Court or by any court of appeals. A few years ago, as an editor, I worked with a few authors who thought they had a hot antitrust topic: buyer power. The Weyerhaeuser case,\(^1\) which raised this issue, was in its infancy but soon headed into an appeal in the Ninth Circuit and then to the Supreme Court. The authors’ articles were right on target and became the leading support in the opinions of both the Ninth Circuit and the Supreme Court.\(^2\) These authors’ prescience was admirable. But when I look back on that process, the one driving force was not the interesting idea; it was the fact that this interesting idea was appealed. Thus, to make predictions about what kinds of antitrust cases the U.S. Supreme Court or courts of appeals may decide, I believe it is important to consider which kinds of cases are more likely to find their way up the appellate ladder.

Cases that Are Not Appealed Do Not Count
First, a reality check: Many interesting topics in the antitrust field are unresolved, but few will ever be heard on appeal. For example, as much as we antitrust lawyers love to discuss the merits (or lack thereof) of the Robinson-Patman Act, it is unlikely that the courts will ever provide clear rules in that area. Few cases are ever brought under the Act, and fewer still are appealed. And when the Supreme Court had a chance to clear up the law in the area, it created more ambiguity than answers.\(^3\)

Another example of an interesting issue that took years to get to the Court can be found in the recent Leegin case, in which the Court decided to change the law of resale price maintenance that had been in effect for nearly one hundred years.\(^4\) Commentators had been complaining about the unreasonableness of a per se rule against resale price maintenance for at least twenty years.\(^5\) So why did it take so long? The law prior to Leegin was more than interesting: it was central to the

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advice that most antitrust practitioners gave their clients. The likely reason that the issue had not been decided sooner is that the issue had rarely made it to the appellate level.\(^6\)

Other interesting cases are simply not heard by the Supreme Court or are not appealed—even by the losing government agency. Schering-Plough is a good example of an important case that the Supreme Court declined to take,\(^7\) and many recent cases that the Federal Trade Commission or the Department of Justice lost were never appealed. New law will never be developed if the agencies refuse to appeal their losses. But recent developments may show a change in direction for the agencies. For example, the FTC recently appealed its district court losses in Whole Foods and in Equitable Resources.\(^8\) Whether the agency loses or wins, in my view, is not as important as having the case heard on appeal with a result that adds clarity to the law.

What Kinds of Antitrust Cases Are Appealed?

In antitrust litigation, almost all cases settle, but three types of cases seem to be more likely to go to trial and then on to an appeal: intellectual property cases, cases involving remedies, and merger cases. These categories often overlap, but recent trends seem to indicate that more litigation, and hence increased chances for appeals, may occur in these general areas.

Aside from a few tying cases, for years there was a disconnect between intellectual property law and antitrust law. However, over the past few years, what one sees in the practice and in the agencies is a growing convergence of the two areas. For example, the agencies have taken on Rambus and Microsoft, and high-tech companies are suing each other over patent rights and antitrust counterclaims at an ever-increasing rate. In the past, these kinds of cases were rarely litigated and appealed. The consent decree in the Dell case is a great example. Dell is often cited as an example of a standard-setting case involving fraud, yet the FTC apparently never had any evidence of actual fraud.\(^9\) One can only wonder what the result and the law would have been if the case had been fully litigated and appealed.

The recent increase in patent-related antitrust cases may change this trend. First, the high-stakes nature of patent cases means that losses are likely to be appealed. Second, many district courts (such as the Eastern District of Texas and the Western District of Wisconsin) have found ways to streamline patent litigation, resulting in more trials. As more of these cases also involve antitrust counterclaims, the chances for an appeal of antitrust issues through intellectual property cases appear to be increasing. It is also important to note that many of these cases focus on technology issues in critical industries related to telecommunications or computers. Perhaps because of the high stakes involved in these cases, companies involved in these industries tend to litigate fiercely, without the usual caution that one sees in other kinds of commercial litigation. For example, Broadcom and Qualcomm litigate against each other in nearly every forum possible, and as

\(^6\) The Court could have taken on the issue in Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990), but the case was decided on the issue of standing. It appears that the next previous, closest case on point was Blanton v. Mobil Oil Corp., 721 F.2d 1207 (9th Cir. 1983), but the issue of whether resale price maintenance was a per se offense was barely addressed by the court.

\(^7\) Schering Plough Corp. v. FTC, 402 F.3d 1056 (11th Cir. 2005) (rejecting the Commission’s theory that settlements of patent claims were anticompetitive shams), cert. denied, 126 S. Ct. 2929 (2006).


a result antitrust issues are being raised on appeal. In short, over the past few years many antitrust appeals have arisen from the intellectual property field, and that trend should continue.

A second area in which the appellate courts and perhaps the Supreme Court may be more active is antitrust remedies. Chicago Bridge in the merger area and Rambus in the intellectual property area are good examples. What the proper remedy is in antitrust cases is an issue that the Supreme Court addressed decades ago in such cases as the Ford case, but there is still plenty of uncertainty in the law. For example, in a merger case brought by the FTC, does Section 11(b) of the Clayton Act mean what it says—that the FTC must order a divestiture upon finding a violation of Section 7? Or does the FTC or a court have discretion to determine whatever remedy is appropriate to resolve the competitive harm, as the FTC attempted to do in the ENH case? The nature of the remedies in antitrust cases involving patents is also an area that needs clarification and is an issue likely to find its way into the appellate courts, if not the Supreme Court. The Rambus case, which is currently on appeal, is a good example.

Finally, the Supreme Court and the courts of appeals have added little to merger law in the last few years. Little has changed in Supreme Court merger law since General Dynamics—or even since Brown Shoe and Philadelphia National Bank. And yet there is little resemblance between those cases and current merger practice at the agencies and in the district courts, even though all three cases are probably still good law.

But merger law will remain unchanged if cases are not appealed. As we all know, many merger cases have been brought and lost by the antitrust agencies over the past five years. Many of those were never appealed. Clearly, there are differences in how courts, even in the same district, handle these cases. But we will not see any more clarity in the law until the government agencies show their willingness to fight on appeal. The problem with the agencies’ reluctance to appeal is that the standards for litigation and negotiation with the government (often resulting in consent decrees or informal resolutions of merger investigations) bear little relationship to the law

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10 See, e.g., Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297 (3d Cir. 2007) (reversing dismissal of an antitrust claim involving standard setting).


14 15 U.S.C. § 21(c) states that:

[If the Commission . . . shall be of the opinion that any of the provisions of [Section 7] have been or are being violated, it shall . . . issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the . . . assets, held . . . in the manner and within the time fixed by said order.]


18 The agencies’ reluctance to appeal has a preclusive effect in the merger area because few cases are ever brought under Section 7 by private parties.
that might have resulted if the issues had been decided through litigation and appeal. If the agen-
cies appeal more of their losses, the courts, and perhaps even the Supreme Court, may address
the lingering issues that exist in the merger area and make the outcomes in these cases more pre-
dictable. I should add, however, that there are three merger cases currently wending their way
through the courts. The FTC has appealed its loss in *Whole Foods* to the D.C. Circuit and its loss
in *Equitable Resources* to the Third Circuit, while the respondent in *Chicago Bridge* has appealed
to the Fifth Circuit. With these and other merger cases on the horizon, the courts of appeals or the
Supreme Court could readdress this area of the law—perhaps clarifying the power of the FTC to
stop mergers pending administrative review or to address the ability of the FTC or the courts to
create broad remedies to resolve violations of Section 7.

**Conclusion**

No one can know what the Supreme Court or the courts of appeals will do when it comes to
antitrust. Many of us have been surprised by the number of Supreme Court antitrust cases in the
past few years. These cases may be enough for the Court at this point. But intellectual property
cases, cases involving remedies, and even merger cases are beginning to find their way into the
appellate courts. These types of cases involve legal issues that have yet to be resolved in any
meaningful way by the Supreme Court. Thus, if any new antitrust cases are heard by the Court,
there is a reasonable chance that these kinds of cases will be among them.
The Supreme Court’s Unfinished Antitrust Agenda

Richard M. Steuer

The Supreme Court has reshaped the antitrust laws over the past thirty years but never more actively than over the past two, so it is natural to ask, “Is there anything left to decide?” Indeed there is; plenty of competition issues still demand attention. Some of these issues encompass more than antitrust alone while others—particularly in the realm of distribution—have lingered as the “low hanging fruit” that critics have eyed for years.

Competition Issues Needing Attention

Competition and Free Trade. The most seismic issue in the new millennium is how to reconcile the “consumer welfare” goal of American antitrust law1 with the pressures of international trade in a global economy. Should low prices for American consumers in the near term be of paramount concern, even at the expense of long-term domestic production and American jobs, or should American markets be open only to countries that suitably reciprocate (whatever that ought to mean)?2

There are those who argue that fixation with achieving the lowest prices for American consumers in the short term, without regard for the welfare of American producers, will leave the United States with nothing but global executives, Pilates instructors, and the unemployed.3 This tension arises in enforcing the dumping laws.4 It arises in merger review.5 It arises in administrative determinations on the right to work.6 It likely will arise in a growing number of arenas as global

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2 See WILLIAM J. BAUMOL, ROBERT E. LITAN & CARL J. SCHRAMM, GOOD CAPITALISM, BAD CAPITALISM, AND THE ECONOMICS OF GROWTH AND PROSPERITY 254–57 (2007) (arguing that although “[o]penness to trade and foreign direct investment . . . arouses the suspicion, and sometimes the enmity, of the general public,” the benefits outweigh the costs).


4 See LAURA D’ANDREA TYSON, WHO’S BASHING WHOM?: TRADE CONFLICT IN HIGH-TECHNOLOGY INDUSTRIES 267–72 (1992) (criticizing anticompetitive effect of current anti-dumping laws and arguing for a test based on sales below marginal or average variable cost on the ground that “[e]ven in perfectly competitive markets, profit-maximizing firms with no significant market power may sometimes find it rational to price below average cost”).


6 See FTC v. Equitable Res., Inc., 512 F. Supp. 2d 361, 364–65 (W.D. Pa. 2007) (upholding state administrative law judge’s approval of merger between state-owned gas utilities on grounds that merger was in the “public interest” because, among other things, it would have a positive impact on customers, the utilities, employees and commerce), on appeal, No. 07-2499 (3d Cir.).
economic rivalry takes center stage in the 21st century. Inevitably, some of these issues will come before the Supreme Court, although it is too soon to predict how or when, or in what order.

**Mergers.** Mergers are sure to come before the Court, which has not examined mergers since *Marine Bancorporation* and *General Dynamics.* Likely candidates to command the Court’s attention are efficiencies,9 refinements in market definition10 and, again, the significance of global competition.11 Will the Court endorse the treatment of efficiencies found in the Merger Guidelines?12 Would the Court endorse any of the market definition approaches argued unsuccessfully by the Department of Justice and Federal Trade Commission in recent cases?13 Would the Court ignore nationality in merger decisions if other counties incubate and coddle “national champions” that compete in the relevant market?14 Are the prices paid by American consumers the only gauge? Will the Court provide guidance?

**Application of State Antitrust Law to Interstate Commerce.** There is inconsistency in the current case law as to whether state antitrust law can apply to commerce with little nexus to the particular state. A recent decision by the Texas Supreme Court overturned a decision below and limited the reach of the Texas antitrust laws.15 So long as the antitrust laws of some states present more attractive alternatives than others,16 litigants will test the limits of each law’s reach and one of these spats eventually will reach the Supreme Court. Will any state be permitted to provide remedies to out-of-state residents?

**Preemption of State Antitrust Law.** The issue of preempting state antitrust law arises repeatedly, in such contexts as preempting *Illinois Brick* repealer statutes17 or preempting state efforts to depart from *Colgate,*19 *Leegin,*20 or federal legislation.21 The exact context in which preemption will

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12 See Merger Guidelines, supra note 9, § 4.
18 See supra note 16.
be confronted is uncertain, but somewhere between ARC America\textsuperscript{22} and American Stores,\textsuperscript{23} the issue is heading for a showdown. For years, a debate has been raging—most recently before the Antitrust Modernization Commission\textsuperscript{24}—as to whether state antitrust enforcement fills a vacuum created by lapses in federal enforcement or creates chaos by raising the specter of inconsistent and even conflicting enforcement decisions.\textsuperscript{25} Ultimately, the Supreme Court will need to supply some resolution.

**Business Method Patents and Their Competitive Effects.** Critics of business method patents complain that one can get a patent on almost any notion, precluding a wide swath of competition.\textsuperscript{26} It started with State Street Bank & Trust Co. v. Signature Financial Group, Inc.\textsuperscript{27} and “one-click” Internet checkout,\textsuperscript{28} but business method patents today are being issued for surgical procedures and even tax advice.\textsuperscript{29} Could a clever new “Colgate policy” be patented by a law firm today, so that no other firm could recommend it without paying a royalty? Legislation is being considered to curtail some especially controversial patents,\textsuperscript{30} and the Federal Circuit recently made it more difficult to secure such patents,\textsuperscript{31} but the Supreme Court has demonstrated that it is willing to step in if the Federal Circuit does not achieve solutions.\textsuperscript{32} Unless the Federal Circuit or Congress adequately rationalizes this area of the law, the Supreme Court is likely to step in at some point and examine whether these patents amount to a recipe for “Easy-Bake” monopolization without fear of antitrust consequences. It is one thing to create exclusive rights through patents in order to encourage innovation and thereby to promote economic expansion and competition; it is not necessarily the same to confer exclusive rights on methods of competing. This makes it particularly important to apply the right test to the evaluation of such patents.

\textsuperscript{25} See ABA Section of Antitrust Law, Monograph 15, Antitrust Federalism: The Role of State Law 5–8 (1988) (noting tension between enforcement of state and federal antitrust laws).
\textsuperscript{27} 149 F.3d 1368 (Fed. Cir. 1998).
\textsuperscript{28} Carl Shapiro, Patent System Reform: Economic Analysis and Critique, 19 Berkeley Tech. L.J. 1017, 1047 (2004) (“Amazon’s ‘one-click’ patent may be the most often criticized software patent.”).
\textsuperscript{29} See Floyd Norris, You Can’t Use that Tax Idea. It’s Patented, N.Y. Times, Oct. 20, 2006, at C1.
Piling-on Remedies. Antitrust violators today can face fines of hundreds of millions of dollars, plus treble damages and, in certain instances, disgorgement, restitution, and the incarceration of their executives. At what point, if any, does this become excessive? The Supreme Court previously has limited the amount of punitive damages that juries may award. The Antitrust Modernization Commission has recommended that civil and criminal monetary remedies remain where they are today. The demise of Arthur Andersen demonstrated how enforcement initiatives—not limited to antitrust enforcement—can result in the elimination of a major competitor. Should there be some parameters established by case law? Should they be coextensive with per se violations, and would that be enough? In Illinois Tool Works, the Supreme Court may step in.

Limits of Criminal Enforcement. The Sherman Act provides for criminal enforcement without regard to the nature of the violation. Prosecutorial discretion has almost always kept criminal cases within the bounds of hard-core horizontal conspiracies. The few excursions into areas like with per se violations, and would that be enough? In

34 15 U.S.C. §§ 15, 15a (providing for treble damages in antitrust cases brought by private parties or the U.S. government).
36 See supra note 35.
37 15 U.S.C. § 2 (authorizing criminal penalties of up to 10 years in prison for individuals violating the Sherman Act).
39 SeeANTITRUST MODERNIZATION COMM’N, supra note 24, at 285–91 (civil remedies), 293–99 (criminal monetary remedies).
41 15 U.S.C. § 1; 1 ANTITRUST LAW DEVELOPMENTS, supra note 10, at 1 n.1 (“Both criminal and civil sanctions may be imposed for § 1 violations.”).
42 ANTITRUST LAW DEVELOPMENTS, supra note 10, at 734–35 (noting that federal antitrust enforcement agencies have “a long-standing policy of seeking criminal indictments only in cases involving ‘hard-core,’ per se unlawful agreements . . . including horizontal price fixing”).
recently observed that tying can be “a federal crime punishable by up to 10 years in prison.”

Conceivably, the Court was just trying to make a point, but sooner or later, there is bound to be an example of overzealous criminal enforcement that may force the Supreme Court to announce a pragmatic rule of interpretation, comparable to its injection of “unreasonable” into the notion of “every contract, combination . . . , or conspiracy, in restraint of trade . . . .”

**Amnesty/Leniency.** Amnesty and leniency programs undoubtedly have been the chief drivers of cartel enforcement in recent years, but are the outcomes always fair? If one of the architects of a cartel turns in its followers and gets off with single damages and no fine, providing it a competitive advantage in the market, is this a suitable result? What if the race to the agency is manipulated—can that constitute an anticompetitive act in itself? There already has been some dissatisfaction with the amnesty/leniency program, and if there ever is evidence that the system is being abused—either by the government or by private parties—an issue may emerge that will be appropriate for Supreme Court intervention.

**Low Hanging Fruit**

The “low hanging fruit” inviting Supreme Court attention is bunched in the area of distribution:

**Tying.** Is it time to shut the door on the last remaining remnant of the per se rule against tying? In *Jefferson Parish*, the Court remarked that tying continues to be per se unlawful where the defendant possesses the power to force buyers to purchase the tied product by virtue of the unique nature of the tying product. In *Illinois Tool Works*, the Court made clear that not all patented products possess this level of uniqueness, but did not hold that tying could never be per se unlawful and lower courts have continued to entertain that possibility. Nevertheless, in recent cases in which the Supreme Court has provided a laundry list of per se offenses, tying is never included. Has it been eliminated by the principle of *expressio unius*? In any event, is it time to remove any doubt, so that lower courts will stop pausing over this issue?

46 Id. at 42.


49 See Christopher R. Leslie, *Antitrust Amnesty, Game Theory, and Cartel Stability*, 31 J. CORP. L. 453 (2006) (noting that the corporate “race to confess” is often won by a small amount of time); see also *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177 (3rd Cir. 2006).


51 *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 9 (1984) (“It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable ‘per se.’”).

52 547 U.S. 28.


Exclusive Dealing/Bundling/Loyalty Discounts. Critics have been clamoring for the Supreme Court to take a bundling case ever since LePage's was decided by the Third Circuit. Subsequent decisions have dispelled many of the questions that case provoked, but there is little doubt that the Court will be strongly encouraged to visit the topic of bundling at every opportunity it gets. Loyalty discounts, which can serve to encourage exclusive dealing, also may attract the Court's attention with enough prodding. Is this subject too hot to handle? Are there good bundles and bad bundles? Did the Ninth Circuit set the right standard in the PeaceHealth case?

“Most Favored Nations” Clauses as Antitrust Violations. Ever since antitrust enforcers first began to view “Most Favored Nations” clauses as vertical restraints, the impact and treatment of these clauses have been the subject of substantial debate. These clauses can apply to either buyers or sellers, and there seems to be considerable uncertainty as to whether each is more likely to raise or depress prices, and whether to do anything about it. Can the Court end this confusion?

Sealy/Topco. Finally, the per se rule against competitors or potential competitors forming a new brand and agreeing not to compete with respect to that brand demands reexamination. Surely, there are cases in which such confederations are unreasonably anticompetitive, but there are other situations in which such arrangements are likely to be procompetitive. Some of these already have been the subjects of favorable business review letters, and both the Broadcast Music and NCAA decisions at least suggest that the per se rule no longer should apply. Nevertheless, Sealy and Topco remain on the books. Should any court see fit to apply the per se rule to such ventures in the future, the Supreme Court might well take the opportunity to refine the law in this area further. Will there be a more flexible rule?

That is a lot. The Supreme Court has not shied away from confronting big antitrust issues in recent years, but some mighty big issues remain.

55 LePage’s Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003) (en banc).
56 See Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).
58 See PeaceHealth, 502 F.3d at 916 (adopting “discount attribution” standard).
What’s Next for the Supreme Court on Antitrust Issues?

Gary P. Zanfagna

When asked to write a Comment about “what’s next for the Supreme Court on antitrust?” I have to admit that my first thought was—are we really looking for more?

Since 2004, the Supreme Court has decided no fewer than nine antitrust cases—an unprecedented antitrust renaissance for the Supreme Court. Starting with Trinko in 2004, the Supreme Court has barely missed an opportunity to help with antitrust—Trinko,1 Empagran,2 Independent Ink,3 Dagher,4 Volvo,5 Weyerhaeuser,6 Twombly,7 Credit Suisse,8 and Leegin.9 Four cases in 2007 alone. All nine antitrust decisions by the Court were pro-defendant, in one way or another, softening the sting of the antitrust laws.

So my prediction of what is on the horizon for the Supreme Court on antitrust? Nothing. Aren’t nine Supreme Court antitrust decisions in three years enough? As important as we all think antitrust is, there must be more pressing matters of constitutional magnitude facing the country.

Wish List

Prediction aside, what would be on my Supreme Court antitrust wish list? My list would be short. One topic: bundling. From my perspective as in-house counsel, one area that continues to present real antitrust risk is bundling. Post-LePage’s, a multi-product company with a significant position in one or more products that engages in bundled rebates does so at its own peril.

LePage’s10 is an utterly standardless decision that, without any guidance, declares bundled rebates unlawful whenever a smaller rival can’t match the rebate because it doesn’t offer a comparable breadth of products. LePage’s can be read to stand for the proposition that Section 2 protects a smaller rival that can’t keep pace. And LePage’s has predictably fueled plaintiffs’ bundling fire—Masimo,11 JBDL,12 Applied Medical,13 PeaceHealth.14 LePage’s has significantly

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10 LePage’s Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003), cert. denied, 124 S. Ct. 2932 (2004).
14 Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).
raised antitrust risk for any multi-product company with a significant position in one or more products that wants to compete aggressively on price by offering bundled discounts.

Is it time for the Supreme Court to revisit bundling? I thought it was ripe with LePage's in 2004. My view then was that there was sufficient guidance from Ortho\textsuperscript{15} and SmithKline\textsuperscript{16} for the Supreme Court to consider bundling and deal with LePage's. But the prevailing view at the time, including that of the Federal Trade Commission and the Department of Justice,\textsuperscript{17} was that the case law needed to develop and more needed to be understood about the competitive effects of bundling before the Court should weigh in.

Have we learned more since LePage's? Yes. There have been considerable contributions to the understanding of bundling from academics, economists, and antitrust practitioners since LePage's. In particular, the Antitrust Modernization Commission (AMC) devoted great energy and thinking to this topic and received significant input from a wide variety of leading antitrust scholars. At the end of their process, the AMC unanimously recommended a three-part test for assessing whether a bundled rebate was exclusionary under Section 2.\textsuperscript{18}

Without getting into a detailed discussion of the AMC's proposed test, I note that I'm in favor of the proposed test, which I would call a modified Ortho attribution test. I think the AMC test is as good as any test proposed for assessing bundled rebates, and it's the test I've been using (at least the first prong) to counsel on bundled rebates for some time.

Have there been developments in the case law since LePage's? Yes. Masimo II\textsuperscript{19} revisited and re-thought Masimo I's\textsuperscript{20} following of LePage's. JBDL\textsuperscript{21} flatly rejected LePage's. Applied Medical's\textsuperscript{22} jury verdict eventually got beyond LePage's. And most significantly, the Ninth Circuit in PeaceHealth\textsuperscript{23} asked for amicus briefs on the right standard for bundling, and then rejected LePage's in favor of the AMC's proposed test.\textsuperscript{24} PeaceHealth presently is on petition for rehearing en banc in the Ninth Circuit.

So my antitrust wish list for the Supreme Court is short—bundling. It's quite possible that the Court will eventually have the opportunity to revisit bundling and fix LePage's with PeaceHealth. That would be my single Supreme Court antitrust wish. From my in-house perspective, that would be a very good thing.


\textsuperscript{18} ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 83 (Recommendation 17) (2007), available at http://www.amc.gov/report_recommendation/amc_final_report.pdf. The elements of the three part test are: (1) after allocating all discounts attributable to the entire bundle to the competitive product, the defendant sold the competitive product below its incremental cost for that product; (2) the defendant is likely to recoup these losses; and (3) the bundled discount is likely to have an adverse effect on competition.


\textsuperscript{23} Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).

\textsuperscript{24} The author's employer, Honeywell, supported an amicus brief in PeaceHealth advocating the AMC's proposed test.
What About Refusals to Deal? The AMC identified refusals to deal as another area that could use further guidance from the courts. The Supreme Court in *Trinko* did stop short of an unqualified unilateral right to refuse to deal with your rival. As in-house counsel, I’d like to have that right, or at least absolute clarity on the limited exceptions to the general rule of no duty to deal with a rival. But I don’t think that is realistic.

From my perspective, *Trinko* certainly helps. I don’t think *Trinko* is revolutionary, but I do think it confirms the status quo that was already generally understood and provides some modest help in understanding the outer limits. Let me explain.

*Trinko* enthusiastically embraces what we thought we already knew—that there is no general duty to deal with a rival. *Trinko* also identifies a couple limited factual situations that could be, but not necessarily will be, problematic: One, terminating a prior (presumably profitable) course of dealing with a rival; and two, refusing to deal with a competitor-customer in the same way as one deals with a customer. Finally, *Trinko* also references the short-term profit sacrifice test, which I read as a tool to understand what’s really going on.

Without getting wrapped up in how the short-term profit sacrifice test is different from its cousin, the no economic sense test from DOJ, or whether either (or some other standard) is the one test for assessing refusals to deal (and other Section 2 exclusionary conduct), my view is that the Court’s short-term profit sacrifice test is simply a tool for insight into the conduct. It certainly could be read to introduce an uncomfortable and unwelcome element of intent into the equation, but I wouldn’t go that far. At the end of the day, we’re trying to figure out whether conduct, such as a refusal to deal, which can be exclusionary, is anticompetitive. The short-term profit sacrifice test is simply a tool to help understand what’s really going on.

So from my corporate counselor perspective, *Trinko* is not perfect guidance, but it does provide helpful guidance. *Trinko* teaches the following: It’s generally okay to say “no” to a rival. Very importantly, before dealing with your rival, think hard about your ability (or inability) eventually to terminate such dealings. Whether you’re starting to deal with a competitor, refusing to do so, or trying to terminate what you already started, explain to me why you’re doing it—what’s your legitimate business justification? And by the way, be careful what you write.

Short of an unqualified unilateral right to refuse to deal with your rival, which I don’t think we’re going to get, I’m fine with *Trinko*. It doesn’t seem that complicated to me.

What About Merger Analysis? This is an obvious substantive antitrust area where the Supreme Court has not opined in over thirty years since *General Dynamics* and *Citizens & Southern National Bank* in 1975. But I see no need for Supreme Court guidance in merger analysis. What would the Court add? As the AMC report observes, there is a general consensus that the framework for analyzing mergers used by the antitrust agencies and the courts is basically sound. No doubt there can be disagreement on the outcome of various cases, but the basic analytical framework for merger review is known and generally accepted.

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26 Id. at 407–08.
27 Id. at 408–10.
28 Id.
What About Tying Analysis? Courts describe tying as per se unlawful. But not really. In order for a tie to be per se unlawful, courts require a showing of power in the tying product. Some might suggest that there is room here for the Supreme Court to clarify or clean up that tying arrangements should be (or really are) judged under the rule of reason. Per se condemnation of tying arrangements is neither accurate nor appropriate.

There is, however, already a general understanding that power is required in the tying product for the tie to be unlawful. Everyone knows that, and I don’t see the need for Supreme Court clarification. If the Supreme Court’s idea of clarifying is *Leegin*, I don’t think we need it. We may or may not agree on whether the Court got it right by bringing the analysis for minimum resale price in line with maximum resale price and non-price vertical restraints, all under the rule of reason. But from my perspective, the practical consequence of *Leegin*, rightly or wrongly decided, is new legal risk—uncharted rule of reason analysis, state law enforcement, and enforcement from relevant foreign jurisdictions, including Canada, that still hold vertical price fixing per se illegal. And by the way, try to explain to sales personnel why some price fixing is still very much illegal and some now may be okay, particularly when the line between customer and competitor can be quite blurred.

Conclusion

In sum, my prediction of what’s next for antitrust at the Supreme Court can be summarized in one word: nothing. Nine decisions in three years are all we can reasonably expect for now. My Supreme Court wish list is short—bundling. Please clean up *LePage’s*.

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31 See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 9–10 (1984) (“It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable ‘per se’”).


Interview with William Blumenthal, General Counsel, Federal Trade Commission

Editor’s Note: Bill Blumenthal became General Counsel of the Federal Trade Commission in March 2005. He was formerly in private practice at King & Spalding in Washington, DC, focusing principally on antitrust aspects of mergers, acquisitions, and joint ventures. Throughout his distinguished career, Mr. Blumenthal has held a number of leadership positions in the ABA Section of Antitrust Law, was the principal author of the ABA monograph Horizontal Mergers: Law and Policy, and project leader for the ABA guide, The Merger Review Process, as well as authoring a variety of articles published in the Antitrust Law Journal, California Law Review, George Washington Law Review, and other publications. In addition, prior to joining the FTC, Mr. Blumenthal was very active in international antitrust, serving on OECD, International Chamber of Commerce, and International Competition Network committees, and as International Officer of the ABA Section of Antitrust Law.

In this interview, Mr. Blumenthal provides his perspective on the role of the Office of General Counsel (OGC) and the sometimes surprising workings of the Commission. He comments on the participation of the OGC in agency litigation and, in particular, its role in appellate advocacy through amicus briefs. Mr. Blumenthal has continued to be very active in international antitrust developments while at the FTC and provides his views on recent developments in Chinese and Indian merger law. Mr. Blumenthal also comments on current topics at the FTC, including mergers, gun-jumping, and the upcoming FTC report on single-firm conduct. The views Mr. Blumenthal expresses in this interview are his own and not necessarily those of the FTC or any of its individual members.

The interview was conducted on November 30, 2007, by Lisl Dunlop for The Antitrust Source.

ANTITRUST SOURCE: Thank you for participating in this interview. We’re very eager to chat with you about your role as General Counsel and some of the recent developments at the Federal Trade Commission. Our readers are going to be very interested in the insights that you have to offer.

Before we get on to the Office of General Counsel, one of the areas that you suggested might be well less understood by practitioners is where the Commission fits in the overall scheme of governance. How does all this work from an insider’s perspective?

BILL BLUMENTHAL: Let me begin with one of the most common areas of confusion: What branch of government is the FTC part of? Are we placed within the executive branch, the congressional branch, the judicial branch, or none of the above? The answer is the executive branch, but that fact is often misunderstood because people are not sure what to make of a so-called “independent agency.” In fact, under Title 5 of the U.S. Code, we are an “independent establishment” within the executive branch.¹ The President has appointment power, but not the removal power that applies to a Cabinet agency—you may remember the Humphrey’s Executor case² from your constitutional law courses.

The way that the institution functions in practice is partly a creature of the Federal Trade Commission Act, and people know about that statute. But people generally are not familiar with

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¹ 5 U.S.C. § 104.
the Reorganization Act of 1949, and that is at least as important day to day. My guess is until I mentioned it here, you probably weren’t familiar with it, either.

**ANTITRUST SOURCE:** We’ll agree with that.

**BILL BLUMENTHAL:** I’m embarrassed to say that I actually hadn’t been either until I came into this job, notwithstanding twenty-five years of practice largely before this agency. Congress in 1949 passed an Act that gave President Truman the power to reorganize the executive branch, with an eye towards enhancing efficiency. That Act then gave rise to a series of reorganization plans during the 1950s and 1960s that defined the ways the agency functions. Under the Reorganization Plan of 1950, the executive and administrative functions of the Commission, by which I mean the “Gang of Five,” are transferred to and vested in the Chairman. The Commission is essentially a board that has fundamental authority with respect to policy and budget, but the day-to-day execution of the policy that the Commission has set is delegated to the staff under the control of the Chairman. That structure, in turn, influences a lot of things in terms of how we function day to day.

**ANTITRUST SOURCE:** Can you give some examples of how that impacts the functioning of the Commission?

**BILL BLUMENTHAL:** Sure. It’s a practical matter. The staff tends to meet most frequently with the Chairman and takes direction from the Chairman. That applies not just to the current Chairman, but it’s inherent in the structure of the institution itself. Among the surprises I had coming into this job, I had had a misconception as to when things got up to the Commission level. When I was on the outside, I had been under the impression that the investigations were initiated and directed essentially by staff and that it was only very, very late in the process that something went up the line. It turns out that that’s not the case. It turns out that very early on, the Chairman’s office is quite integrally involved with many of the early investigations. And as soon as compulsory process is to be issued, the matter will go to the full Commission at least for purposes of the compulsory process determination. From that point until later in the investigation, the process reverts back to the staff under the control of the Chairman’s office.

**ANTITRUST SOURCE:** Let’s focus in a bit more on the role of the General Counsel and the General Counsel’s Office (OGC). What’s the focus of your position and the general functions of the OGC in the overall mission of the Federal Trade Commission?

**BILL BLUMENTHAL:** Let me give you the definition in the regulations and then try to give a little bit more of a real-world answer. Under the regulations, the General Counsel is the agency’s “chief law officer.” The regulations give the office broad responsibilities in the sense of rendering necessary legal services, representing the agency in courts, and rendering advice on law and policy. And the regulations then give somewhat more focused responsibilities in terms of ethics, legislation, and disclosure of confidential information.

As a practical matter, for those people who are accustomed to dealing with clients and particularly accustomed to dealing with clients in service industries, we’re probably best analogized to

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3 16 C.F.R. § 0.11.
the law department in a service business. In a sense what this agency does is provide investigation and enforcement services in the competition and consumer protection fields. OGC is like a law department that advises the service providers on issues of law that they get into. To some degree, those issues relate to the particulars of the mission—the various statutes, the competition and consumer protection acts that get enforced. But more fundamentally, OGC is spending a lot of its time dealing with all of the other legal issues that the agency encounters. As you know, there’s an extensive body of law beyond competition and consumer protection law that deals with what one might term “the law of government.” It’s as if we run into another new acronym each day. It’s like in any other business or governmental organization—a full range of legal questions: labor and employment, unions, ethics, procurement, torts, basically everything you learned in law school.

ANTITRUST SOURCE: Have you expanded your knowledge of other areas of the law in this job?

BILL BLUMENTHAL: Stunningly. The percentage of time that I spent on the things that I used to do for a living before I came into this job may be in the single digits; it’s certainly in no more than the low double digits. I spend more of my time on labor and employment matters than I do on merger matters.

ANTITRUST SOURCE: Well, we don’t have any questions about labor and employment law—you’re probably relieved about that. Sticking with the OGC, could you give us a bit of an overview of how the OGC works with the other parts of the Commission: the Commissioners themselves, the Bureaus of Competition and Economics, Bureau of Consumer Protection, etc.?

BILL BLUMENTHAL: OGC has three or four main units. We have a litigation shop, a legal counsel shop, a policy shop, and then there is separately some energy responsibility. Within one of the shops that I described, we also handle things like the Freedom of Information Act (FOIA) and e-discovery.

On the litigation side, we tend to handle appellate matters. We coordinate on a dotted-line basis with the bureaus when they are considering whether to initiate litigation; and if things start getting rocky, we will sometimes provide an assist. But fundamentally, the bureaus are the ones that handle litigation at the trial court level or during administrative proceedings. OGC then steps in at the appellate stage.

The litigation shop will also be involved with the agency’s litigation that is not in furtherance of the competition or consumer protection mission, as such, but that the agency gets involved in as an organization. For example, if there’s labor litigation or tort litigation, we won’t necessarily handle that directly. Often those will be handled by the Justice Department because we’re an agency of the United States, and the Justice Department usually handles litigation where another government agency does not specifically have litigation authority. But the OGC litigation shop will work with our counsel at the Justice Department. It may be in a U.S. attorney’s office as opposed to main Justice, but we’ll work with the Justice Department on those matters.

On the legal counsel side, we routinely will get questions on all sorts of issues: ethics questions; questions relating to procurement law if we want to hire an expert; questions relating to tort issues; real estate questions; tax questions. There are lots of Administrative Procedure Act questions, questions about jurisdiction, questions about the Sunshine Act. I don’t know if you’re familiar with the Paperwork Reduction Act, but we have a lot of questions on that. All of those are typ-
ically handled by the legal counsel side of the shop.

**ANTITRUST SOURCE:** You mentioned that you have a policy department. There is an Office of Policy Planning at the Commission as well. Is that a separate office?

**BILL BLUMENTHAL:** It is. The Commission has three shops that might be regarded as discrete policy shops. One of them is within the Bureau of Competition. One of them is a free-standing Office of Policy Planning that reports directly to the Chairman. And then within the Office of General Counsel is the unit known as the Office of Policy Studies. The three policy shops have slightly different functions. They operate with slightly different types of policy analysis. We try to coordinate the activity among them. But, yes, OGC’s is a different unit.

**ANTITRUST SOURCE:** Do you have different areas of policy competence that you would cover within the OGC versus the Bureau of Competition or the Office of Policy Planning?

**BILL BLUMENTHAL:** I don’t know that it so much a different area of competence as it is a different “manufacturing process.” You know how certain factories are designed for long production runs and certain factories are designed for short production runs? And sometimes you have factories that do highly routinized things and others that do highly customized things? The different units focus on different types of policy work. The one in the Office of General Counsel tends to do much longer-run, intensive policy analyses—detailed things that will take an extended period of time, often measured in years, and will typically yield extensive and lengthy reports.

By contrast, the Office of Policy Planning handles a range of things, but its most common deliverables are relatively short pieces of a competition advocacy variety. I think it’s fair to say that’s where the bulk of the agency’s competition advocacy work rests. OPP does some other, longer things as well, such as our net neutrality report. But if you look, for example, at the agency’s work in dealing with state legislatures and other governmental units on competition advocacy in businesses like wine and real estate, OPP has been responsible for most of those.

**ANTITRUST SOURCE:** You took office as General Counsel in March 2005, so you’ve been at the Commission for nearly three years. We talked earlier about some of the things that surprised you about the job involving the inner workings of the Commission. Have there been any others?

**BILL BLUMENTHAL:** Oh, sure. The two biggest surprises are going to sound as if they’re somewhat in tension, which I suppose they are.

The first is the amount of unscheduled time. It’s a lot larger than I ever would have expected. There is one job in the agency for which the schedule is fully booked—more than full-time scheduled—and that’s the Chairman’s job. Virtually everybody else has pockets of unscheduled time, and to me those pockets were surprisingly large. Several hours a day are fairly free and usually available on quick turnaround to meet with colleagues or people on the outside. Coming in to the job, I had an expectation that my days would be fully scheduled from 9:00 until 5:00 or 6:00, and that’s just not the case.

At the same time—and this is the part that is going to sound like it’s in tension—you would be stunned by the cascade of different matters that come over the waterfall. The number of issues that we have to deal with is larger than I ever would have imagined—whether to open or close an investigation, to bring an enforcement action, to issue a report or hold it for more work. To some
extent the volume is because OGC is one of the few offices that deals with both the competition and consumer protection side. The cascade isn’t quite so severe in either BC or BCP.

**ANTITRUST SOURCE:** Have there been any major changes in the organization? Or have you tried to change things since you’ve been in the role?

**BILL BLUMENTHAL:** Not within the Office of General Counsel. I found it in very good shape and I’ve tried to do what I can not to ruin it.

Probably the most significant organizational change in my time here was not within the OGC. It was the creation of the separate Office of International Affairs. Previously the international functions had been found in three separate places. The Bureau of Competition and the Bureau of Consumer Protection each had an international office. And partly as a historical artifact, within the Office of General Counsel, there was a unit that handled technical assistance work. Those three units were pulled out of their respective offices or bureaus and moved into a new consolidated office. That happened about a year ago.

**ANTITRUST SOURCE:** And yet you personally seem to stay very involved in international affairs?

**BILL BLUMENTHAL:** Sure. That involvement is not inherent in the General Counsel job. But it just happens that a number of the people who have inhabited this office had international background before coming into the office and found that an area of continuing interest and activity.

**ANTITRUST SOURCE:** When you were appointed to the FTC, the announcement noted that you were on the OECD and the International Chamber of Commerce Competition Committees, as well as the U.S. Chamber of Commerce Antitrust Council, and that you also had a role as a private practitioner in the ICN. What bodies are you currently sitting on?

**BILL BLUMENTHAL:** None officially. One of the first things I did, simply for ethics reasons, was to step down from all of the formal relationships that I had with private sector organizations. I’m still in touch with many of those fairly often. I still have a lot of friends in them. But I limit my international activity to what I can pursue wearing a governmental hat.

**ANTITRUST SOURCE:** What are the areas that are of most interest to you in the development of international antitrust at the moment?

**BILL BLUMENTHAL:** They tend to be more country-specific than policy-specific. When I came into the post I had an interest in certain large jurisdictions that were likely to be enacting competition laws or had recently enacted them and were going to begin implementing them. That has been my primary focus. Much of that time has been given over to China, and recently I’ve been doing a little bit of work involving India.

**ANTITRUST SOURCE:** I see that you’ve taken a lot of trips to China and given a number of speeches about Chinese antitrust law. How is antitrust developing there? They’ve got merger control. What about other aspects of regulation?

**BILL BLUMENTHAL:** Well, the merger control is only just beginning. And it has begun largely as a
foreign acquisition regulation, as opposed to the competition regulations themselves. At this point
the new competition law that was enacted in late August has not yet become effective, but there
is competition review occurring under the foreign acquisition regulations.

In terms of how it’s going, my office has been quite pleased with the transparency of the
process that the Chinese government followed. I think that the new competition law is quite main-
stream in its text. It has a lot of the types of provisions that people would regard as quite familiar.
A few things that came in late in the process are more industrial-policy-like in nature. We’re not
entirely sure how that is going to work out once implementation really begins.

**ANTITRUST SOURCE:** Can you elaborate on those industrial-policy aspects of the new competition
law?

**BILL BLUMENTHAL:** There are particular provisions that deal with state-owned enterprises and pro-
tected sectors; there are some provisions that deal with macroeconomic objectives; and there are
some provisions that deal with coordinating activity undertaken by industry associations. Those
are not standard types of provisions in a competition law. You don’t see them in most other juris-
dictions. How those are really going to work out, how they are going to be reconciled with the more
traditional competition objectives is something we’re watching with great interest.

**ANTITRUST SOURCE:** The ABA Antitrust and International Sections recently commented on India’s
proposed merger notification regime. One concern was that it could potentially apply to a broad
range of transactions with a very limited nexus to India. Have you had any dealings with the Indian
government about the new merger control law there? And if so, what’s going on with it?

**BILL BLUMENTHAL:** The Chairman in her Fall Forum speech indicated that I had gone over to
India, and I think that’s also reported in an article in *The Deal* that recently appeared about the
Indian law.4

India’s competition law was enacted in late 2002, but it was caught up in a number of legal
challenges within India. There was an effort undertaken earlier this year by the Indian Congress
to enact some amendments that would deal with the constitutional problems under the original ver-
sion of the law. While those revisions were being made, some other changes were put in place.
One in particular dealt with merger notification. The earlier version of the law had contemplated
that the merger notification regime would be voluntary. The details of the provisions in the merg-
er notification system were designed for a voluntary scheme and would be perfectly appropriate
for voluntary scheme. Very late in the process, people recognized that many other jurisdictions,
including the U.S. and the EC, had a mandatory regime, not a voluntary regime.

So a shift was made in the text simply to provide that what theretofore had been a voluntary sys-
tem would now be mandatory, with a couple of other accommodating changes made. But the sys-
tem was not completely redesigned in a way that you typically might if you are shifting from a vol-
untary to a mandatory merger control regime. That has led to a number of anomalies based on
the text itself. I think this was just an unintended glitch, and we’re hoping the anomalies are going
to get addressed as the process of drafting regulations proceeds. My sense is that the Indian gov-

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government is alert to the concern. I think they were alert to the concern before the ABA or the IBA sent their comments. Pretty much everybody is speaking with consistent concerns and is offering a similar menu of what needs to be addressed.

ANTITRUST SOURCE: Apart from the merger notification regime issues, are there other areas within the Indian antitrust law that you’ve been involved in?

BILL BLUMENTHAL: Only on the periphery. Because implementation of the law was suspended for a number of years pending resolution of the constitutional challenges, people haven’t been proceeding actively with any of the sorts of implementation work that one otherwise would have seen. With the amendments to the law having lifted the constitutional cloud, I think we’re expecting that other aspects are going to begin to move forward. But up until now I haven’t been centrally involved in those.

ANTITRUST SOURCE: In 2004 you wrote in the Antitrust Law Journal about the challenge of sovereignty to convergence in the area of substantive antitrust law development. And at that time, you noted that, if anything, the trend was away from material convergence on substantive antitrust law and that new and discordant guidelines were being issued in a variety of jurisdictions. Three years on, has your view of this changed, and do you see more or greater convergence in substantive antitrust?

BILL BLUMENTHAL: The answer is both. It seems to me that there are two things going on. The first is that you have more regimes that are enacting laws or developing new initiatives under the laws that they have, so you have a broadening of activity, and that increases the risk of discordant views and inconsistent enforcement. At the same time, those who have had a system in place for some period of years, at least the major regimes, are working harder than ever to try to smooth out the inconsistencies. I think everybody is mindful of the complications for the international business community of having different and inconsistent rules. So you have tendencies pulling in both directions.

ANTITRUST SOURCE: With maybe the newer regimes pulling against, but the more established regimes pulling towards convergence?

BILL BLUMENTHAL: That’s correct. One hopes that at some point new regimes will have been fully spoken for, and at that point you’ll have a tendency only in the direction of greater convergence.

ANTITRUST SOURCE: How do you see the role of guidelines figuring in this process? Do you think it’s a helpful or unhelpful trend? Have we reached the point of having too many guidelines?

BILL BLUMENTHAL: Well, another article I wrote in the 2000 Antitrust Law Journal talks about guidelines. One of my observations there is that people favorably remember the good guidelines, but tend to forget that there have been an awful lot of guidelines that were ignored and sometimes were counterproductive.

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I’m a fan of guidance. I think it’s important for agencies to be reasonably transparent in letting the public know where they stand. But having the moniker of “guidelines” on a document tends to elevate the significance of the document, and using that name can sometimes lead to complications if the document is not of the right type.

ANTITRUST SOURCE: What would be an example of a document not of the right type?

BILL BLUMENTHAL: Well, I’m not going to name a particular document, and I would refer people back to that 2000 article. The proposition is that if guidelines are going to be effective, they need to be reasonably specific. They need to be reasonably well articulated, enough to let people know whether the conduct is or is not proper under the guidelines, and that often means that discretion is going to be somewhat limited. They need to be reasonably well specified. Oftentimes in policy statements that isn’t done.

ANTITRUST SOURCE: The European Commission has just come out with a new set of non-horizontal merger guidelines. The last set of guidelines in the U.S. on the subject of non-horizontal mergers date from 1984, and there has been some vertical merger enforcement activity at the agencies through the late 1990s. Do you think the U.S. should be introducing new non-horizontal merger guidelines?

BILL BLUMENTHAL: I don’t see any need to. There haven’t been that many non-horizontal cases, and the ones that the agencies have brought have been addressed in analyses to aid public comment or competitive impact statements. The cases have been addressed in speeches. And I think the public has a reasonably good sense as to what theories are currently regarded as valid. One of the risks of new guidelines in the field is that we would tend perhaps to overdignify the level of concern. If you’re dealing with a handful of cases, issuing guidelines might suggest that the concern is greater than it is.

ANTITRUST SOURCE: While we’re talking about mergers, let’s talk a little about the involvement of the OGC in merger review. One specific role that I think the OGC has is in the second request appeals process. How is that working? Have many parties availed of themselves of it over the last couple of years?

BILL BLUMENTHAL: I’ve read of that process. Candidly, I have not seen a single appeal. I think that there have been four of them in the lifetime of the mechanism. There have been none in my time.

ANTITRUST SOURCE: Another issue that comes up in the context of merger review is clearance between the FTC and the Antitrust Division. The Antitrust Modernization Commission report earlier this year made a recommendation that a formal clearance process be instituted and suggested some incentives to get things moving in terms of timing. Have you witnessed any major clearance battles during your time at the OGC? And do you think a formal clearance system is required?

BILL BLUMENTHAL: The answer, I guess, would be yes and no. Have I seen any major clearance battles? Sure. But they are extremely rare. In my time here there have been maybe ten. But also in my time here there have been probably 6,000 filings, so we’re dealing with a problem that arises about 0.2 percent of the time.
Before coming on board here, my practice was very heavily on the merger side of things. And like a lot of other merger practitioners, I’ve had the experience once or twice of having a long delay for clearance. And if you’ve been through it, it tends to impress itself on your memory. But from the inside, seeing the overall pattern of activity, it does strike me that it is a rare event. And I would be reluctant to start designing systems to deal with things that are one-off.

**ANTITRUST SOURCE:** What kind of clearance delays have you seen?

**BILL BLUMENTHAL:** In terms of having the review assigned to one agency or the other, how much delay? Well, if you assume that clearance ordinarily would have come on day 8 or 10 or 15, it could be delayed to day 28 or 29 or 30. Obviously people don’t like that. We don’t like it internally, either. But as I say, it doesn’t happen very often.

Now in terms of how one might deal with that, while I didn’t often relish the prospect of dealing with both agencies simultaneously back when I was a practitioner, it’s not an unknown technique. It’s not one that I advocate, and I don’t offer that as a justification or as remedy. But again, I think people need to step back and ask themselves how severe the problem is and whether efforts to fix the problem potentially might make things worse.

**ANTITRUST SOURCE:** This year was a very active year in merger enforcement, with the FTC seeking preliminary injunctions in three cases, but none of them was successful. Is there any single principle or lesson to be derived from this experience?

**BILL BLUMENTHAL:** Well, let’s take the matters one at a time. In one of the three, there is an injunction that’s in place right now. And one of the others is on appeal. Two of the three remain both in active litigation in the courts and in administrative litigation, so I’m going to be quite guarded in what I say.

I’m not sure that there is a single particular lesson to be taken from the three, since each of the three has its own fact pattern, has its own situation. *Equitable Dominion* is the case where the lower court initially dismissed on state action grounds, but the Third Circuit granted an injunction pending appeal based on the emergency appeal we brought. So that deal is in suspense at the moment, pending resolution of our arguments to the Third Circuit.

The *Western-Giant* case was quite fact-bound.

**ANTITRUST SOURCE:** Is that why no appeal has been made from it?

**BILL BLUMENTHAL:** That was one of the significant factors, a combination of its being fact-bound and the sense that there was no central issue of law that was new to the case.

In the case of *Whole Foods*, we’ve filed our appeal, and it’s clear from our papers that we believe the district court misapplied the 13(b) standard. We’ll see what the court of appeals thinks about that.

**ANTITRUST SOURCE:** In other cases like *Arch Coal*, you discontinued administrative proceedings after losing a preliminary injunction action. Is there any kind of policy on what to do in this situation and what criteria come into play in making the decision?

**BILL BLUMENTHAL:** *Arch Coal* was before my time—at least the activity in the district court was
before my time—and the decision not to proceed was being taken just as I was walking in the door. There is a multi-factored policy statement that the Commission published in the mid-1990s.\(^7\)

It’s on the Web, and it describes the same sort of factors I was alluding to a moment ago in connection with the thought process on such cases.

**ANTITRUST SOURCE:** Private equity continues to be a major source of merger activity and an area where the Commission seems to be taking a more active role these days, for example the Kinder Morgan/Carlyle settlement earlier this year. Can we expect to see greater attention paid to private equity deals and partial ownership issues?

**BILL BLUMENTHAL:** We haven’t heard a lot about private equity in the last five or six months, but earlier this year there was a bit of a public kerfuffle about the role of private equity under the antitrust laws. It was largely in reaction to Kinder Morgan, and it struck me as a misplaced concern. There really is nothing new about private equity. If you look at the long list of merger cases over the last twenty years, you’ll recognize many private equity names. Now, we didn’t call it “private equity” fifteen years ago; typically we called them “buy-out funds.” But if you go down the list, you’ll see an awful lot of familiar names in matters under either Section 7 or Section 7A—Hicks Muse, KKR, Blackstone, MacAndrews & Forbes, Reliance Group, Hearst Trust, Trump, Milnot, Castle Harlan. From my perspective, while there was another case this year involving privately held companies, the ownership raised nothing new under the antitrust laws. But it happened to coincide with a newfound broader interest in the press in private equity, and it was seized on at least partly for that reason. From our perspective whether the ownership is through a public company or not is generally immaterial.

**ANTITRUST SOURCE:** Let’s turn to gun-jumping. You’ve written a number of times on pre-closing coordination, and in November 2005 you gave a now-famous speech, “The Rhetoric of Gun-Jumping,” which has been very useful in thinking about this area.\(^8\) Although you gave the usual disclaimer that your views did not necessarily represent the position of the FTC, I think you sought in that speech to dispel over-conservative counseling. What prompted the speech? Is this an area in which you have a personal interest, or was there some kind of Commission view that there needed to be some guidance in the area?

**BILL BLUMENTHAL:** It was more a personal sense that there was an overhang from some old statements that probably did not reflect Commission policy even at the time they were made, but that I kept running into as a merger practitioner. It seemed to me that there had been quite a bit of misunderstanding as to what was and was not permissible. And that was leading to confusion and more significantly to some inefficiencies. I thought that one well-placed speech probably would be able to clean that up.


ANTITRUST SOURCE: Do you think it has?

BILL BLUMENTHAL: I think so.

ANTITRUST SOURCE: Has there been any attempt to assess whether there has been any change in conduct since then? I suppose it’s hard from the inside to work that out.

BILL BLUMENTHAL: I have what you might call anecdotes from the outside. But I don’t think there is any systematic sense as to what changes have been made.

ANTITRUST SOURCE: Turning to non-merger antitrust, the FTC and DOJ held joint hearings on single firm conduct through the end of last year and the first half of this year. Has there been any outcome of those hearings? Do you have any views on what impact they might have on Section 2 enforcement?

BILL BLUMENTHAL: That project is within the policy shop in the General Counsel’s office, so I’ve been following it very closely. As to the bottom-line message that I take away from the hearings, it’s fair to say that the consensus identified no significant problems in the administration of Section 2 in the United States today. The one concern that speakers identified is the area of bundled discounts, following LePage’s and now PeaceHealth. The speakers did express quite a bit of concern about the tendencies outside of the U.S. in enforcement against dominant firm conduct.

There’s a lot of material that came out of those hearings, and we’re working with DOJ in writing it up. That process is taking more time than we would have liked. I won’t say it’s taking more time than we expected, because this will be a large report. We’re fairly far along in some of the drafting. But I don’t see it as a 2007 delivery.

ANTITRUST SOURCE: Although the Schering case is now relatively old news, we understand that pharmaceutical patent settlements are still a hot topic at the Commission. What is the current thinking, and are there any cases you can talk about at this time?

BILL BLUMENTHAL: There’s activity on a number of fronts. The issue is a subject of active legislative proposals. The issue is also before us in number of active investigations. It’s fair to say that the Commission remains quite concerned about the adverse competitive effect of at least some pharmaceutical settlements that we’re seeing. We’re optimistic that sooner or later, the matter will come before the Supreme Court. And we’re hoping that when it does, the Court will adopt a view along the lines we have urged.

ANTITRUST SOURCE: Turning to consumer protection, about 90 percent of the OGC’s caseload seems to be in this area. What are the key enforcement areas or areas that are the most challenging from your perspective in consumer protection?

BILL BLUMENTHAL: Let me distinguish the litigated cases from the enforcement generally, because a lot of the enforcement is resolved not through litigation but through consent orders. The matters that actually go to litigation often involve something that is more akin to simple fraud, whereas the overall mix is much broader. We’re seeing matters relating to data security, identity theft, spam, spyware, Internet types of abuses. For a long time there have been cases involving mortgage lend-
ing, truth-in-lending questions, fair credit reporting questions, and debt collection issues. There have been an awful lot of cases involving health-related claims that border on fraud. We have a number of do-not-call cases. We have the usual mix of business opportunity and franchise cases.

ANTITRUST SOURCE: The FTC has filed amicus briefs in many of the key Supreme Court cases of the last couple of years—Leegin, Billings, Weyerhaeuser, Independent Ink, Dagher, Volvo. How do you decide which ones you want to get involved in?

BILL BLUMENTHAL: All of those were while I’ve been here, although the Solicitor General makes the filing and we simply were participating in the process and signing on to what the SG did in most those cases.

To the extent there is a Supreme Court amicus situation involving antitrust or consumer protection, we will almost always have involvement where the Court asks for the government’s views. Again, that request is directed to the SG, and we would be one of a number of agencies providing input into the SG’s office. In the absence of a Court request for the government’s views, the usual pattern is not to submit an amicus brief, and it would be quite exceptional for the SG to initiate an amicus brief in the absence of an invitation from the court. We’re speaking here of the cert stage.

Below the Supreme Court, when we’re dealing with amicus briefs in the court of appeals, those can be filed by the Commission under its own authority. We do so on occasion, but we are quite guarded. We typically would not appear before a court of appeals unless there was a quite compelling reason to do so. We find that especially in competition cases, parties tend to be well-represented, and the arguments tend to be adequately developed by the parties themselves. And we’re generally better off keeping our powder dry, in case the matter ultimately comes before the Supreme Court.

ANTITRUST SOURCE: Of the cases you’ve gotten involved in through amicus briefs, which have been the most notable ones for you personally?

BILL BLUMENTHAL: Well, I have been involved in all of the ones you named, but the one that probably matters most to me personally was Dagher. As somebody who used to spend a lot of time practicing in the merger and joint venture area, I was quite concerned about the potential of the lower court decision to damage joint venture law. I thought cleaning that up was important.

ANTITRUST SOURCE: Final question: what have been the best things about the job so far and what do you hope to get done in your remaining time there?

BILL BLUMENTHAL: The best thing is not having to keep time sheets. I like the people as well. As for the limited time I have remaining here, the most important things probably would include seeing the Section 2 report to completion and continuing to work with some of the major emerging regimes outside the United States.
Carbon Neutral: The New Green—Substantiation Issues for the Next Generation of Environmental Claims

Randal Shaheen, Amy Ralph Mudge, and Matthew Shultz

In the early 1990s, consumer interest in the environment, particularly in the use and misuse of natural resources, began to grow. Industry raced to respond, and products began to appear with claims such as “biodegradable,” “recyclable,” and “made from recycled material.” These terms, however, had little definition, and any limitations on such claims were often poorly understood by consumers. As a result, regulators, primarily at the state level, jumped in with legislation and enforcement actions intended to stem a tide of unsubstantiated or misleading environmental claims.\(^1\) Efforts by industry to make legitimate environmental claims then became hampered by a patchwork of state laws that created often inconsistent and contradictory criteria for environmental terms. Anxious to preserve their ability to continue marketing products that met consumer demands for environmental responsibility, manufacturers petitioned the Federal Trade Commission to intervene and issue guidelines or rules that would provide a uniform federal standard and preempt state law.

In 1992, the FTC responded and issued guides for the making of environmental claims.\(^2\) The Green Guides provided specific criteria for the use of terms, such as biodegradable, recyclable, and recycled, as well as guidance for use of more general terms, such as “environmentally friendly.” The FTC environmental guides have withstood the passage of time well, and consumer interest in products with these claims and the number of products sporting such claims continues to grow. However, a new generation of environmental claims not contemplated when the FTC issued its original Green Guides have come in to vogue. Spurred on by former Vice President Gore’s book and movie,\(^3\) an above-average Atlantic hurricane season, and talk of melting polar

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\(^{1}\) For example, in 1990, seven state attorneys general brought an action against Mobil Chemical Co. alleging that its claim that its Hefty trash bags were biodegradable was misleading because the bags would not biodegrade under normal landfill conditions. CAL. ATTORNEY GENERAL ET AL., THE GREEN REPORT: FINDINGS AND PRELIMINARY RECOMMENDATIONS FOR RESPONSIBLE ENVIRONMENTAL ADVERTISING 7–8 (1990), available at \[http://www.p2pays.org/ref/24/23677.pdf\]. Also in 1990, California enacted statutory provisions regulating environmental marketing claims. See Cal. Bus. & Prof. Code §§ 17580, 17581 (West 2007). These statutes were subsequently amended to make compliance with the FTC’s Guides for the Use of Environmental Marketing Claims, 16 C.F.R. pt. 260 (2007), a defense. See id. § 17580.5(b).


\(^{3}\) AL GORE, AN INCONVENIENT TRUTH: THE PLANETARY EMERGENCE OF GLOBAL WARMING AND WHAT WE CAN DO ABOUT IT (2006); AN INCONVENIENT TRUTH (Paramount Classics 2006).
ice caps and rising seas, the American consumer has become more and more interested in the issue and the implications of global warming. Terms like “carbon footprint” and “carbon neutral” have become part of everyday parlance, as consumers try to assess the impact of carbon emissions on the environment and what they and business can do about it.

Once again the marketplace has responded. Companies have begun to calculate their carbon footprint and market products with claims of carbon neutrality. For example, in the spring 2007, Mohawk Fine Papers announced that several of its paper product lines are now carbon neutral.4 Rene Geneva Design has announced that it has assigned a carbon value to each of its clothing articles and will be making corresponding donations to organizations that offset greenhouse gas emissions.5 In August 2007, Dole Food Company announced that its Costa Rican subsidiary and the Costa Rica government will be collaborating to establish a carbon neutral banana and pineapple supply chain.6 Indeed, even the former Vice President’s movie was marketed with a claim that “100% of the carbon dioxide emissions from air and ground transportation and hotels for production and promotional activities” were offset “making the film the first carbon-neutral documentary ever.”7

In addition to companies trying to make their products more attractive based on their carbon offset, a stand-alone carbon offset industry has emerged for consumers interested in offsetting their own emissions. For example, when consumers buy plane tickets through Expedia.com, they are given the option to purchase TerraPass carbon offsets to offset the carbon emissions of their flight.8

We find ourselves in a similar position to where we were fifteen years ago when there was widespread use of terms like “biodegradable” and “made of recycled content” and the Green Guides had yet to be published. Many consumers are interested in buying carbon neutral products, and manufacturers are interested in advertising their efforts to reduce their contribution to global warming, but there is little in the way of a common definition for such terms and what limitations may be implicit in their use. For example, what do consumers understand is included in a calculation of a company’s carbon footprint? Does it include only emissions by a manufacturer in making a particular product? What about the carbon emissions of third-party suppliers? Similarly, numerous questions arise with respect to the meaning and substantiation of a carbon neutral or carbon offset claim. What are the criteria for a legitimate carbon offset? Does it matter if the offset would have happened anyway or if it may not be permanent? Can an offset include funding research into possible ways to reduce carbon, and, if so, must the tentative nature of the offset be

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disclosed? Further, what obligations does a company have to investigate the legitimacy of carbon offsets that it purchases from a third party?

Another concept, “water neutrality,” is in an even more nascent state. Coca-Cola, for example, just pledged to become “water neutral.”9 Such claims raise similar questions as to how one calculates a water footprint and how one substantiates a claim that water usage has been “offset.”

In this article we investigate the questions that may arise as companies strive to make legitimate claims relating to carbon and water neutrality. We also suggest possible approaches to some claims based upon prior FTC guidance in the environmental area and elsewhere.

Other regulators have already started asking some, but not all, of these questions. Congressman Edward Markey recently held a Congressional hearing to explore whether there should be regulation of the carbon offset industry and, after the hearing, sent a letter to the FTC urging it “to undertake a public process designed to update the Commission’s Guides for the Use of Environmental Marketing Claims . . . so that consumer confidence in the offset market can be assured.”10 In his letter, Representative Markey also urged the FTC to examine standards already being developed by those in the industry.11 In response, the FTC said that it has been monitoring the developing carbon offset market and would hold a public workshop in the coming months to “seek input on the consumer protection issues raised by carbon offset sales and the need for more direct FTC guidance than that already provided by the Green Guides and other advertising directives.”12 The FTC also said that it wanted “to better understand the market to avoid acting in a way that could restrain innovation or harm consumers” and would consider the industry’s efforts to self-regulate.13

At the same time, state action to regulate carbon offsets is beginning.14 Although the issues involved are complex and not always susceptible to easy answers, given these regulatory stirrings, consumers and industry alike are perhaps best served by the FTC stepping forward and issuing uniform federal guidelines so that claims of carbon and water neutrality can be made and relied upon with confidence.

### Understanding Carbon Footprints and Carbon Neutrality

To understand the substantiation issues that arise with respect to claims of the size of a carbon footprint or carbon neutrality, we first need to examine how these terms have been used. A “carbon footprint” is intended to be a measure of the amount of carbon dioxide (or greenhouse gases) emitted as a result of the activities of an individual, a household, or a business. A product or serv-

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11 Id.


13 Id.

ice can also be said to have a carbon footprint—or the amount of carbon dioxide emitted in the various activities involved in producing a product or providing a service.

The size of one’s carbon footprint can be computed using a “carbon calculator,” available at numerous Internet sites. For example, the Web site for the movie An Inconvenient Truth features a carbon calculator, as does the Environmental Protection Agency’s Web site. Some carbon calculators capture only emissions of carbon dioxide, while others also attempt to capture emissions of other greenhouse gases.

Most carbon calculators are designed for individual or household use, prompting the user to enter information relating to electricity usage, home heating, driving, and flying. However, other more sophisticated calculators have been developed as tools for business. For example, CarbonCounted promotes software that businesses can use to calculate their total carbon footprint and footprint per product or unit. This software allows a business to enter information relating to its carbon dioxide emissions from production, research and development, and administrative functions. Data from suppliers, including raw materials suppliers, can also be linked, as well as data for carbon emissions by retailers that sell the manufacturer’s product. The manufacturer can then calculate its total carbon footprint or distribute that total per unit of product. CarbonCounted does not capture any carbon emissions associated with a product’s use by consumers. Thus, for example, with this tool General Motors or ExxonMobil could calculate the carbon footprint associated with the manufacture and sale of a car or gasoline but not the actual use of those products. In addition, CarbonCounted’s methodology focuses on activities and operations associated with the variable costs in producing a product and thus does not account for carbon dioxide emitted during the creation of fixed manufacturing elements, such as construction of buildings or the manufacture of equipment.

While the goal of many is reduction of carbon dioxide emissions, complete elimination of carbon emissions may not be practical or technically feasible. As a result, the concept of carbon offsets was developed as a way for companies to make up for their release of carbon dioxide into the atmosphere. In essence, it is like a dieter who eats a donut but then runs a mile to burn off the extra calories. Specifically for carbon, the offset involves investment in an activity to reduce carbon emissions (such as by planting trees that capture carbon from the atmosphere) by an amount equal to the carbon emissions sought to be offset (such as emissions associated with air travel). A company that offsets (or pays others to offset) all of its carbon emissions is said to be carbon neutral. This concept is well-established in emissions trading allowed under existing U.S. regulatory programs, particularly for air pollution control. For example, under the Clean Air Act Acid Rain program, electric utilities have a set number of tons of sulfur dioxide (which contributes to acid rain) they are allowed to emit. If they wish to emit more than that allowance, they can buy...

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18 Id. § 2.7.
20 42 U.S.C. § 7651b(a)(1); 40 C.F.R. pt. 73, subpt. B.
allowance credits from other electric utilities that have decided to emit less than they are allowed.\footnote{See 42 U.S.C. § 7651b(b).}

In this way, the purchased allowances from those who make an extra effort to reduce sulfur dioxide are used to offset the extra emissions from another company. Similarly, new manufacturing plants that are constructed in certain areas with poor air quality are required under the Clean Air Act to find a way to “offset” the new emissions they will add to the area, usually by paying another company to reduce its emissions by an equal amount.\footnote{See 42 U.S.C. § 7503(c).}

Most companies do not undertake to offset their carbon emissions directly. Instead they purchase offsets from third parties. Offsets come in many shapes and sizes but take three primary forms. Planting trees (or reforestation) is one such means. In 2005, U.S. forests sequestered the equivalent of 698.7 million metric tons of carbon dioxide.\footnote{U.S. EPA, Publ’n No. 430-R-07-002, Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990–2005 7-7 (2007); available at http://epa.gov/climatechange/emissions/downloads06/07CR.pdf.}

Further, it is estimated that a single, fast-growing tree planted in the tropics will absorb an average of fifty pounds of carbon dioxide per year for at least forty years.\footnote{See About Us: Global Cooling Center, http://www.treesftf.org/about/cooling.htm.}

A second method uses offsets related to renewable energy sources, such as wind power. Such offsets can take the form of credits or funding of renewable energy projects. In general, a renewable energy credit embodies the environmental benefits of—that is, the carbon dioxide emissions avoided by—generating a unit of electrical power from a renewable energy source as opposed to a traditional energy source, such as coal or natural gas.\footnote{See, e.g., Frequently Asked Questions: About BEF’s Green Tags, https://www.greentagsusa.org/GreenTags/faq_pages/about_greentags.cfm.}

A third means is the funding of technology or research into methods of reducing emissions of carbon dioxide. Other more esoteric means of carbon offsetting have also been proposed. For example, one company “fertilizes” the ocean with iron in the belief that it promotes a plankton bloom, which in turn draws a significant amount of carbon dioxide out of the atmosphere.\footnote{See Carbon Offsets: Keeping Faith with Climate-Conscious Consumers: Hearing Before the Select Comm. on Energy Independence and Global Warming (July 18, 2007) (testimony of Russ George, President & CEO, Planktos, Inc.) [hereinafter Carbon Offsets Hearing].}

Today there are three dozen or more voluntary offset providers in the United States, including companies such as TerraPass, Bonneville Environmental Foundation (BEF), and Carbonfund.org. Worldwide, the voluntary offset market has an estimated volume of over $100 million. Some believe that by 2010 voluntary offsets may achieve reductions of several hundred million tons of carbon dioxide per year.\footnote{See id. (testimony of Derik Broekhoff, Senior Associate, World Resources Institute).}

As compared to an estimated 25 billion tons of greenhouse gases emitted into the atmosphere every year by human activity, offsets make at most a modest contribution, yet represent a significant economic market.

Water neutrality is an emerging concept similar to carbon neutrality. This concept is not as well-defined as carbon neutrality. It encompasses efforts to reduce one’s “water footprint”—the volume of freshwater used to produce goods or services—through conservation and efficiency gains and efforts to offset one’s water footprint. A company can offset its water footprint by returning the water it uses to the environment at a quality that can support aquatic life and agriculture or by supporting efforts to establish, maintain, or improve freshwater sources.
With the exception of the Coca-Cola Company, which in June 2007 issued a press release heralding its goal of “water neutrality” featuring the familiar panda logo of its partner in the effort, the World Wildlife Fund, few companies appear to be using the notion of water neutrality to appeal to consumers. However, several initiatives aimed at getting companies involved in reducing their corporate water footprint were set in motion in 2007. In July 2007, the UN Global Compact, a UN organization encouraging “corporate citizenship,” issued a “CEO Water Mandate” billed as “a strategic framework for companies seeking to address the issue of water sustainability in their operations and supply chains.”

In August 2007 at World Water Week, organized by the World Business Counsel for Sustainable Development, the “World Water Tool” was launched. The tool allows a company to map its water “risk” and to calculate the volume and efficiency of water use in its operations. Notably, the World Water Tool was developed by a slate of corporations which may look to appeal to consumers by achieving and then advertising a reduced water footprint, including Pepsico, Kimberly Clark, and Unilever.

Both the calculation of one’s carbon or water footprint and the use of carbon or water offsets create challenges with respect to consumer understanding of these terms and substantiation of their truthfulness. We discuss first below the FTC’s general standards for substantiation of advertising claims as well as the general framework of the FTC’s Green Guides and then turn to a more specific discussion of the issues associated with footprints and offsets, focusing on carbon. As it develops, the emerging concept of water neutrality will likely raise similar issues and questions.

The experience of the FTC and the marketplace in grappling with claims of carbon footprints and neutrality may facilitate the use and understanding of future claims relating to water neutrality.

**FTC Standards for Interpreting and Substantiation of Advertising Claims**

The FTC has broad authority to prohibit “unfair or deceptive acts or practices.” The FTC’s Deception Policy Statement provides that an advertisement is deceptive if it contains a misrepresentation or an omission that is likely to mislead consumers acting reasonably under the circumstances. While to be actionable, a deceptive claim must be material to consumers’ decisions to buy a product or service, the FTC does not need to prove actual injury to consumers. Deceptive claims may be express or implied. With express claims, the representation itself establishes the meaning of the claim. Claims can also be implied based on the language of the claim coupled with the net impression created by the ad as a whole. To demonstrate an implied claim, the FTC may rely on extrinsic evidence, such as a consumer survey, but it is not required to do so. The FTC is presumed to have sufficient expertise to determine whether an ad makes a deceptive implied

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33 Id. at 176.

34 Id. at 179 & n.32.
Claims can be limited or modified with the use of disclosures or disclaimers, so long as the disclaimer language is clear and conspicuous. Disclaimers cannot be used, however, to contradict express or implied claims.

Advertisers must have a reasonable basis for making objective claims. The level of substantiation will vary on a case-by-case basis depending on: (1) the type of claim; (2) the benefits of the claim if true or the consequences of the claim if false; (3) the type and availability of evidence adequate to substantiate the claim; (4) the type of product; and (5) the extent of consumers’ reliance on the claim. For certain claims, including environmental claims, competent and reliable scientific evidence is usually required, meaning “tests, analyses, research, studies, or other evidence based upon the expertise of professionals in the relevant area, that has been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results.”

The Green Guides give specific guidance on the application of Section 5 of the FTC Act to environmental advertising and marketing practices. The Green Guides do not specifically preempt state and local law governing the use of environmental marketing claims, but several states repealed or modified their existing laws to make them consistent with the FTC Guides.

The Green Guides provide some guidance with respect to general environmental claims. For example, the FTC recognized that environmental claims may be made as to the packaging of a product or to the product itself and requires the claim make clear if the environmental benefit asserted relates to the product as a whole, the product’s packaging, or a portion of the product, package, or service. A green claim should not overstate the benefits to the environment.

38 Thompson Medical, 104 F.T.C. at 839 (appending FTC’s Advertising Substantiation Policy Statement).
41 16 C.F.R. § 1.6 (2007).
45 16 C.F.R. § 260.6(b) (2007).
example, it is misleading to state “50% more recycled content than before” if the manufacturer increased the recycled content of the package from two to three percent. Similarly, comparative claims such as “20% more recycled content” or “less waste than the leading national brand” must be substantiated and make clear the basis of the comparison.

The Green Guides frown on the use of general marketing claims because the FTC believes such terms convey that a product has far-reaching environmental benefits. Unless qualified, the FTC requires substantiation of such terms for their broadest possible meaning. Examples include “eco-safe,” “environmentally friendly,” “environmentally safe,” “environmentally preferable,” “essentially non-toxic,” and “Earth Smart.” Marketers are advised to make clear exactly how their products are environmentally safe, friendly, or preferable. Similarly use of eco-seals or certifications from third parties should explain the basis for the award.

However, the FTC also believed it beneficial to provide guidance as to the meaning and use of specific types of environmental claims, including degradable/biodegradable/photogradable, compostable, recyclable, recycled content, source reduction, refillable, and ozone safe/ozone friendly/no CFCs. Presumably the FTC would also find it beneficial to provide specific guidance as to the use of newly emerging environmental claims.

Between 1990–2000, the FTC brought thirty-seven environmental cases. In response to a request by a California state legislator to review the effectiveness of the Green Guides, then Bureau of Consumer Protection head Joan Bernstein wrote, “[W]e believe the Commission has established a consistent approach to environmental marketing regulation that has resulted in substantial benefits for consumers and businesses alike.” Can the FTC’s sound approach to environmental marketing or “green” claims translate into the 21st century and the next generation of environmental claims?

46 Id. § 260.6(c).
47 Id. § 260.6(d).
48 Id. § 260.7(a).
49 Id.
50 Id. § 260.7(b) (explaining that these terms mean that all of the materials in a product will break down over time and return to nature within a reasonably short time after disposal and requiring qualification if necessary as to the ability of the product to degrade in an environment where it is customarily disposed and the rate/extent of degradation).
51 Id. § 260.6(c) (defining composting as breaking down all materials in a product or package in a safe and timely manner to material that enriches the soil and returns nutrients to the earth and requiring qualification if composting is only possible at a municipal composting facility rather than at home).
52 Id. § 260.6(d) (defining recyclable (or “Please Recycle” claims) as applicable to a product and packaging that can be collected or separated from the solid waste stream and used again or reused in the manufacture or assembly of another product through an established recycling program and requiring qualification if the entire product is not recyclable or if the product is made from recyclable materials but not generally accepted in recycling programs for some reason).
53 Id. § 260.6(e) (allowing recycled content claims only for products that have been recovered from the solid waste stream during the manufacturing process or after consumer use and requiring qualification if less than 100 percent of the content is recycled).
54 Id. § 260.6(f) (defining that such claims mean a reduction in weight, volume, or toxicity of a product or package and requiring qualification as to the amount of source reduction and the basis for the claim).
55 Id. § 260.6(g) (explaining such a claim can be made only if a system is provided for the collection and return of the package for refill or the later refill of the package by consumers with product sold in another package).
56 Id. § 260.6(h) (defining the terms to mean that neither the product nor its packaging contributes to the depletion of the upper atmosphere ozone layer or to the formation of ground-level ozone).
57 See http://www.ftc.gov/appliances/ (for a listing of the cases follow the “Environment” hyperlink, then follow the “Enforcement” hyperlink).
Definition and Substantiation of Carbon Footprint and Carbon Offset Claims

**Carbon Footprint.** Perhaps the most important and most fundamental question with respect to the calculation of a carbon footprint is whether consumers understand that term to be limited solely to the emission of carbon dioxide. Carbon dioxide emissions are significant to consumers only because of the impact such emissions are believed to have on global warming. However, other so-called greenhouse gases, such as methane and nitrous oxide, are also believed to contribute to global warming.

Thus, when a company makes a claim as to the size of its carbon footprint or claims that it is carbon neutral, do consumers understand that claim in a broader implied sense to mean that the company does not otherwise contribute to global warming? As discussed, the FTC is presumed to have expertise in how claims are interpreted by consumers even without the use of reliable survey evidence. The FTC may choose to utilize its expertise to answer this question, much as it has done in the past with respect to the meaning of other environmental marketing terms. For example, in its Enforcement Policy Statement on Food Advertising, the FTC notes that when several nutrients all contribute to a health problem, for example, sodium, fat, and cholesterol: “A claim regarding one of these nutrients is likely to give rise to a misleading impression regarding the benefit of the food absent disclosure of the presence of the other nutrient. Under these circumstances, the failure to correct these misimpressions through adequate disclosures is likely to be deceptive.”59 This suggests that at least in some circumstances, absent disclosure, it may be misleading to make a claim about the size of a carbon footprint or carbon neutrality unless emissions of other greenhouse gases are accounted for or a disclaimer to the contrary is made clearly and conspicuously.

There are at least two other definitional questions to consider. First, should the size of a carbon footprint include upstream emissions? For example, there is “line loss” associated with the transmission of electricity from a utility to a user. Should emissions associated with this “line loss” be included in the size of the user’s carbon footprint? At least one carbon calculator, BEF’s, attempts to capture such upstream emissions.60 Second, to what extent should a company’s carbon footprint include emissions by suppliers, at least to the extent that suppliers have not already offset them? As noted above, CarbonCounted’s software program allows companies to include supplier emissions in their total footprint.

With respect to the latter question, the FTC’s position with respect to Made in USA claims may provide some insight. Under the FTC’s Made in USA guidelines, a Made in USA claim is substantiated primarily by demonstrating that “all or virtually all” of the costs of manufacturing a product are domestic.61 With respect to inputs purchased from third-party suppliers, the FTC’s policy suggests that the domestic content of such inputs must be included in the Made in USA calculation if there is a close relationship between the input and the finished product. However, inputs from suppliers do not have to be included if the input is not a significant component of the final product and undergoes significant transformation in the manufacturing process. The FTC’s view is that “[f]oreign content incorporated early in the manufacturing process often will be less significant to consumers than content that is a direct part of the finished product or the parts or com-

ponents produced by the immediate supplier." Thus, even if the petroleum used to manufacture plastic is imported it need not be included in the Made in USA cost calculation, but the steel in a pipe or wrench should be considered. In our experience, application of this principle sometimes involves difficult line drawing, but it may well be that the FTC would require it of companies making claims relating to carbon footprints or carbon neutrality. Absent imposition of such a requirement, the carbon footprint of two companies making an identical product could be dramatically different depending upon the extent to which each relies upon third-party inputs.

**Carbon Offset and Carbon Neutrality Claims.** There are also numerous questions associated with consumer understanding of the terms “carbon offset” and “carbon neutral” and how such claims can be substantiated. First, what are consumer expectations about how soon the greenhouse gas emissions will be offset? For example, if the carbon offset value of a tree is based upon carbon absorbed by the tree during its expected lifetime, will consumers understand that the carbon being emitted by the production of a good today is being offset by a tree over the course of the next forty years? Even if consumers have such an understanding by use of a disclaimer or otherwise, is the offsetting of carbon emissions over the course of many decades a legitimate contribution to an effort to reduce global warming? Similarly, what about the use of offsets, such as research into carbon emissions reduction, which hold the promise of reducing carbon but not the certainty? Can such offsets be legitimately used as part of a carbon neutral claim, even if in the end they yield no real reduction in overall carbon dioxide?

Second, should it matter if the trees that are planted or the renewable energy generated would have been planted or generated anyway? For example, in the case of many renewable energy offset credits, the renewable energy source is already up and running. Is it legitimate for companies to claim environmental credit for funding activities that would have happened anyway?

The existing FTC Environmental Marketing Guides perhaps provide some idea how the FTC might resolve this question. With respect to claims that a product is made from recycled material, the FTC Green Guides state that such a claim is deceptive if the waste material ordinarily is reused by the manufacturer and would not have otherwise entered into the waste stream. Similarly, the FTC may take the position that carbon offsets that would have been put in place anyway cannot be used to substantiate a claim of carbon neutral. However, the analysis in this situation may be more complex in that some carbon emission reductions that would have already taken place may be accelerated through offset funding.

Finally, some have questioned whether there is meaningful carbon offsetting if it is not known whether planting trees in one location will lead to chopping down trees in another so that there is little if any net increase in the number of trees. However, it seems only fair to ask the same question as above—would those trees have been chopped down anyway? If so, then while there is no net gain in carbon offsetting, there is still a real benefit.

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63 Questions might also be raised with respect to whether the carbon footprint should be limited to activities associated with production of a product; for example, should the footprint include emissions associated with construction of the manufacturing facility or should the footprint include emissions associated with consumer use of the product? In our view, it seems unlikely that most consumers would associate either type of emissions with a company’s carbon footprint or carbon neutral claim for its product.

64 See, e.g., Ben Elgin, Another Inconvenient Truth: Behind the Feel-Good Hype of Carbon Offsets, Some of the Deals Don’t Deliver, Bus. Wk., Mar. 26, 2007, at 96 (reporting on several offset projects).

65 16 C.F.R. § 280.7(e); Complying with the Environmental Marketing Guides, supra note 3, at 10.

66 See Carbon Offsets Hearing, supra note 26 (testimony of Joseph Romm, Senior Fellow, Center for American Progress).
Perhaps the most important but also most difficult question is which carbon offsets legitimately reduce carbon dioxide or other greenhouse gases and what is the amount of such reduction. Even trees, which indisputably absorb carbon dioxide, have been questioned by some as carbon offsets because outside of the tropics, trees are typically darker than the landscape they replace so that more of the sun’s heat is absorbed than previously, warming the atmosphere and thus negating some, if not all, of the benefits of increased absorption of carbon dioxide.67 Other forms of carbon offsets pose even more difficult questions—for example, the use of iron to create plankton blooms. Clearly the FTC, with the additional benefit of outside scientific expertise, is up to the task of creating safe harbors for categories of carbon offset claims, but finding consensus in what is still a relatively nascent and controversial area may not be easy.68

The often complex scientific questions that surround carbon offsets also raise difficulties for companies wanting to make legitimate carbon offset claims. As noted above, most companies purchase carbon offsets from third parties. As a result, they often lack the expertise to evaluate the effectiveness and value of the carbon offsets they are purchasing or even to know whether the third parties they are dealing with are selling the same offsets to multiple parties.69 Here, as well, the FTC has wrestled previously with a similar predicament. The Commission has long recognized that although advertising agencies have considerable expertise in evaluating the nature of any marketing claims they are less well equipped to evaluate the truthfulness of such claims, particularly when the substantiation for such claims consists of scientific or clinical studies. As a result, the FTC has stated that agencies need not do more than ascertain whether the substantiation is facially adequate and not obviously flawed.

Similar accommodation seems appropriate here in recognition of the fact that most companies are not equipped to evaluate closely the value of carbon offsets they are purchasing. The Commission may wish to consider assisting by creating safe harbors for certain carbon offset providers or programs, much as it did for the Children’s Online Privacy Protection Act (COPPA).70 Under the FTC’s COPPA Rules, an industry group or other person can request Commission approval of self-regulatory guidelines. Once approved, compliance with such guidelines creates a safe harbor for COPPA compliance.71 In a similar vein, providers of carbon offsets could request Commission approval of their offset program such that purchasers of offsets from approved providers are deemed to be compliant with any relevant FTC guides.

The FTC may also look to existing carbon offset and trading schemes in evaluating carbon offset and carbon neutral claims or in developing guidance for companies making such claims. Internationally, the Kyoto Protocol established an emissions offset market called the Clean Development Mechanism (CDM).72 The CDM has developed methodologies for many types of

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67 Id.
68 Of course, the FTC would not be setting environmental policy; rather, it would be determining whether consumers are harmed by unfair or deceptive marketing claims. See Letter from Chairman Majoras to Rep. Markey, supra note 12.
69 See Carbon Offsets Hearing, supra note 26 (statements of Reps. Markey & Sensenbrenner); Fiona Harvey, Beware the Carbon Offsetting Cowboys, FTN. TIMES, Apr. 26, 2007.
70 16 C.F.R. § 312.10 (2007).
71 Id.
offsetting projects that measure a project’s baseline emissions.73 “Additionality”—the emissions reductions that would not have occurred but for the offsetting project—is measured from this baseline and is used to determine the offset credits associated with the project.74 In the absence of FTC regulation or guidance, the CDM methodologies provide companies with generally accepted means to exercise due diligence with respect to offsets they plan on purchasing.

In the United States, several states have begun to develop similar mechanisms. The Regional Greenhouse Gas Initiative (RGGI) is an effort by several Northeast and Mid-Atlantic states to establish a regional cap-and-trade system for carbon dioxide emissions from power plants.75 In California, the Global Warming Solutions Act of 2006 mandated statewide caps on greenhouse gas emissions and allows the state’s Air Resources Board to adopt market-based mechanisms, such as a cap-and-trade system, to accomplish the mandated emissions reductions.76 As these state initiatives come on-line, they may provide additional guidance to the FTC and to companies exercising due diligence in their purchases of offsets.

Conclusion

While discussions of carbon footprints and carbon offsetting have become quite common in the marketplace, there are numerous questions that surround such claims. Establishing parameters for the definitions and substantiation of carbon claims is a difficult task. Yet it is a task the FTC has handled well previously in response to a prior generation of environmental marketing claims.

The FTC is understandably reluctant to regulate too quickly in this emerging area. The FTC’s caution in this respect has served it well in the past. However, given the explosion of consumer interest in this area, the rapidly increasing economic value that carbon offsets and carbon claims represent, and the risk that states may jump in and create a potentially inhibiting patchwork of regulation, it may make sense for the FTC to issue guidance in this area sooner rather than later.●

74 Id.
Patent Exhaustion—
A Simple Problem Made Hard

Robert P. Taylor and Henry C. Su

The U.S. Supreme Court will revisit this Term, for the first time in sixty-five years, the “patent exhaustion” or “first sale” doctrine. In Quanta Computer, Inc. v. LG Electronics, Inc., the defendant petitioners, supported somewhat surprisingly by the U.S. Solicitor General (SG), are asking the Court to hold as a matter of law that a patent cannot be enforced against entities that use or resell a patented product in contravention of lawful license restrictions imposed by the patent owner. Specifically, the Quanta defendants ask the Court to hold that their purchase of patented microprocessors from Intel, a licensee of the plaintiff patent owner LGE, carries with it an absolute right to incorporate those microprocessors into computer systems also covered by LGE’s patents, notwithstanding an express limitation to the contrary in the patent license to Intel and their knowledge of that limitation. The SG, while recognizing the contractual freedom of a patent owner to impose reasonable conditions on its licensees, would make formal transfer of title to a licensed product an operative event to cut off any subsequent assertion of patent rights against that product or a larger product into which it is incorporated. Although the SG suggests that antitrust concerns underlie its position, it offers little but the decades-old mantra of “exhaustion” to justify a rule that would operate in every case regardless of the commercial circumstances of a transaction or the intent of the patent owner and those with whom it deals.

It is time for the Court to abandon the formulaic and dogmatic approach that has characterized the case law on patent exhaustion for over a century. The Court should ground the analysis instead on fundamental, uncontroversial, and widely accepted principles of patent licensing, foremost among which is the freedom of knowledgeable entities to enter into a binding license that serves the needs of their particular technology and industry. The commercial realities facing companies that use and rely on the patent system provide a better basis for determining when there should be exhaustion of the patent right than does an automatic rule rooted in common law prohibitions against restraints on alienation. Nor should antitrust law dictate the outcome, at least not the now defunct notions of per se illegality that characterized much of antitrust analysis during the first seventy-five years of the 20th century and that played a role in shaping the exhaustion doctrine. If patent licenses happen to be used by those with market power to restrain trade beyond the scope of the lawful exclusive rights awarded by their patents, then antitrust law is amply equipped to address that situation without rote reliance on the exhaustion formalism.

The global economy today is markedly more complex than that of the 19th and early 20th centuries, when the exhaustion doctrine first took shape, as are the products that reach consumers. In contrast to a century ago, there are many situations today in which a patent owner, in an effort to maximize the implementation of new technology, may want to license one or more entities to

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make separate patented components of a larger whole, others to combine these components into patented systems, and still others to sell such systems for use in specified applications. As long as there exists a set of lawful contracts that carefully define the rights of the patent owner and its licensees in such arrangements, it is difficult to justify judicial intervention to prohibit the assertion of patent rights against those who violate or ignore the license terms and who otherwise meet the statutory definition of infringement.

It is no answer to argue that the patent owner might have contractual remedies against an errant licensee in the event of a breach, because that remedy may not apply to the offending parties (as may be true in the *Quanta* case). Moreover, the patent statute gives the patent owner the exclusive right to control—separately—the importation, manufacture, sale, and use of its invention, and any one of these activities undertaken without a license is deemed an infringement.\(^2\)

Companies that knowingly purchase products in violation of a use or resale restriction imposed by the patent owner are in no position to argue that their activities are nonetheless “licensed” by the patent owner. Accordingly, those activities should be treated as infringement no less than the manufacture of patented components without authorization.\(^3\)

**Origins of Exhaustion**

The exhaustion doctrine, at its inception, addressed a default situation in which a patent owner or its licensee has sold a patented product to an ordinary customer for its intended use. In *Adams v. Burke*, the plaintiff patent owner licensed the sale of patented coffin lids within a specified geographical area.\(^4\) The defendant undertaker purchased such a lid from the licensee within the designated area but used it outside that area. In ruling for the purchaser of the lid in a suit brought by the patent owner, the Court acknowledged that “the right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee.”\(^5\) Nevertheless, the Court held that the patent rights had been exhausted by the sale because the patent owner had been fully compensated for use of the patent as to that sale. “[W]hen the patentee . . . sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use.”\(^6\) In *Adams*, exhaustion made sense because there was no evidence of any restriction on use or resale imposed by the patent owner on the customer, only a restriction on where the lid initially was to be sold which had been duly observed.\(^7\)

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\(^3\) See, e.g., *Aro Mfg. Co., Inc. v. Convertible Top Replacement Co., Inc.*, 377 U.S. 476 (1964). In *Aro Manufacturing*, the Court explained:

> But with Ford lacking authority to make and sell, it could by its sale of the cars confer on the purchasers no implied license to use, and their use of the patented structures was thus “without authority” and infringing under § 271(a). Not only does that provision explicitly regard an unauthorized user of a patented invention as an infringer, but it has often and clearly been held that unauthorized use, without more, constitutes infringement.

*Id.* at 484 (citations and footnote omitted).

\(^4\) 84 U.S. (17 Wall.) 453 (1873).

\(^5\) *Id.* at 456.

\(^6\) *Id.*

\(^7\) See also *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 666 (1895) (“[A]s between the owner of a patent on the one side, and a purchaser of an article made under the patent on the other, the payment of a royalty once, or, what is the same thing, the purchase of the article from one authorized by the patentee to sell it, emancipates such article from any further subjection to the patent throughout the entire life of the patent.”); *Bloomer v. McQuewan*, 55 U.S. (14 How.) 539, 553 (1853) (“The right to construct and use these planing machines [had] been purchased and paid for without any limitation as to the time for which they were to be used. They were the property of the respondents. Their only value consists in their use.”).
By contrast, in Mitchell v. Hawley, on which the Adams Court relied, the Court did not find exhaustion, holding that the intent of the patent owner was determinative as to the scope of the license. The Court affirmed a finding of infringement by one who had purchased a patented machine from a licensee who had the right to make and use but did not have the right to sell the machine during the term of the patent. The Court distinguished the situation before it, in which the patent owner had clearly restricted the right of a licensee to sell machines, from one in which “the sale is absolute, and without any conditions” and the buyer would therefore be free to treat the machine as his or her “private, individual property.”

Facially, it might seem that a rule of law derived from these seminal cases would not support exhaustion in situations where, as in Quanta, the patent owner has contractually imposed use restrictions on sales by its licensee and has communicated those restrictions to customers of the licensee. Unfortunately, the law on exhaustion has grown needlessly confusing and ambiguous, in part because the Court itself has not been consistent in describing the rationale for applying the doctrine or its reach. Moreover, dicta in many cases have exceeded the actual holdings. In some cases, the Court has held that exhaustion does not apply to sales made by a licensee that were subject to use restrictions. In other cases, the Court has treated exhaustion as an absolute concept that arises from the fact of sale itself, whether by a licensee or the patent holder, and renders nugatory the imposition of contractual restrictions on use or resale. Still other cases fall somewhere in between. In United States v. General Electric Co., for example, the Court accepted, without analysis, that a sale by a patent owner would “exhaust the monopoly” and preclude the imposition of price restrictions on resale, but ruled that a license provision imposing price restrictions on sales by a licensee would be proper and lawful. This formal distinction between sales made by a licensee and those made by a patent owner makes little sense. If a patent owner is permitted to control the prices charged by its manufacturing licensee, it is difficult to understand why its sales through a reseller distributor should be subject to a different rule.

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8 83 U.S. (16 Wall.) 544, 548 (1873).
9 Id.
10 For example, in General Talking Pictures Corp. v. Western Electric Co., 305 U.S. 124 (1938), discussed infra, the Court affirmed a finding of infringement by a company that used patented sound amplifiers in violation of a use restriction in the seller's license. See also Mitchell, supra note 8.
11 An example of this approach is reflected in United States v. Univis Lens Co., 316 U.S. 241 (1942), also discussed infra, in which the Court used the exhaustion doctrine as part of its rationale for holding that the patent owner's effort to establish minimum prices to be charged by licensees for patented multifocal eyeglasses was a per se violation of the Sherman Act. The "first sale" was the patent owner's sale of patented lens blanks that were subsequently ground into patented lenses to be sold by licensees.
12 272 U.S. 476 (1926). The General Electric Court reasoned:
   It would seem entirely reasonable that [the patent owner] should say to the licensee, "Yes, you may make and sell articles under my patent, but not so as to destroy the profit that I wish to obtain by making them and selling them myself." He does not thereby sell outright to the licensee the articles the latter may make and sell, or vest absolute ownership in them. He restricts the property and interest the licensee has in the goods he makes and proposes to sell.
   Id. at 490.
13 The SG acknowledges the apparent anomaly in drawing this distinction but argues that it is a “necessary and explicable result” of the decision in General Talking Pictures. Brief for the United States as Amicus Curiae Supporting Petitioners at 17–18, Quanta Computer, Inc., v. LG Elecs., Inc., No. 06-0937 (U.S. Nov. 2007). This is oddly true, but only if one accepts the propriety of using the formulaic legalism of exhaustion for the analysis.
Time to Simplify

In Quanta, the Supreme Court has an opportunity to simplify the exhaustion doctrine and to reconcile it with 21st century economics and widely accepted licensing principles. The key lies in examining the nature of the patent right and asking why the exhaustion doctrine exists in the first place. Although described and applied in many different ways, the exhaustion doctrine at bottom is properly analyzed as a species of implied license made necessary by the Patent Act itself.14

By statute, a patent owner is given the exclusive and severable rights to make, use, and sell the patented invention, along with the right to proceed against others for any one or more of those activities undertaken without its authorization.15 Because these rights are severable, a patent owner theoretically could sue its own customer for using or reselling a patented product, were it not for the fact that the sale itself normally carries with it an implied authorization to put the product to its intended use and enjoyment. In a typical sales transaction, the patent owner—whether selling directly or through a licensee—captures the full value of its invention in the initial sales price and conveys to the buyer an unrestricted right to use the patented product whenever and wherever it chooses, including the right to resell the product to others who can enjoy the same rights. In such a transaction, the patent owner remains silent about the authorization of downstream uses and resale because it intends to part, fully and permanently, with any rights to control the product after it is sold.

Analyzed in light of the multiple exclusive rights awarded by the Patent Act, the ordinary buyer in this type of transaction acquires—in addition to ownership of the patented product—an implied license to use and to resell the product and to pass along the same set of rights to subsequent owners, free and clear of claims of the patent owner. It is reasonable to assume, moreover, that if the patent owner wanted to restrict the freedom of the first purchaser in some way, either the purchase price would be lower or there would be fewer customers willing to accept the more limited

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14 Notably, the patent and copyright statutes differ significantly in the types of exclusive rights they confer and the economic incentives they intend to foster, a point that argues in favor of analyzing exhaustion separately for copyrights and patents. Some of the more confusing exhaustion cases are those that equate the two. See, e.g., Bauer & Cie v. O’Donnell, 229 U.S. 1, 17 (1913) (“Upon such facts as are now presented we think the right to vend secured in the patent statute is not distinguishable from the right of vending given in the copyright act. In both instances it was the intention of Congress to secure an exclusive right to sell, and there is no grant of a privilege to keep up prices and prevent competition by notices restricting the price at which the article may be resold.”).

15 35 U.S.C. § 271(a) of the Patent Act provides that whoever imports, makes, uses, offers to sell or sells any patented invention infringes the patent. 35 U.S.C. § 271(a). Section 271(b) provides that whoever actively induces others to infringe also infringes. 35 U.S.C. § 271(b). Under Section 271(c), whoever knowingly sells or offers to sell something especially adapted to infringe the patent infringes contributorily. 35 U.S.C. § 271(c). This aggregate description of activities that constitute acts of infringement is qualified by the phrase “without authority,” which allows those who might otherwise be held infringe to show that they were “authorized” by the patent owner—i.e., licensed either directly or indirectly—to import, make, use, offer to sell or sell, as appropriate, the patented invention. Where an activity infringes, Sections 281–283 allow the patent owner to bring a civil action for damages and injunctive relief. 35 U.S.C. §§ 281–283.

16 Even this type of exhaustion is not absolute. A well recognized limitation on the rights of the owner of any patented product comes into play when it seeks to rebuild a worn out product. An extensive body of case law exists in which the Supreme Court and Federal Circuit have attempted to define the point at which permissible repair becomes impermissible reconstruction. See, e.g., Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476, 484–85 (1964) (distinguishing the infringing repair of an unlicensed convertible top structure, which perpetuated the infringing use, from the permissible repair of a licensed convertible top structure, as seen in Aro Mfg. Co. v. Convertible Top Replacement Co., 365 U.S. 336 (1961)); Wilbur-Ellis Co. v. Kuther, 377 U.S. 422, 424–25 (1964) (holding that refurbishing a fish-canning machine and adapting it to pack fish into five-ounce cans instead of one-ounce cans constitutes permissible repair); Fuji Photo Film Co. v. ITC, 474 F.3d 1281, 1297 (Fed. Cir. 2007) (holding that the legal distinction between repair and reconstruction does not hinge upon whether the element being replaced is deemed to be an “essential” or “distinguishing” part of the invention).

In addition, it has long been held that foreign sales of a product under a foreign counterpart of a U.S. patent do not exhaust the U.S. patent rights of the patent owner. Boesch v. Graff, 133 U.S. 697, 703 (1890).
set of rights. This, in a nutshell, is the exhaustion doctrine: the first sale exhausts the patent rights because normally that is what both parties are deemed to have intended at the time of sale, whether or not they expressed that intent.16

That the vast majority of commercial transactions involving patented products are of this ilk, however, is not a reason for prohibiting other ways of commercializing inventions. There is a fundamental difference between implying a license to use and resell when the first sale is unconditional and implying one when the patent owner has stated—clearly and unambiguously as was done in the Quanta case—that the sale of licensed components does not include a license to use them in a patented system without a separate license from the patent owner. In the first situation, the exhaustion doctrine is anchored in common sense and traditional commercial practices. In the latter, it is based only on formalistic incantation, uninformed by the purpose of the patent system or the needs of the parties. It is well settled in other contexts that the parties to a contract are permitted to override implied rights with express provisions.17

Three Anchoring Principles

A proper analysis of exhaustion can be grounded on three relatively uncontroversial principles that underlie the U.S. patent system. First principle: The U.S. patent system is one in which free market forces and their effects on a process of arms-length bargaining determine patent value. Stated differently, a patent owner is normally free to charge “whatever the market will bear” by way of a sales price or a royalty.18 Applied in a licensing context, this means that a patent owner should be permitted to capture value from its licensees in whatever form makes commercial sense. If a patent owner chooses to license one company to manufacture and sell a product embodying some or all of the patented invention, but not to pass on to the first purchasers a license to further use the product absent a further license, the patent owner should be permitted to do so because that may be the most efficient way to maximize the value of the invention. As long as the licensee understands and assents to such a condition, there is no compelling argument—rooted in either


Adding to the confusion that attends this subject is the Federal Circuit’s apparent treatment of the exhaustion question as separate and distinct from whether there is an implied license. In the Quanta case, the Federal Circuit dismissed the defendant’s claim of an implied license before addressing exhaustion because the manufacturing licensee, Intel, had informed its customers, the defendants, that they were not licensed for the uses to which the products were put. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1369 (Fed. Cir. 2006), cert. granted sub. nom. Quanta Computer, Inc., v. LG Elecs., Inc., 128 S. Ct. 28 (2007). There is no apparent need for this separate inquiry. The license itself made clear that Intel was not empowered to grant a use license to its customers for the accused systems. Id. Unless such a license restriction is unlawful, that should end the inquiry regardless of what the licensee did or did not do.

18 See Biotechnology Indus. Org. v. Dist. of Columbia, 496 F.3d 1362, 1372 (Fed. Cir. 2007) (“[T]he Patent Act creates an incentive for innovation. The economic rewards during the period of exclusivity are the carrot. The patent owner expends resources in expectation of receiving this reward. Upon grant of the patent, the only limitation on the size of the carrot should be the dictates of the marketplace.”) (quoting King Instrs. Corp. v. Perego, 65 F.3d 941, 950 (Fed. Cir. 1995)), reh’g & reh’g en banc denied, 2007 U.S. App. LEXIS 25351 (Fed. Cir. Oct. 30, 2007); Schor v. Abbott Labs., 457 F.3d 608, 610 (7th Cir. 2006) (“The price of NORVIR cannot violate the Sherman Act: a patent holder is entitled to charge whatever the traffic will bear.”), cert. denied, 127 S. Ct. 1257 (2007).

A few courts have, from time to time, expressed the erroneous view that excessive royalty demands by a patent owner may give rise to a form of patent misuse, rendering the patent unenforceable. See, e.g., American Photocopy Equip. Co. v. Rovicco, Inc., 384 F.2d 813 (7th Cir. 1967). In Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, 215 (1980), the Supreme Court held that a patent owner has no obligation to license its patent. Implicit in that holding is that the patent owner should be permitted to hold out for whatever royalty it chooses as long as the demand does not restrain trade in commerce beyond the scope of the patent or inhibit the development of competing technologies.
antitrust law or patent law—for prohibiting the arrangement. If the licensee wants a broader set of rights than the patent owner has offered, the licensee is free to offer more for the license in hopes of encouraging the patent owner to enlarge the scope. The property right, however, belongs to the patent owner, who should not be prohibited from capturing value from the marketplace in whatever form or fashion it chooses.

Second principle: The patent owner should be free to relinquish selectively its right of exclusivity to the various activities granted by statute, i.e., the rights to import, make, offer, sell and use the invention, unless to do so would violate antitrust or other laws. Since the beginnings of the patent system, courts have recognized that a patent owner can subordinate its exclusive rights in any manner it chooses. As noted by the Court in *Bement v. National Harrow Co.*, Notwithstanding [certain] exceptions, the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts.

Particularly illustrative of this principle is *General Talking Pictures Corp. v. Western Electric Co.*, where the Supreme Court held that use of a patented product in contravention of a license restriction imposed on a licensed seller was infringement. The patents in question covered sound amplifiers and had been licensed separately to a number of companies for various types of home use, with the restriction that licensed amplifiers were not to be sold for or used in commercial theaters. The latter market the patent owner reserved for itself. The defendant theater operator purchased its sound system from an entity licensed to sell only for amateur radio applications. It argued that the exhaustion doctrine nevertheless allowed theater use of the amplifiers because they had been manufactured by a licensee “under the patent” and sold “in the ordinary channels of trade” for full consideration. The Supreme Court disagreed, holding that the amplifiers at issue had not been made and sold under the patent because the field of use restriction limited the scope of the seller’s license. The defendant theater operator had notice of this restriction because the seller had included a “license notice” with each sale setting forth the restriction on use.

19 Of course, such a licensee may have an obligation to inform its customers that they cannot use or resell the product without a separate use license from the patent owner, but this is largely a matter of contract between the licensee and its customers, and not an issue necessarily involving the patent owner. It is elementary that a licensee cannot pass onto to a customer any greater license rights than it receives from the patent owner. See *Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544, 550 (1873) (“Persons, therefore, who buy goods from one not the owner, and who does not lawfully represent the owner, however innocent they may be, obtain no property whatever in the goods, as no one can convey in such a case any better title than he owns, unless the sale is made in market overt, or under circumstances which show that the seller lawfully represented the owner.”).

20 186 U.S. 70, 91 (1902). See also *Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456 (1873) (“The right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee.”); accord *Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964).

21 305 U.S. 124 (1938).

22 *Id.* at 127.

23 *Id.* at 125, 127.

24 *Id.* at 125. The dissent by Justices Black and Reed is noteworthy. Relying upon *Motion Picture Patents Co. v. Universal Film Co.*, 243 U.S. 502 (1917), a tying case, the dissent argued that a patent owner was not permitted to restrict the use of a product once it was sold. *General Talking Pictures*, 305 U.S. at 129 (Black, J., dissenting). The majority rejected this view in favor of the broader principle of freedom to contract. Whatever relevance the *Motion Pictures* case may have ever had was effectively eliminated with the passage of 35 U.S.C. § 271(d)(5),
Patent owners thus may license separately (or in some selected combination) the importation, manufacture, use, and/or sale of the invention.\(^\text{25}\) They may restrict the geographical territory and/or the field of use in which a license is effective, the duration of the license, and the customers to which the licensee may sell.\(^\text{26}\) They may license some claims of a given patent, but not others, or some but not all of their patents that relate to a given technology. In short, patent owners are given wide latitude to offer and bargain for a license that is appropriate for their particular industry.

Third principle: The exhaustion doctrine plays an extremely important role where the patent owner has failed to state, clearly and expressly, the limitations it seeks to impose upon its own sales or those of a licensee. As already noted, under these circumstances the sales contract between the first seller and the first buyer implies a license to use and resell without restriction that arises at the moment of sale for the agreed upon price. It is both unfair and commercially disruptive to allow the patent owner thereafter to change the rules and exact additional value from use or resale of the product.\(^\text{27}\)

In this connection, the Court must also keep in mind that it may not always be easy to ascertain whether the patent owner has been sufficiently explicit in limiting the license to overcome the implied right that buyers are otherwise entitled to assume. These issues can arise in many ways. At one extreme are cases like *Quanta*, where the agreement between LGE and Intel was explicit that the license did not extend to systems in which products of the licensee were combined with components supplied by unlicensed entities and where the buyers of the licensed components were fully aware of this restriction. This situation is virtually indistinguishable from that of *General Talking Pictures*. At the other extreme are cases in which the first sale is unrestricted and made under circumstances where the first purchaser is entitled to assume that it enjoys free and unrestricted control of the patented products. These situations can be seen in *Adams* and some of the other cases where exhaustion was found. Between these extremes, the number of possible variations is almost unlimited and reflects a continuum of factual issues that will often require careful analysis of what reasonable expectations attended the first sale.

It is only fair that ambiguity in the terms and conditions of any license restrictions should be charged against the patent owner, so that repose in commercial transactions is not disrupted. In addition, there may be further obligations imposed on a patent owner regarding notice to customers of its licensees. Although such issues will need to be worked out on a case-by-case basis, with attention paid to contemporary commercial standards and customs in the marketplace, they should not be predetermined through mere recitation of an ancient legalism.

**Addressing Mallinckrodt**

One decision of the Federal Circuit that has received much attention and criticism in this area is *Mallinckrodt, Inc. v. Medipart, Inc.*\(^\text{28}\) There, the Federal Circuit provided an extensive analysis of the exhaustion doctrine in the context of a patented device (a “nebulizer”) used for inhaling which provides that tying in a patent license cannot be challenged as anticompetitive unless the patent owner enjoys market power in the patented tying product.


\(^{27}\) In *Met-Coil Systems Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684 (Fed. Cir. 1986), the Federal Circuit refused to allow the patent owner, after the initial sale, to impose use restrictions on its customers, noting that the implied license to use arose at the moment an unrestricted sale was made. The court acknowledged that the same restriction imposed before the sale would have been proper. *Id.* at 686–87.

\(^{28}\) 976 F.2d 700 (Fed. Cir. 1992).
radioactive material for diagnostic or therapeutic purposes. Mallinckrodt sold the nebulizer, complete with a specified quantity of the diagnostic material, and included a “single use only” label restriction attached to the device and also in the packaging. A hospital to which the device was sold, despite knowledge that Mallinckrodt did not intend to license its patent for subsequent use of the device, nevertheless sent used devices to defendant Medipart for sterilization and other processing and then reused them. Like the hospital, Medipart was also aware of the restriction imposed by Mallinckrodt. The district court held, as a matter of law, that the exhaustion doctrine nullified any effect of the label restriction on the hospital’s license to use and enjoined Mallinckrodt’s efforts to provide additional notice to correct any contractual deficiency in that regard. The district court held that no cause of action could lie for patent infringement and declined to decide whether a contract cause of action might lie.

The Federal Circuit reversed, relying principally on General Talking Pictures, and held that the exhaustion doctrine was not controlling and could not be applied without first determining whether Mallinckrodt’s efforts to control subsequent use of its devices were contractually binding on the hospital as a license restriction. The court remanded for further consideration of these contract issues. In reaching its decision, the Federal Circuit addressed and rejected most if not all of the principal arguments for an expansive reading of the exhaustion doctrine that the Supreme Court will be considering in Quanta. Indeed, it appears to be more the Federal Circuit’s narrow treatment of exhaustion in Mallinckrodt that has motivated the SG to favor Supreme Court review in Quanta than the latter case’s relatively unremarkable facts.

A primary argument advanced by the SG for reversing the Federal Circuit in Quanta, and for rejecting the rationale of Mallinckrodt, harkens back to the 1942 decision of the Supreme Court in United States v. Univis Lens Co. There, the Antitrust Division challenged as an unlawful restraint of trade under the Sherman Act a licensing system created by Univis for the manufacture and sale of lenses for multifocal eyeglasses, which included control of the prices at which the lenses could be sold by licensed laboratories and resold by retailer opticians. Lens blanks covered by the Univis patent in question were manufactured and sold by a Univis subsidiary to finishing laboratories, which then completed the process of grinding them into lenses and resold the finished lenses to retailers. Univis, the patent owner, received its entire compensation in the form of royalties based on the price of the finished lens. The Supreme Court rejected this argument, invoking principally the exhaustion doctrine, and held the price restrictions to be per se unlawful. The Court concluded that sale of the blanks was an authorized sale that exhausted Univis’s patent rights. The Court gave no weight to the fact that purchasers of the blanks practiced the patent separately by grinding and polishing the blanks into finished lenses and that their customers also practiced the patent by selling the finished lenses at retail:

29 Unfortunately, the findings ordered by the Federal Circuit were never made because the Mallinckrodt case was settled a few months after the decision. 1992 U.S. Dist. LEXIS 22902 (N.D. Ill. 1992). In B. Braun Medical Inc. v. Abbott Laboratories, 124 F.3d 1419, 1426–27 (Fed. Cir. 1997), the Federal Circuit reversed a finding of patent misuse based on the defendant’s claim that the patent owner had imposed improper conditions on a customer’s use of a patented product, and it remanded for further findings on whether the conditions restrained trade that was not legitimately within the exclusive rights given to the patent owner.

30 316 U.S. 241 (1942).

31 Id. at 242.
An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold. . . . Sale of a lens blank by the patentee or his licensee is thus in itself both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure. In the present case the entire consideration and compensation for both is the purchase price paid by the finishing licensee to the Lens Company.32

Based on the fact that Univis had received its full pecuniary reward through royalties generated by sale of the blanks, the Court ruled that Univis could not lawfully impose price restrictions on sale and resale of finished lenses without violating Section 1 of the Sherman Act.33

Univis, as an antitrust decision, reflects an earlier era when the Court’s antitrust jurisprudence was far less grounded on sound economic principles than it is today. If Univis were before the Court today, the facts would likely be viewed in much the same way as those in Leegin Creative Leather Products, Inc. v. PSKS, Inc.34 Univis had developed an advanced technology for creating multifocal lenses for use in glasses. It believed, as did the defendant in Leegin, that the best way to market its lenses was to control the quality of production from glass blanks to finished lenses and also to maintain healthy margins as incentives for lens grinders and retailers to maintain and emphasize the quality of the product delivered to patients and to provide related fitting services. As in Leegin, there was no danger that the pricing policy would cause any lessening of consumer welfare or diminished output because Univis had no more than a 3 percent share of the market for multifocal lenses. Indeed, Univis had adopted its pricing policy primarily as a way of increasing its market share and therefore its contribution to the total output. To whatever extent the Supreme Court believes that Univis stands as an obstacle to simplification and rationalization of the law on exhaustion, it should overrule Univis, leaving to rule of reason analysis any antitrust inquiry into the competitive impact of license restrictions.

A footnote in the United States’ brief suggests that the SG’s principal concern in the Federal Circuit’s approach to the exhaustion doctrine lies in the danger that it expands the “scope of the patent defense” and thereby limits application of “rule-of-reason analysis to resale price maintenance agreements involving patented goods.”35 No citation is offered for this point and none is apparent. To the extent that a patent license raises antitrust concerns, nothing in the Mallinckrodt...
The decision precludes anyone from raising them.\textsuperscript{36} Indeed, in \textit{Mallinckrodt} the Federal Circuit observed that competitive effects outside the reach of the patent claims would be reviewable under a rule of reason antitrust analysis, but added that a patent owner should not be worse off than one selling unpatented goods merely because its goods are covered by a patent.\textsuperscript{37}

A number of the briefs filed on behalf of petitioner, including that of the United States, emphasize that the microprocessors at issue in the infringement allegations have no use other than as components of a larger system. Whether or not this is correct, it is irrelevant to whether there should be a per se exhaustion rule. Although the customer’s inability to use a product without a further license from the patent holder might be probative of whether the totality of facts surrounding a given transaction show an \textit{implied} license, where there are \textit{express} provisions limiting the ability of purchasers to use the product without a further license, the absolute rule urged by the SG and the \textit{Quanta} defendants runs contrary to basic principles of contract law.

Another argument made implicitly in the SG’s brief, and made more explicit in recent articles on the exhaustion doctrine, addresses the commercial fairness of allowing a patent owner to exact its compensation at multiple levels of the commercial process.\textsuperscript{38} This is really just a disguised way of saying that the patent owner should be required to take less for its technology than what the market is willing to pay. Such a result would be inconsistent with how Congress intended the patent system to operate, allowing inventors to derive pecuniary rewards for their discoveries and innovations from the free market.

\section*{Conclusion}

The issues in \textit{Quanta} are important. However the Court chooses to tackle the exhaustion question, the effort is likely to have far-reaching implications for the way in which patent property (and to a lesser extent copyrighted property) is exploited. One hopes that the commercial realities of today’s global economy and current economic learning will guide the Court’s work. A return to first principles is likely to be more useful in the long run than an opinion that tries to reconcile the multitude of conflicting outcomes and rationales that one finds in a century and a half of exhaustion cases. And while per se rules may provide unmistakable bright lines to parties structuring their transactions, such rules needlessly diminish commercial flexibility and complicate the ability of at least some patent owners to maximize the value of their inventions.

\textsuperscript{36} Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 703 (Fed. Cir. 1992) (“The conditions of such waiver are subject to patent, contract, antitrust, and any other applicable law, as well as equitable considerations such as are reflected in the law of patent misuse.”).


\textsuperscript{38} See, e.g., Mark R. Patterson, \textit{Contractual Expansion of Patent Infringement Through Field of Use Licensing}, (Fordham Law Legal Studies Research Paper No. 946413, Nov. 14, 2006), available at \url{http://ssrn.com/abstract=946413}. Mr. Patterson identifies a number of situations in which patent owners have employed restrictions on use, reuse, and resale to increase the profitability of their technology, including some in which he concludes that licenses actually increased the range of conduct that should be held to infringe. The authors have some difficulty understanding just how conduct that lies outside the scope of a patent claim can infringe. To the extent that patent licenses are used contractually to affect commerce outside the scope of what is patented, they must pass muster under a rule of reason antitrust analysis.
Why *Twombly* Does (and Should) Apply to All Private Antitrust Actions, Including Alleged Hard-Core Cartels: A Reply to William J. Blechman

Steven F. Cherry and Gordon Pearson

In the October 2007 issue of the *Antitrust Source*, William J. Blechman argues that the “general standard[]” for pleading a claim for relief recently affirmed by the Supreme Court in *Bell Atlantic Corp. v. Twombly*\(^1\) should not be applied to private antitrust cases involving alleged “hard-core cartels.”\(^2\) Mr. Blechman contends that extending *Twombly* to such cases is “unsound public policy” and would “chill[]” private antitrust litigation by effectively (1) precluding such lawsuits absent a prior, successful government prosecution and (2) limiting complaints to the “four corners of the government’s case.”\(^3\) Furthermore, he argues hard-core cartels operate in secret, and, thus, plaintiffs challenging such conduct “cannot reasonably be expected to know” enough facts before discovery to state a claim under *Twombly*.\(^4\)

Such concerns are unwarranted. In fact, *Twombly* itself involved a purported hard-core cartel—an alleged horizontal conspiracy among a small group of competitors not to compete and to allocate customers and markets. Moreover, the antitrust laws provide enormous incentives and tools to encourage private enforcement, and *Twombly* does nothing to diminish them.

While *Twombly* is unlikely to chill private antitrust enforcement, it should have a positive effect that benefits both plaintiffs and defendants, not to mention courts. As the Supreme Court intended, *Twombly* should encourage more careful investigation of claims before the filing of complaints, which in turn should both reduce the waste of private and judicial resources on ill-defined and overbroad claims that now plagues private antitrust litigation, and focus private enforcement on well-pleaded, factually supported claims.

**Bell Atlantic Corporation v. Twombly**

*Twombly* involved an alleged conspiracy to restrict competition in regional telecommunications markets. The plaintiffs, who sought to represent a class of “subscribers of local telephone and/or internet services,”\(^5\) alleged the regional telecommunications companies had illegally restrained competition by “agreeing not to compete with one another and to stifle attempts by others to compete with them and otherwise allocating customers and markets to one another.”\(^6\)

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3. *Id.* at 1, 5–7.
4. *Id.*
6. *Id.* at 1963 (quoting Am. Compl. ¶ 64).
The plaintiffs specifically alleged (1) the identities of the participating regional telecommunications companies, (2) the approximate time period of the conspiracy, (3) the services affected, (4) the opportunities for collusion between the companies due to their participation in trade and other organizations, and (5) a detailed description of the characteristics and history of the regional telecommunications industry that made it susceptible to cartelization. More important, the plaintiffs alleged the defendants had “engaged in parallel conduct unfavorable to competition,” including repeated failures to pursue “especially attractive” and “lucrative [business] opportunities” to compete by entering into each other’s regional market, and specific “wrongful acts” aimed at inhibiting competition from third-party providers.

The complaint also alleged (1) the CEO of one defendant stated “it would be fundamentally wrong” for the defendants “to compete,” even though they would likely profit from doing so; (2) a consumer group specifically accused defendants of illegal collusion; and (3) at least two members of Congress formally asked the Antitrust Division of the Department of Justice to investigate. Further, the complaint alleged the defendants engaged in “affirmative, deceptive practices and techniques of secrecy . . . to hide their wrongdoing . . . [and] actively misled Plaintiffs and the Class.”

Notwithstanding these allegations, the Supreme Court held that the complaint failed to state a claim. After noting “the Sherman Act ‘does not prohibit [all] unreasonable restraints of trade . . . but only restraints effected by a contract, combination, or conspiracy,’” the Court found the plaintiffs’ allegations, which focused primarily on the defendants’ parallel conduct, equally consistent with either conspiracy or independent action. The Court explained that “an allegation of parallel conduct and a bare assertion of conspiracy” does not by itself state a claim for relief under Section 1 of the Sherman Act. “[W]ithout some further factual enhancement” or “circumstance pointing toward a meeting of the minds,” the Court reasoned such allegations neither “raise a right to relief above the speculative level” nor offer “enough facts to state a claim to relief that is plausible on its face.”

Twombly Involved an Alleged Hard-Core Cartel
The hard-core-cartel label has typically been used to refer to conduct that is a per se violation of the antitrust laws—i.e., conduct that “always or almost always tends to raise price or reduce output.” A survey of enforcement authorities from eighteen countries recently found “widespread consensus” as to “the three common components” of a hard-core cartel: “1) an agreement;
2) between competitors; 3) to restrict competition.”

In his article, Mr. Blechman defines a hard-core cartel as “a relatively small number of firms engaged in a horizontal agreement not to compete through a variety of mechanisms, including fixing, maintaining, or stabilizing prices; restricting output; rigging bids; or allocating territories or customers.” In addition, Mr. Blechman states that a hard-core cartel “operates in secrecy,” and participants often attempt to conceal its existence, making such cartels “difficult to track, and thus difficult to prove.”

The alleged conspiracy in *Twombly* is plainly a hard-core cartel: five regional telephone companies secretly engaged in an alleged horizontal agreement not to compete through a variety of mechanisms, including allocating territories and customers. That the *Twombly* plaintiffs relied largely on “circumstantial” allegations of “parallel conduct” to show the alleged agreement does not mitigate the anticompetitive nature of the claimed conspiracy or otherwise distinguish *Twombly* from the typical hard-core-cartel case. To the contrary, the Supreme Court has long held such horizontal agreements to allocate customers and markets are “classic examples of a per se violation” of the antitrust laws, and nothing in *Twombly* suggests otherwise.

Moreover, while *Twombly* did not follow the announcement of an apparently related government investigation (as is often the case in private antitrust class actions), that likewise does not distinguish the alleged conspiracy in *Twombly* from other hard-core cartels. The mere fact the government has opened an investigation neither is itself evidence of the nature or scope of any antitrust conspiracy nor justifies an exception to the general pleading standard for a complaint that otherwise fails to state a claim. As Judge Alsup of the Northern District of California recently explained:

The [existence of a government] investigation . . . carries no weight in pleading an antitrust conspiracy claim. It is unknown whether the investigation will result in indictments or nothing at all. Because of the grand jury’s secrecy requirement, the scope of the investigation is pure speculation. It may be broader or narrower than the allegations at issue. Moreover, if the Department of Justice made a decision not to prosecute, that decision would not be binding on plaintiffs. The grand jury investigation is a non-factor.

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19 Hard-Core Cartels, supra note 2, at 3.


21 Indeed, *Twombly* cannot be distinguished in any meaningful way from other more recent hard-core-cartel cases. See, e.g., In re Elevator Antitrust Litig., 502 F.3d 47, 49–51 (2d Cir. 2007) (hard-core-cartel claim not plausibly supported by allegations of parallel conduct and unsupported assertions of agreement). Although the *Elevator* complaint included conclusory assertions of “fixing . . . price” and “rigging bids” along with “allocating markets and customers,” all three mechanisms independently indicate hard-core cartel conduct. Id.

22 The filing of the *Twombly* complaint, however, did follow the disclosure of a congressional request for such an investigation. See Am. Compl., supra note 5, ¶ 45.

In short, the *Twombly* plaintiffs asserted a classic hard-core cartel: a horizontal agreement between competitors to restrict competition; they just did not allege “enough facts” to support a plausible inference the cartel existed.

**Twombly Will Not Chill Private Antitrust Enforcement**

Any concern *Twombly* will chill private antitrust enforcement ignores the economic reality that drives such litigation. Congress, the courts, and the Antitrust Division of the Department of Justice have created financial incentives and strategic advantages that benefit antitrust plaintiffs and ensure vigorous private enforcement of the antitrust laws. *Twombly* leaves those incentives and advantages undiminished.

Such financial incentives include the ability to recover treble damages, as well as attorneys’ fees and costs. Moreover, a defendant cannot reduce the amount of damages by showing that a plaintiff passed on a portion of the alleged overcharge to its customer, even though that customer may also be able to recover the same damages from the defendant under state law.24 Liability is also joint and several with no right of contribution, which allows the plaintiff to pursue the deepest pocket (or pockets) for full recovery of damages attributable to all participants in the conspiracy.

The strategic advantages granted private plaintiffs provide unmatched aid to plaintiffs in developing and pursuing antitrust claims. To start, the Sherman Act tolls private claims during any government prosecution plus one year.25 This facilitates private enforcement because the public record from such proceedings can provide a treasure trove for plaintiffs searching for facts to support their claims. In addition, if the government obtains a final judgment or decree against a defendant in such proceedings, a private plaintiff can use it as prima facie evidence against the defendant in a follow-on private action.26

Even more important, the Antitrust Division’s extremely successful Corporate Leniency Program encourages companies to self-report antitrust violations to obtain full immunity from criminal prosecution.27 Outside the Leniency Program, companies are encouraged to provide additional evidence voluntarily to obtain a downward departure in criminal sentencing. These incentives substantially increase the frequency of public prosecutions, which in turn facilitates and assists private enforcement through public disclosure of antitrust violations.

In addition, the benefits of the Leniency Program often grow exponentially due to its related Amnesty Plus Program. Under Amnesty Plus, a defendant otherwise ineligible for full immunity for a particular violation can obtain a reduction in penalties for that violation by being first to report another violation for which it will also receive full immunity.28 This “plus” incentive can produce a cascade effect as the companies involved “clean house.” The Antitrust Criminal Penalty Enhancement and Reform Act of 2004 (ACPERA) further encourages self-reporting by substantially

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26 See id. § 16(a).
28 Id. at 13.
limiting civil liability for a qualifying company.\(^{29}\) To obtain that relief, a company must cooperate with the plaintiffs, providing witnesses and documents to help them build cases against the other defendants.

Joint and several liability with no right of contribution provides another valuable tool. Because a private plaintiff can recover full damages from just one or a few of the defendants, the plaintiff can offer an inexpensive settlement to one defendant before filing suit in exchange for cooperation against the other defendants.

Together, these financial incentives and strategic advantages “place[] the private antitrust litigant in a most favorable position.”\(^{30}\) They have produced a knowledgeable private antitrust plaintiffs’ bar with a long and successful history of zealously pursuing antitrust cases on behalf of consumers and small businesses.

*Twombly* does not in any way diminish these financial incentives and strategic advantages. So long as they remain to reward and assist plaintiffs, there is no plausible reason to conclude that *Twombly* will discourage private antitrust enforcement, at least as to well-founded claims.

**Twombly Will Not Prevent Plaintiffs from Pursuing Well-Founded Claims**

Even aside from the powerful financial incentives and strategic advantages provided to private antitrust plaintiffs that *Twombly* leaves unaffected, there is no reason to believe that a broad application of *Twombly* to hard-core-cartel cases will inhibit or restrict plaintiffs’ ability to pursue such cases.

Nothing in *Twombly* should delay private enforcement or prevent such actions from proceeding absent a successful government prosecution. Like plaintiffs in all other types of cases, private antitrust plaintiffs can conduct their own investigation, develop their own facts, and bring their claims before the government has completed its investigation. *Twombly* simply requires plaintiffs to allege enough facts to support a plausible claim for relief whenever they elect to file their complaints. The existence of a government investigation should not excuse that obligation.\(^{31}\)

Similarly, nothing in *Twombly* should confine private antitrust complaints to the “four corners of the government’s case”\(^{32}\) or otherwise limit the claims private antitrust plaintiffs can pursue. However, to the extent a plaintiff chooses to rely solely on the government’s prosecution for the factual allegations in his or her complaint, that plaintiff has no basis to assert claims or sue parties beyond the scope of the government’s case. Moreover, given the strong incentives for disclosure provided by the Leniency Program, including the availability of Amnesty Plus, the possibility of downward departures under the sentencing guidelines, and ACPERA, it is highly unlikely the government’s investigation will fail to uncover and disclose the relevant facts.

Further, that hard-core cartels generally operate in secrecy is no reason to restrict *Twombly*’s application. As noted, the combination of the Leniency Program and ACPERA’s cooperation...


\(^{31}\) The distinction between the role of government investigators and the role of private plaintiffs appears to be at the heart of the criticisms private antitrust plaintiffs and their counsel have leveled at *Twombly*. Of course, the government has the right to use its subpoena power to conduct wide-ranging investigations of an industry to determine whether to pursue legal action. Private antitrust plaintiffs have no such right. Like all other private plaintiffs, they must articulate at the outset the factual basis for their own personal claims that they have been harmed by the defendants. Only if those facts sufficiently state a plausible claim, should a court allow the litigation to proceed and impose the extraordinary costs of civil discovery on the defendants.

\(^{32}\) *Hard-Core Cartels*, supra note 2, at 7.
requirement, along with the threat of joint and several liability, give private antitrust plaintiffs substantial tools to uncover facts. It should also be noted that the Twombly complaint included explicit allegations of fraudulent concealment but that did not cause the Supreme Court to allow the plaintiffs any special leeway in pleading their antitrust claim.

**Twombly’s Potential Effect—Mitigating Unintended Consequences**

While it is unlikely Twombly will chill private antitrust enforcement, it may have a small, but potentially beneficial, systemic effect on how such litigation proceeds.

The very same financial incentives and strategic advantages that motivate plaintiffs to pursue private cartel enforcement also create costly and unintended consequences. In particular, the economic benefits that accrue to successful antitrust plaintiffs—especially in connection with class actions—engender robust and, at times, overzealous competition among plaintiffs to control the litigation. This competition often leads to wasteful litigation, unnecessary expense, and delay.

For example, the announcement of a government antitrust investigation too frequently commences a race to the courthouse as plaintiffs vie for leverage by filing numerous duplicative class action complaints as quickly as possible, often alleging nothing more than the fact of the investigation and conclusory allegations of collusive conduct. In many cases, however, the government’s investigation proves fruitless, undermining the only rationale for the private plaintiffs’ prematurely filed complaint. Even when the government’s efforts ultimately find an actual antitrust violation, the private plaintiffs’ initial complaints still frequently are overbroad and misdirected—e.g., brought by plaintiffs unaffected by the conspiracy, against many defendants that did not participate in it, or based on sales in the wrong product or geographic market or during the wrong time period. This occurs because, when plaintiffs rush to draft these initial complaints, they are essentially shooting in the dark with only vague press reports to guide them and a strong incentive to cast the widest possible net.

This leads to further waste as (1) plaintiffs’ counsel may hesitate to cooperate with opposing counsel to identify defendants and claims that should be voluntarily dismissed and stake out overly aggressive positions to demonstrate the “zeal” with which they will pursue the putative claims; (2) defendants seek dismissal of unsubstantiated and prematurely filed complaints; and (3) plaintiffs’ counsel, uninformed due to little or no pre-filing investigation, seek to identify facts to support a claim through overly broad and unfocused discovery. In addition, the potential for interference with any on-going government investigation will frequently arise as the various plaintiffs’ counsel often at the outset know of nowhere else to look for information about the putative claims.

But there is no reason for private antitrust litigation, or any litigation for that matter, to proceed in this fashion. As the Supreme Court made clear, Twombly did not create a “heightened fact pleading” standard applicable only to antitrust conspiracies based on parallel conduct. To the contrary, Twombly reasserted the “general standard[]” for pleading a claim for relief under Federal Rule of Civil Procedure 8(a) applicable to all claims, and then applied that standard to the Section 1 claim alleged. In so doing, Twombly clearly reaffirms the principle that a plaintiff and his or her counsel should bring claims only after a reasonable investigation (not before) and based on “enough facts” (not conclusory assertions) “to state a claim to relief that is plausible on its face.”

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34 Id. at 1964–65.
35 Id. at 1974.
Thus, *Twombly* has the potential to encourage an alternative scenario in which plaintiffs and counsel who seek a lead role in private antitrust class actions are not disproportionately rewarded by the court for being first in line, but instead receive consideration based on the pre-filing work they do to investigate and focus their allegations and potential claims. While such a hope may seem implausible, it aligns precisely with the recent amendment to Federal Rule of Civil Procedure 23(g), governing the appointment of class counsel. Rule 23(g) now provides that in appointing class counsel, the court must consider “the work counsel has done in identifying or investigating potential claims in the action.”36

Book Review

Microsoft in Detail

William H. Page and John E. Lopatka

The Microsoft Case: Antitrust, High Technology, and Consumer Welfare
University of Chicago Press • 2007

Reviewed by Jeffrey Prisbrey

With regard to the Microsoft case, believe it or not, there are some points which reasonable people can agree on.¹ For example, it is clear that Microsoft invested heavily in developing and marketing its browser and related software in order to counter the competitive threat Netscape’s browser and Sun’s Java represented to the dominance of Windows.² Microsoft integrated its Internet Explorer (IE) into its Windows operating system, priced IE at zero, and paid Internet service providers (ISPs) and computer manufacturers (OEMs) for distribution. Microsoft also created a modified version of Sun’s Java that was optimized for Windows and that would not interoperate with Sun’s version. But, beyond these points consensus becomes more difficult and the discourse more animated.

One of the problems is that a complete understanding of the case and of its antitrust context requires a detailed knowledge of the underlying facts and events. It is difficult to get a complete understanding, however, because the volume of information is very large. For example, the government’s interest in Microsoft dates back at least as far as the Federal Trade Commission’s 1989 investigation into Microsoft’s actions towards rival operating systems. The primary case, the one generally referred to as Microsoft, was initially filed by the Department of Justice and others in 1998. Microsoft was not finished until the court of appeals gave its final approval in 2004. In all there were more than 150 opinions issued in the antitrust cases against Microsoft.³ And that still did not settle everything. There was still private litigation to consider, and also proceedings by the European Commission and by other governments.

What the public discourse needs is a detailed and comprehensive source for the context, facts, and events that make up Microsoft. William H. Page and John E. Lopatka’s recent book, The Microsoft Case: Antitrust, High Technology, and Consumer Welfare, is one such source. It carefully presents all the required detail, starting with the antitrust context that gave rise to the government’s action and stepping through a careful description of the facts and events. The book is an extremely valuable compendium and worth reading for this information alone.

But, in addition to the raw information, Page and Lopatka also provide extensive and pointed commentary about the arguments made in Microsoft and the conclusions reached by the courts. The authors are not shy about their pro-Microsoft opinions, and they effectively use Microsoft and the arguments surrounding it to advocate an “evolutionary” or market-oriented position towards monopolization cases. In fact, it would not be unreasonable to conclude that Page and Lopatka’s main motivation for the book was to advocate for this evolutionary position, and that Microsoft was simply the vehicle for their advocacy.

In any case, along with informing the reader with welcome detail, they challenge the reader at every step and provide a book that will surely be a focus for more discussions to come. Following the structure of their book, I have summarized the most prominent facts, arguments, and opinions addressed by Page and Lopatka. My summary is not exhaustive; more detail is available in the book itself. I conclude by offering some additional points that provide balance to Page and Lopatka’s presentation.

**Historical Overview**

Page and Lopatka begin with a historical overview of monopolization cases in the United States. At a general level they argue that antitrust enforcement is influenced by two conflicting ideologies: the “evolutionary” camp that believes that free markets produce efficient outcomes without the help of government, and the “intentionalist” camp that believes that free markets produce “unfair outcomes” without government supervision.\(^4\) It is safe to say that Page and Lopatka fall into the evolutionary camp.

In their criticism of early decisions in such cases as Standard Oil and Alcoa, Page and Lopatka introduce two themes that they weave into later parts of the book. Their first theme is that market forces will generally act to counter anticompetitive monopoly conduct more effectively than the courts. Their second, and perhaps more important theme, is that the behavior of monopolists is not necessarily inefficient and that the courts may have difficulty telling inefficient behavior from efficient behavior. This second theme is the natural outgrowth of the Chicago School analysis. The Chicago School analysis concluded that practices like tying, exclusive dealing, and predatory pricing were not effective tools for maintaining a monopoly and that those practices were often efficient.

It was the development of post-Chicago School analysis that provided the underlying theoretical setting for Microsoft. Page and Lopatka write that the case “drew on a novel economic theory of network effects to support a claim of liability for product design decisions, tying arrangements, and exclusive dealing contracts, all practices long thought by Chicagoans to be efficient except in rare circumstances.”\(^5\)

**The Decisions**

Next, Page and Lopatka provide a very welcome and very detailed description of the court decisions that flowed from Microsoft. In Microsoft, the government argued, among other things, that “Microsoft’s practice of bundling IE with both Windows 95 and Windows 98, along with various provisions in its contracts with Internet Service Providers (ISPs), Internet content providers (ICPs), and OEMs, violated the antitrust laws.”\(^6\) A shorter version of the allegations is that Microsoft had

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\(^4\) Id. at 3.  
\(^5\) Id. at 22.  
\(^6\) Id. at 30.
crushed the competitive threats to its operating system that were posed by Netscape’s Web browser and Sun’s Java technologies.\(^7\)

Page and Lopatka provide a guide through the watershed events.\(^8\) After hearing the case, Judge Thomas Penfield Jackson largely ruled against Microsoft and adopted a set of remedies (stayed pending appeal) which, among other things, would have broken Microsoft into two firms, with one firm limited to operating systems and the other limited to applications. In 2001, the court of appeals reversed many of Judge Jackson’s decisions and remanded the case to Judge Colleen Kollar-Kotelly. After the remand, the United States and nine states settled with Microsoft on the terms of a consent decree. Then, after an additional hearing, Judge Kollar-Kotelly limited the non-settling states to essentially the same result as the settlement. The consent decree prohibited certain anticompetitive behavior, but did not contain any of Judge Jackson’s structural remedies. Judge Kollar-Kotelly’s decisions closely followed those of the court of appeals, and were upheld by the court of appeals in 2004.

Page and Lopatka describe each of the individual holdings made by Judge Jackson and whether or not these holdings were affirmed by the court of appeals (and by implication Judge Kollar-Kotelly) and why. They then turn to a more in-depth discussion of each of the key issues.

**The Markets**

The first key issue was how Microsoft, Netscape, Sun, and others interacted with each other and with consumers. What were the relevant antitrust markets? How did different software products compete with or complement each other? How would they compete with each other in the future? The answers to these questions provide the context needed to judge whether or not Microsoft’s actions actually harmed consumers.

As Page and Lopatka explain, the district court and the court of appeals both found that the relevant market at issue was for Intel-compatible PC operating systems.\(^9\) Both courts found that Microsoft had monopoly power in that market and that Microsoft’s monopoly was protected by network effects arising from the large set of applications written for Windows APIs.\(^10\) The open question, then, was whether or not Microsoft’s actions towards Netscape and Sun maintained its monopoly to the detriment of consumers.

Both Netscape’s browser and Sun’s Java were applications that provided APIs to other applications developers. These types of applications are known as middleware. Because both types of software provide APIs, middleware and operating systems are both platforms for other applications. As such, middleware and operating systems can compete with each other for the attention of applications providers. Does that mean they are in the same relevant antitrust market, or that they might be in the same relevant antitrust market in the future? The answer to this question is related to the theory of network effects.

Page and Lopatka divide network effects into two types: “direct effects,” where users benefit directly from the number of other users (as in a phone network where more users implies more potential calls) and “indirect effects” where users benefit because more complementary products are produced for larger numbers of users (as in an operating system where more users can pro-

\(^7\) Id. at ix.
\(^8\) Id. at 34–35.
\(^9\) Id. at 96.
\(^10\) Id.
vide increased incentives to applications developers). While they acknowledge the direct network effects from being able to share files with other users, Page and Lopatka conclude that, in the case of operating systems, indirect effects are more important than direct effects.\(^\text{11}\)

Page and Lopatka explain that network effects can lead to tipping if the networks do not interoperate, and therefore to a single dominant firm. In the simplest case, if a larger network provides more value to users, then users will only want to join the largest network. Because of this, competition for the first users will be intense because whichever firm wins those first users will win all the others due to the benefits of the network effect. This phenomenon is called tipping. Furthermore, once a market is tipped to a single dominant firm, that firm’s dominance may persist due to network effects even in the face of more efficient rivals.

As Page and Lopatka discuss, the network effects relevant in Microsoft are two-sided. All else equal, application developers have increased incentives to write applications for operating systems with more users. And, all else equal, users have increased incentives to use operating systems that support more applications. Together, these network effects are known as the applications barrier to entry.

Page and Lopatka criticize the courts’ final decisions about market definition. They write:

[O]ne could imagine defining a relevant antitrust market narrowly to include only Windows, on the ground that its substantial advantage in the number of applications supported [the applications barrier to entry] renders every other operating system incapable of constraining Microsoft’s power. Or one could imagine defining the market more broadly to include all platform software.\(^\text{12}\)

The court chose to do neither. Instead, the court chose to include non-Windows Intel compatible operating systems like BeOS in the relevant market, but not to include non-Intel based systems like the Mac OS. The authors take issue with the failure to include the Mac OS, but acknowledge that the conclusions about market power would not have been much different had the Mac OS been included.\(^\text{13}\)

More importantly, the court chose to exclude middleware from the market. The court “rejected Microsoft’s contention that all platform software, particularly the very middleware products that were the subject of its allegedly anticompetitive conduct, should be included in the market.”\(^\text{14}\) And yet, the court found that Netscape’s browser and Sun’s Java were nascent competitors.

The hair splitting here is very important. As Page and Lopatka point out, “[I]f middleware were in a completely separate market [that is, if they were not even nascent competitors], Microsoft’s actions taken against it could not be anticompetitive, and thus would not violate the antitrust laws.”\(^\text{15}\) A question that was left unanswered is what relevant antitrust market were Netscape’s browser and Sun’s Java actually in? Page and Lopatka explain that the failure to effectively address this question doomed the government’s allegations of tying and monopoly maintenance.\(^\text{16}\)

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\(^{11}\) Id. at 97. I am not convinced, however, that Page and Lopatka are correct in their conclusion. The direct network effects certainly include more than just the ability to share files. They also include the ability to collaborate and the ability to share operating systems and other software specific knowledge.

\(^{12}\) Id. at 100.

\(^{13}\) Id. at 102.

\(^{14}\) Id. at 100.

\(^{15}\) Id. at 105.

\(^{16}\) Id. at 109.
Microsoft’s Bundling and Integration of Software

According to Page and Lopatka, Microsoft’s bundling and integration of IE and Windows constitute “the most important issue both for the case itself and for the future of antitrust in high technology markets.” Judge Jackson initially found that many of Microsoft’s bundling actions were anticompetitive, but the court of appeals overturned many of those findings. Page and Lopatka remind us that the key to understanding the final decisions is to recognize that “harm to competition should be measured by harm to consumers rather than harm to rivals.”

In particular, Judge Jackson found that the following categories of Microsoft actions had violated antitrust laws:

- Licensing Windows and IE as a bundle at a single price;
- Contractually prohibiting OEMs from removing easy access to IE from the Windows desktop, and excluding IE from the Windows Add/Remove Programs utility, making the removal of easy access to IE more difficult;
- Overriding users’ choices of a default browser in favor of IE in certain cases; and
- Comingling IE and Windows code in the same library files, making the removal of IE functionality more difficult.

Microsoft defended its actions by describing how they benefited consumers:

1. Microsoft argued that the simple bundling of Windows and IE at a single price benefited consumers by reducing the cost of acquiring IE. And, because the additional price for IE was zero, consumers were not forced to make a sunk investment in IE that hindered them from choosing a rival browser.

2. Microsoft argued that preventing the removal of easy access to IE and excluding IE from the Windows Add/Remove Program utility allowed it to maintain control over the integrity of its Windows desktop and prevent unnecessary user confusion. Furthermore, Page and Lopatka add that these actions prevented OEMs from removing easy access to IE and making a preemptive browser choice for consumers. Thus, paradoxically, they argue that these steps taken by Microsoft to limit what OEMs and consumers can do may actually have improved consumer choice.

3. Microsoft argued that overriding a user’s default browser was helpful in certain contexts—for example, when the user invoked Windows Help functions, or when the user tried to access the internet using a Windows specific utility. According to Microsoft, other browsers would not work properly in these contexts, so overriding the default was helpful to the consumer.

4. Microsoft argued that comingling IE and Windows code in the same library files allowed it to offer a more complete set of APIs to applications programmers at little to no cost to consumers.

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17 Id. at 115.
18 Id. at 117.
19 Id. at 116.
20 Id. at 138.
21 Id. at 136–37.
22 Id. at 142–43.
23 Id. at 144.
24 Id. at 145–46.
25 Id. at 118, 124–25.
In the end, the final judgment as approved by the court of appeals only prohibited actions in category two, and partly prohibited actions in category three.26 The court concluded that preventing the user from removing access to the browser or browser code was anticompetitive because it limited consumer choice (and thereby the number of Netscape users) without providing an obvious benefit to consumers.27

Page and Lopatka take issue with these findings in general, however, because they do not consider the long-term effect of Microsoft’s actions on consumer welfare. Given the way the court had defined the relevant market to be Intel-based PC operating systems, none of these actions affected an actual competitor. At best, the actions affected a potential competitor, and that, in Page and Lopatka’s view, is not enough. They believe that the court should have required further proof of Netscape and Java’s potential competitive significance, proof that they think would not have been forthcoming. They conclude that “because the browser could not have evolved into a platform that reduced network effects in the operating system market, Microsoft’s actions to integrate the browser and the operating system did not cause a reduction in competition.”28

Market Division, Exclusive Contracts and Java

Page and Lopatka next describe Microsoft’s proposal to Netscape to divide the browser market. Microsoft proposed to provide support for Netscape’s products, to invest capital in Netscape, and to not compete for non-Windows 95 browsers if, in return, Netscape would not compete for Windows 95 browsers. If Netscape did not agree, Microsoft threatened to withhold competitively important technical information.

Microsoft’s market division proposal was seen by some as an indication of Microsoft’s anti-competitive intent. It was only after the proposal was rejected by Netscape that Microsoft integrated IE and Windows and contractually limited OEMs and others in ways that restricted their ability to distribute Netscape’s browser. Although Judge Jackson found that Microsoft’s proposal was an illegal attempt to monopolize the market for browsers, Page and Lopatka explain that the court of appeals did not examine the conduct because it found that the government had failed to define a relevant market for browsers.29

Microsoft also entered into contracts with certain third parties to promote IE exclusively and to limit their distribution of Netscape’s browser. And Microsoft entered into other contracts that had third parties promise to make IE the default browser for certain software and to use the Windows HTML help function. Page and Lopatka claim that these contracts all involve exclusivity of some sort, and that for exclusivity to be competitively harmful it must “appreciably increase competitors’ distribution costs.”30 They characterize these contracts as having little effect on competition, but also as having no obvious efficiency justification.31

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26 Id. at 117.
27 Id. at 148.
28 Id. at 155.
29 Id. at 177.
30 Id. at 187.
31 Id. at 184.
Page and Lopatka next turn to a discussion of Java. They report Judge Jackson’s finding that, in an effort to suppress Sun’s Java, Microsoft had illegally

created an implementation of Java that was incompatible with Sun’s cross-platform implementation; it tricked developers into unwittingly writing Java applications that used Windows-specific Java; it offered valuable consideration to developers for making Microsoft’s JVM the default and in one case the exclusive JVM used and distributed by their Java applications; and it thwarted the creation of cross-platform Java interfaces by pressuring Intel to stop developing them.\(^{32}\)

Yet, Microsoft’s modifications to Java had at least some clear consumer benefits. Because of this, the court of appeals did not find the modifications to be anticompetitive. Page and Lopatka write that “for the appellate court, the decisive fact was that Microsoft’s implementation was better than Sun’s along a relevant dimension—specifically, speed.”\(^{33}\)

Page and Lopatka call the appellate court’s reasoning on the Java issue “unprincipled” and argue that the court should have used a balancing test comparing the benefits of Microsoft’s improvements to Java to any alleged harm to competition.\(^{34}\) After all, a balancing test is what the courts used when judging the merits of improvements due to Microsoft’s integration of IE and Windows.

**Remedies**

Page and Lopatka bring their discussion of Microsoft to a close with an examination of the different proposed remedies, from the structural remedies initially adopted by Judge Jackson but later reversed, to the conduct remedies eventually approved by the court of appeals. From the beginning of their examination, it is clear that Page and Lopatka are skeptics. They write that “neither structural nor conduct remedies in monopolization cases have done much to increase consumer welfare.”\(^{35}\) In any case, they argue that courts should focus on “interdicting specific offenses” when designing remedies.\(^{36}\) Remedies should not seek to restore “some economic utopia but the market that would have existed had the defendant not engaged in anticompetitive behavior.”\(^{37}\)

It does appear that some of the proposed structural remedies went beyond interdicting specific offenses and may have done more harm than good. According to Page and Lopatka, for example, a horizontal divestiture that created multiple operating system companies (“Baby Bills”) would have destroyed the network effects that were so valuable to consumers.\(^{38}\) Similarly, a vertical divestiture that created an operating system company and an applications company would have created double marginalization and potentially destroyed other production efficiencies.\(^{39}\) And perhaps more to the point, Page and Lopatka argue that these proposed structural remedies had little relationship to the actions found to be anticompetitive.

\(^{32}\) Id. at 193.

\(^{33}\) Id. at 195.

\(^{34}\) Id. at 197–98.

\(^{35}\) Id. at 204.

\(^{36}\) Id. at 205.

\(^{37}\) Id.

\(^{38}\) Id. at 207.

\(^{39}\) Id. at 209–10.
For the most part the court of appeals is in agreement with that argument. Thus, the remedies reflected in the final consent decree were limited, except in a few instances, to restrictions on conduct that the court of appeals held to be illegal. For example, Page and Lopatka list the following remedial restrictions from the final consent decree: 40

- Microsoft was prohibited from the sort of retaliation and threats used to induce firms to stop supporting or developing competing technologies.
- Microsoft must provide Windows to OEMs under uniform licenses, for a single published royalty, thus prohibiting discrimination against OEMs that deal with Microsoft’s rivals.
- Microsoft cannot form contracts with Internet service providers, Internet access providers, or Internet content providers that require those firms to refrain from distributing competing software.
- Microsoft must permit OEMs to configure the Windows desktop and boot sequence in ways that promote competing software.
- Microsoft must permit OEMs and end-users to delete easy access to Microsoft middleware.
- Microsoft must provide the means to delete easy access to certain specific products, including IE and Microsoft Media Player.
- Microsoft must allow other middleware to be designated to launch in the place of Microsoft middleware (except when connecting to a Microsoft server or when a rival’s product cannot technically provide the required functionality).

Significantly, Microsoft was not required to provide the means to remove middleware code that had been com mingled with Windows operating system code.

Page and Lopatka conclude their section on remedies with a discussion of the damages awarded to competitors, OEMs, and consumers in the private follow-on litigation. In doing so, they delve briefly into the various damages theories and issues revolving around class certification.

Counterbalancing Comments

Page and Lopatka have written a valuable book about Microsoft. Not only does the book provide a comprehensive and valuable source for the context, facts, and events that make up Microsoft, but it also challenges the reader with its extensive and pointed commentary on the arguments made and the conclusions reached. I recommend it as part of the required reading for anyone interested in Microsoft and the discussions that surround it.

However, while Page and Lopatka’s analysis of Microsoft is challenging and assured, it is fundamentally one-sided. In this section, I balance some of their analysis with basic counter-arguments made by the government. A fair interpretation of the issues is not possible without also understanding the government’s analysis. 41

Perhaps the key issue in Microsoft was how Microsoft, Netscape, Sun, and others interacted with each other and with consumers. In considering these interactions, Page and Lopatka focus on the courts’ determination of relevant markets. As I noted above, Page and Lopatka criticize the courts’ determination of a relevant market for Intel-compatible PC operating systems. Furthermore, they argue that if Netscape and Sun were in different relevant antitrust markets from Windows,

40 Id. at 214–17.
then Microsoft's actions could not be anticompetitive. The main thrust of Page and Lopatka's analysis depends upon market definitions (or lack thereof) rather than a direct analysis of competitive effects.

An alternative view of the interactions is presented by Franklin M. Fisher and Daniel L. Rubinfeld, who were economic experts for the government. They argue that Netscape's browser and Sun's Java were clearly not in the same market as Intel-compatible operating systems. A user of an Intel-compatible computer could not substitute a browser for the operating system. Instead, Fisher and Rubinfeld argue that Netscape's browser and Sun's Java were complements to Windows.

However, when considering the competitive effect of Microsoft's actions, Fisher and Rubinfeld argue that even as complements (or because they were complements) Netscape's browser and Sun's Java were threats to Windows. They were threats because the applications barrier to entry did not protect Windows from encroachment from complements. Fisher and Rubinfeld write:

If enough users acquired Navigator or Java, then applications writers might find it tempting to write for them. If that happened to a great enough extent, then it might not matter what operating system ran underneath them. In Microsoft's words, the operating system would become "commoditized," and the applications barrier to entry would be gone. Thus, Navigator and Java were facilitating devices that had the potential to aid the entry of competing operating systems. The competition that Microsoft feared would come from that entry and not directly from Navigator and Java.

Thus, Fisher and Rubinfeld argue that Microsoft's actions towards Netscape's browser and Sun's Java protected the applications barrier to entry and therefore contributed to the maintenance of Microsoft's monopoly. They claim their argument does not depend upon the exact definition of markets, but upon the direct analysis of competitive effects.

Furthermore, Fisher and Rubinfeld argue that evidence of intent should be considered when determining the nature of competitive effects, while Page and Lopatka caution against its use. Fisher and Rubinfeld write that "where the defendant claims to have taken its actions for other, pro-competitive ends, clear contemporaneous statements about intent can assist in evaluating that claim." They argue that "Microsoft's internal documents make clear that Microsoft undertook its browser development not to make money from browsers, but to prevent Netscape's browser from facilitating competition with Microsoft's monopoly operating system." They conclude that the evidence shows that Microsoft's intent was anticompetitive.

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42 Note that, while I was an economist in the Antitrust Division of the Department of Justice during part of these proceedings, I had no role on the Microsoft case.

43 Fisher & Rubinfeld, Misconceptions, Misdirections and Mistakes, supra note 41, at 89.

44 Fisher & Rubinfeld, United States v. Microsoft: An Economic Analysis, supra note 41, at 15.

45 Fisher & Rubinfeld, Misconceptions, Misdirections and Mistakes, supra note 41, at 89. For another view of the market interactions that is similar to Fisher and Rubinfeld's, see Tim Brennan, The Legacy of U.S. v. Microsoft, Regulation, Winter 2003–2004, at 22–28. Note that Page and Lopatka do discuss this theory and, in fact, mention Bill Gates's fear that Navigator would "commoditize the underlying operating system." Page & Lopatka, supra note 3, at 64–66, 97.

46 Fisher & Rubinfeld, Misconceptions, Misdirections and Mistakes, supra note 41, at 90.

47 Page & Lopatka, supra note 3, at 200.

48 Fisher & Rubinfeld, Misconceptions, Misdirections and Mistakes, supra note 41, at 94.

49 Fisher & Rubinfeld, United States v. Microsoft: An Economic Analysis, supra note 41, at 19.
The fact that there is an inherent potential harm to competition in certain markets with network effects is something that Page and Lopatka acknowledge in their discussion of tipping and path-dependence.50 They acknowledge that network effects can cause barriers to entry which lock the market into an inefficient outcome. Does such a potential provide the grounds for government intervention regardless of the actions of the monopolist? One might think that the government has a duty to help markets avoid such inefficient outcomes.

In my opinion, when these network effects occur, actions on the part of the monopolist that reinforce the barrier to entry must be viewed with skepticism. It is not enough to simply point to immediate consumer benefits from the actions. In addition, the potential implications of the actions on the continuing presence of the barrier to entry must be accounted for.

Fisher and Rubinfeld make this point generally when they caution that any conclusion that focuses solely on present consumer harm misses the anticompetitive potential of every predatory act. They write:

Predatory campaigns can offer immediate consumer benefits. A firm that prices below cost to drive out rivals and earn or protect monopoly rents does so by offering consumers a deal that is, in effect, too good to be true. During such a campaign, consumers benefit from the low prices. If a showing of present consumer harm were required, no predator could be stopped until after the campaign was over, when it might well be too late to avoid substantial consumer harm.51

Page and Lopatka certainly believe that it is necessary to balance the different long run effects of an alleged anticompetitive act. But, in their opinion, the ability of Netscape’s browser and Sun’s Java to erode the applications barrier to entry was purely “speculative.”52

50 PAGE & LOPATKA, supra note 3, at 94.
51 Fisher & Rubinfeld, Misconceptions, Misdirections and Mistakes, supra note 41, at 88.
52 PAGE & LOPATKA, supra note 3, at 150.
Book Review
Antitrust Lessons for India
Vinod Dhall, editor
*Competition Law Today: Concepts, Issues, and the Law in Practice*
Oxford University Press India • 2007

Reviewed by Ronald W. Davis

In the Spring 2007 issue of *Antitrust* magazine, Professor Eleanor Fox wrote about “India: The Long Road to a Full-Function Competition Law,” and Vinod Dhall, Member of the Competition Commission of India and editor of the volume under review, wrote about “Competition Law in India,” summarizing India’s Competition Act of 2002.¹ The (relatively) new statute is intended to replace an earlier enactment that addressed the monopoly problem by, among other things, requiring bureaucratic approval for large firms to expand. By contrast, the new law deals with anticompetitive agreements, abuse of dominant position, and business combinations in more familiar ways and will raise far fewer eyebrows among the worldwide antitrust community.²

Despite the modernity of the new substantive provisions, the long, long road that Professor Fox described is still awinding, as underlying ideological and political conflicts continue to promote institutional inertia and delay the implementation of the substantive provisions of the new Competition Act. In this context, while Mr. Dhall’s new book, *Competition Law Today: Concepts Issues, and the Law in Practice*,³ has many features of interest to international readers, one gleans that among its major objectives must be to inform Indian decision makers and opinion leaders about how competition law works in a variety of other jurisdictions and thereby to encourage a movement in India toward international best practices—in short, antitrust benchmarking.

The work’s twenty-five chapters—all, apparently, prepared expressly for this book—are written by experts with superlative credentials, including senior enforcement officials, professors, and competition lawyers Some will be familiar to American readers: Valentine Korah, Eleanor Fox, and Stephen Calkins, for example—the last of whom would surely be my number one pick to cover “Competition Law in the United States of America” in only twenty-four pages.

Part I features ten chapters on the major substantive and policy issues of world competition law. The work opens with an overview, written by the editor, on “Key Concepts in Competition Law,” which packs a surprising amount of information into thirty-five pages, including a number of use-


² More surprising is a 2007 amendment on premerger notification that reads like Hart-Scott-Rodino on steroids, and has evoked carefully phrased but pointed comment, See Joint Comments of the American Bar Association’s Section of Antitrust Law, Section of Business Law and Section of International Law on Implementing Regulations for and Amendments to the Merger Control Provisions of India’s Competition (Amendment) Act, 2007 (Nov. 2007), available at http://www.abanet.org/antitrust/at-comments/2007/11-07/Comments-Indian Competition.pdf.

ful insights on the relevance of competition law for developing countries. In the next chapter Richard Whish’s discusses the law of cartels and anticompetitive agreements, focusing on areas of agreement, and debate, in respect of cartel enforcement. Mr. Whish is careful to place the subject in its historical context—for example, the “Constitution of Zeno of AD 483 punished price fixing in relation to clothes, fishes, sea urchins, and other goods with perpetual exile, usually to Britain.”

The chapter on cartels is complemented by another on leniency programs, authored by Paul Crampton and Graham Reynolds.

In keeping with the analytical difficulty and controversy surrounding issues of monopoly and dominance, Robert Anderson and Alberto Heimler lay out the issues in some detail, focusing on the EU and the United States. Writing on merger control, Alan Goldberg offers a very succinct international comparison of substantive and procedural issues, with many examples from Australia. Valentine Korah writes lucidly on the IP/competition law intersection, with particular reference to India.

The chapter by R. Shyam Khemani on antitrust exemptions and exceptions begins with an international comparison of competition law exemptions so detailed that one despairs of finding common threads. Then, when hope is almost lost, the author pulls it together by summarizing the rationales for competition law exceptions (balancing unequal bargaining power, reducing risk and uncertainty, etc), and concludes with six policy recommendations. Philip Lowe and Geraldine Emberger offer a meaty treatment of competition of competition advocacy by enforcement agencies, Alan Fish addresses competition and regulation, and Lennart Göranson offers up some very provocative thoughts on what success for a competition authority looks like.

Eleanor Fox concludes part I’s overview of substantive and procedural issues with a chapter on “World Competition Law—Conflicts, Convergence, Cooperation,” elaborating on “negative comity” and its limitations as a means of harmonization; the need for global solutions to global problems: “The whole is not the sum of the national-interest parts.” she declares. Professor Fox’s chapter surveys bilateral and multilateral cooperation agreements, and describes in some details her views on the question of global antitrust convergence.

Part II has eight chapters describing the competition regimes of as many jurisdictions. The treatment of this topic cannot be described as comprehensive or encyclopedic, because if eight are included, more than ninety—notably including Canada and Japan—are omitted. One may infer, I think, that the editor’s purpose is not to provide a detailed handbook for the international antitrust practitioner, but rather to give the reader a feel for the common factors in 21st century antitrust by looking at representative jurisdictions. To that end, each chapter describes the history and background of the jurisdiction it addresses, as well as its substantive and procedural law, but the style and focus differ from chapter to chapter.

Sitesh Bhojani provides an extended discussion of jurisprudential issues and a summary of leading cases in Australia. Michael J. Reynolds, writing on the EC, is particularly strong in his discussion of current modernization initiatives. The chapter on Germany, authored by Ulf Böge, features a meaty discussion of cartel enforcement, dominance, and mergers, with illustrative case examples.

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4 Id. at 41.
5 Id. at 231.
In Alberto Pérez Motta’s chapter on Mexico we learn—via a quote from a report from the Organisation for Economic Co-Operation and Development (OECD)—that the Mexican statute’s “elegant organisation and clear conceptualisation reveal its origin as a product of technical expertise, rather than populist adventurism or political compromise.” Despite this observation by the OECD, evidently intended as a compliment, the author provides a candid assessment of the pros and cons of the antitrust regime in Mexico. As with the Australia chapter, he also gives case summaries.

Writing on South Africa, David Lewis gives a particularly interesting account of how antitrust helped that country achieve liberation from the economic effects of apartheid and protectionism. He also provides an extended discussion of the advisability of opposing anticompetitive mergers. The following chapter, on Korea, by Youngjin Jung, provides a rather dramatic contrast: here a central concern is not apartheid but rather a perceived need to place reins on the chaebol (conglomerates). The author explains how, in consequence, competition regulations are adopted—without definition and assessment of a relevant market—in order to keep financial capital separate from industrial capital and thus to avoid chaebol dominance of the national economy. The author sees a potential conflict between regulating chaebol and promoting efficiency through more traditional antitrust enforcement. Christopher Bellamy gives a straightforward summary of competition law in the UK, focusing on recent efforts to bring UK law into line with EC law. Part II concludes on a particularly high note, with Stephen Calkins’s short and breathless but informative romp through U.S. antitrust history, procedure, and substance.

Part III addresses, in three chapters, economic and other policy considerations in connection with competition law—issues that, from an American perspective, it is surprising to see treated almost as an afterthought. Dando B. Cellini writes a short essay on the reasons for the increasing role of antitrust law around the world. Amit Bubna and Shubhashis Gangopadhyay treat “The Economics of Competition Law” in a well written but breathtakingly short thirteen pages. And Simon J. Evenett gives us an interesting chapter on the intersection of competition policy and industrial policy, with a number of practical suggestions on how competition agencies might usefully respond to industrial policy initiatives that reduce allocative efficiency (e.g., a proposed merger to monopoly for the purpose of creating a national champion).

Part IV, focusing on India, concludes the work. Amitabh Kumar provides historical perspective on “The Evolution of Competition Law in India.” The final chapter is by the editor, Vinod Dhall, and provides extended treatment of the Competition Act of 2002, giving, among other things, comprehensive commentary on the sources for, and the construction of, the act’s substantive provisions, commentary that will no doubt prove valuable to practitioners as and when those provisions become effective.

It is to be expected—and certainly to be hoped—that this work will prove highly useful in India, as that country completes the work of antitrust modernization. Moreover, as noted above, it will likewise be interesting and useful to many in the antitrust community outside India, particularly to those involved in planning and implementing new antitrust regimes around the world.

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7 DHALL, supra note 3, at 327.
Paper Trail: Working Papers and Recent Scholarship

Editor’s Note: In this issue we feature one paper that argues for the addition of networks as a third classification of antitrust practices, alongside vertical and horizontal restraints, and one paper that discusses how the FTC staff operationalized the analysis of entry barriers as described in the Merger Guidelines. Send suggestions for papers to review, or your comments, to: page@law.ufl.edu or jwoodbury@crai.com.

—William H. Page and John R. Woodbury

Recent Papers

George L. Priest, Rethinking Antitrust Law in an Age of Network Industries
(Yale Law & Economics Research Paper No. 352, 2007), available at SSRN:

The title of this paper by Professor George Priest of the Yale Law School is literally accurate, but understates the scope of its argument. In the main part of the paper, Priest examines three of the Antitrust Division’s most prominent recent challenges to practices in network industries. But he also argues for a broader reinterpretation of older precedents to take account of network interpretations of the practices at issue. Most fundamentally, he argues for the addition of networks as a third classification of antitrust practices (and prototypical cases) alongside vertical and horizontal restraints.

Priest begins by reviewing the basic economics of network markets. Network effects are economies of scale on the demand side. Their key characteristic is that the addition of new users to the network confers an external benefit on existing users. This benefit can arise directly in two-way communication networks and indirectly in markets for durable goods with which a variety of highly complementary products are used over the durable goods’ useful life. In these circumstances, if the new user must pay the full cost of joining, the network will not reach the optimal size. The antitrust question these phenomena most often raise, according to Priest, is whether a practice “represents a strategy to overcome the consumer’s inability to capture the positive externalities that results from his or her decision to join the network or the positive externalities that derive from other actions that might expand networks.”

Priest suggests that these characteristics of network markets require a “reversal of presumptions” about the effects of some familiar practices. Vertical restraints, for example, are traditionally viewed as most problematic when firms with market power use them to increase market share. In network markets, however, high market shares are normal and the use of various practices to increase the size of the network may actually enhance social welfare. Horizontal arrangements like product standardization and mergers also may be more likely to be socially beneficial in network markets than in others. Finally, below-cost pricing is “inevitable” in network industries, at least at certain stages of their evolution, because the cost to the consumer of joining the network is greater than the sum of the private and social gains from adding the consumer.
With this introduction, Priest criticizes three recent public enforcement actions in network markets. First, he argues that both the Antitrust Division and the court erred in the predatory pricing case against American Airlines by focusing narrowly on the definition of incremental costs and failing to “take account of the network character of the airline industry.” Airlines create hubs in order to aggregate traffic to and from numerous locations “to support more frequent service to smaller spoke cities.” Air travelers receive a network benefit from this strategy’s linkage of more spoke cities with more flights. Traditional predatory pricing standards do not address the distinctive issues in cases involving competition between an airline that supports a hub-and-spoke network with low-cost airlines that “siphon” off travelers on more heavily traveled routes. Priest argues that the appropriate question in such cases is whether competition from low-cost carriers reduces social welfare by preventing the maintenance of a network. He suggests that the fact that air travelers in the American Airlines case preferred the hub airline over the low-cost carrier at the lower fares suggests that consumers valued the network benefit that the hub airline provides.

The credit card industry is also a network because of the benefits that wider use of the card confers on both participating merchants and cardholders. There is competition both between and within card networks for acquisition of merchants to accept cards and the issuance of cards to consumers. The Antitrust Division persuaded the courts that Visa and MasterCard violated the antitrust laws by forbidding their member banks from also issuing American Express and Discover cards. Priest argues that this argument failed to account for the network nature of the market, in which large market shares are to be expected, but the most important competition is among networks. According to Priest, exclusivity provisions are ubiquitous in franchise networks, because they align the incentives of the franchisees with those of their network and against other networks.

The Antitrust Division did rely on network effects theory in the Microsoft case, but, according to Priest, did so incorrectly. The government contended that Microsoft had a monopoly of operating systems for Intel-compatible PCs that was protected by network effects, or an “applications barrier to entry.” Even though the government conceded that Microsoft acquired this position lawfully, it argued that that Microsoft’s effort to improve its network by adding a browser was monopolistic because it hindered the possible emergence of a rival platform.

Priest argues that the government’s case, which the district court endorsed, failed to show that the emergence of a rival platform would benefit consumers more than the enhancement of an existing network that had “emerged naturally.” Priest criticizes the court of appeals for affirming certain aspects of the district court’s decision without considering network benefits the practices may have had. Nevertheless, he endorses the court of appeals’ recognition of network considerations in its adoption of a rule of reason analysis for tying in the market for platform software.

After his review of recent cases, Priest undertakes to show that numerous familiar antitrust precedents had network characteristics that the conventional wisdom fails to recognize. He offers brief but provocative network interpretations of the early railroad cartel cases, Dr. Miles, Terminal Railroad, the trade association cases of the 1920s, Chicago Board of Trade, Associated Press, BMI, Radiant Burners, NCAA, and Aspen Skiing. For example, he notes that the usual point-of-sale services explanation for resale price maintenance does not explain Dr. Miles itself, which involved the sale of sketchy “potions.” Instead, he asks us to conceive of the distributors of the product as a network that requires the subsidy of resale price maintenance to achieve the optimal size.

In a final section, Priest proposes a recategorization of antitrust precedents, in which many of the cases he discusses are viewed as prototypical of a new class of network cases. In this kind of case, Priest argues, courts should:

(a) Expect large market shares based upon the extent of network benefits;
(b) Expect subsidized pricing in some form;
(c) Expect other practices that serve to expand the network in order to capture network benefits.

Evidently, these market phenomena should not be presumed to be suspicious. Moreover, courts should

Evaluate practices as to whether they are network expanding in single network contexts or competition expanding where competing networks can survive. The ultimate economic question is whether there is a net increase in welfare from expansion of the network versus the reduction in alternative output.

As Priest recognizes, these questions will be difficult to answer in litigation, so the import of this recategorization will depend in large part on how the courts allocate burdens of proof.

—WHP


Video gamers have mixed feelings about this time of the year (i.e., the holiday season). On the one hand, video game companies release their most promising games during the holiday season. On the other hand, the companies are so pressured to release the games during the holiday rush that the games themselves are rushed out of the development door before being sufficiently tested. Potentially great games fail to meet expectations because of this rush (raising the question of how this can occur repeatedly in efficient markets). Gamer expectations are dashed, although later “patches” can fix the shortcomings in some of the games. This paper by long-time FTC economist Malcolm Coate reminds me of this type of experience—a potentially enlightening paper but released before its time—it needs a few patches.

Coate observes in the paper’s abstract that any definition of an entry barrier “must be linked to the specific theory of competitive concern under review . . . a theoretical barrier definition is unlikely to be useful. Instead, an operational definition of barriers to entry is required. This paper explores the operationalization of the Merger Guidelines barrier to entry concept.” Yet it isn’t until Section IV that the reader can finally see how (in this paper) the FTC staff operationalized the analysis of entry barriers as described in the Merger Guidelines (and summarized below). The bulk of the discussion preceding that section focuses on the evolution of the entry barrier concept and its development within the context of the Merger Guidelines. Some of this discussion is useful, as when the paper recounts the Bain, Stigler, and Posnerian definitions of entry barriers. But much of this discussion focuses on strategic barriers to entry driven by sunk cost differences between the incumbent and the entrant. This discussion tends to be too cryptic, as when the paper discusses the distinction between entry in the “Post-Chicago school of economics (PCE)” and the “multi-sided version of PCE (MS-PCE)” advanced by the Chicago school. And Coate only peripherally relates this distinction to how the agency evaluated entry barriers.

To get to what I think is the heart of the paper, Coate identifies how the timeliness, likelihood, and sufficiency of entry have been evaluated by the FTC staff in various merger cases.1 Following the Merger Guidelines, Coate notes that entry is timely when the entrant can “move from the initial

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1 Subsequently, Coate notes that the sufficiency condition really is addressing the timeliness factor and the likelihood factor and suggests that the sufficiency factor should be absorbed into these other two factors. I agree—trying to define sufficiency in a way that is independent of timeliness and likelihood is a real challenge.
planning stage to a significant market impact within two years.” (p.11). Entry is regarded as likely if it is profitable at pre-merger prices. And entry is regarded as sufficient if the market impact of timely and likely entry can offset any post-merger tendency for prices to increase.

Coate reviewed 138 different matters investigated by the staff of the FTC’s Bureaus of Competition and Economics. In determining which matters to review, he focused on those with a “core horizontal competitive concern.” (p.21). It’s not completely clear what this means. For example, does this mean that any proposed merger that potentially raised vertical as well as horizontal concerns was excluded? Or were some mergers that raised vertical issues nonetheless included because the “core” concern was horizontal, and, if so, what determined whether the vertical consideration was sufficiently marginal that it could be ignored? In addition, it’s not clear whether Coate defines entry to include the kind of product repositioning considered when unilateral concerns are a focus. If he does not consider repositioning, that would be surprising given the heightened interest in unilateral effects analysis during this time period and the similarity of the repositioning analysis to entry analysis. Unfortunately, much of the empirical analysis in this paper could be better explained or described.

At the outset, he finds that 80 percent of the 138 matters evaluated multiple “styles” or sources of entry—e.g., de novo entry, expansion by an existing firm, or entry by a firm in a related product area. Thus, rarely does the staff consider only one entry mode, so the ultimate conclusion on entry by the staff likely is based on the aggregate effect of the multiple entry modes, although the paper is not explicit about how the adding up occurs (or that the profitability of one entry mode likely depends on whether entry by another occurs).

Of the 138 matters reviewed, he concluded that 109 found that there were impediments to entry and 29 found entry to be easy. A particularly striking finding of the paper is the evaluation of the role of the timeliness of entry. One hundred of the 138 matters contained “suggestions” (p.24) that at least one style of entry would not be timely, with three recurring factors assessed—regulatory delays (e.g., a certificate-of-need requirement for constructing a new hospital), lengthy entry timelines (i.e., the time from entry planning to production), and reputation-building delays. Lengthy entry timelines were key in sixty-four of the one hundred matters for which entry impediments were found, while reputation-building delays accounted for thirty of the one hundred cases.²

There have also been three kinds of arguments that have led the FTC staff to question the likelihood of entry. The first are Stiglerian entry barriers, i.e., ones that result in entrants having higher costs than incumbents. These include certificate-of-need requirements, patents, and access to critical inputs. The second are lock-in kinds of arguments, such as long-term contracts, network effects, and “structural rigidities,” all of which suggest that the prospective entrant would find post-merger sales opportunities too limited. (Coate never explains what he means by structural rigidities.) Third is an evaluation of minimum viable scale, i.e., the output level required for entry to be profitable at current prices. If the scale is large relative to current output, that would raise the possibility that the post-entry price would fall below the pre-merger price.

Certificate-of-need considerations were relevant in the evaluation of the likelihood of entry in eighteen matters, other Stiglerian entry barriers in six matters, lock-in in ten matters, and a large

² Coate notes that there were multiple explanations for a finding of an entry impediment in fourteen of the matters. The paper later observes that in a number of matters, the staff relied on firms in the process of entry to gauge the timeliness of entry.
minimum viable scale in fifteen matters.\(^3\) Thus, about half of the 109 matters where entry impediments were found by the FTC staff are accounted for by these three reasons.

What about the other half? Coate concludes that the findings that entry was not likely “lacked clear empirical support.” Again, for us practitioners, it would be nice to know his definition of “clear empirical support.” For example, he notes that in fourteen matters, the staff made the argument that entry would not be profitable, but according to Coate, “the argument was under-developed, as no evidence underpinning the lack of profitability was developed.” (p. 25). But nowhere does Coate explain with any more precision how profitability was gauged or why the profitability analysis was under-developed. Perhaps where there was a high probability that entry would not be timely in any event, the need to focus resources on likelihood (or argue in the alternative) was not as necessary. Thus, the staff may have provided a more “developed” likelihood position if timeliness evidence wasn’t dispositive. However, Coate does note that in thirteen of the matters where the likelihood arguments were under-developed, that argument was “crucial” to a staff finding of entry impediments.

In addition, the paper also reports that there were fifty-six staff findings that entry would not be sufficient, with five types of reasons offered by the staff. The scarcity of inputs was key in eight findings, reputational effects (including product qualification requirements) in seven matters, and network effects in five matters. The absence of a substantial fringe played a role in thirty-seven matters (some of which also cited other reasons for the lack of entry sufficiency), while the need to have a full-line of products was important in seven of the matters. Interestingly, in contrast to his misgivings about some of the likelihood evidence, Coate does not opine on the strength of the underlying evidence for the sufficiency findings.

Moreover, the paper notes that the FTC staff apparently attaches significant weight to evidence of recent or expected future entry. According to the paper, the staff found no entry impediments in 58 percent of the matters in which such entry was identified. In only two of sixty-one cases where the staff found no evidence of recent entry did the staff conclude that entry was nonetheless easy. Thus, Coate concludes that “market entry evidence does not guarantee a theoretical finding on ease of entry, but the lack of such evidence is highly correlated with the finding of some type of entry impediment.” It would have been helpful to understand what distinguished the persuasive from the unpersuasive entry evidence.

So what can the practitioner take away from this paper? First, the evaluation of the timeliness of entry is key—if the agency is unpersuaded that entry is timely, a mountain of evidence on likelihood and sufficiency won’t matter. Second, Coate provides the practitioner with arguments the agency considers when evaluating the likelihood of entry—certificate-of-need, patents, input scarcity, lock-ins, and minimum viable scale. A similar list can be constructed for sufficiency. Third, evidence of actual or expected entry can play a substantial role in evaluating the efficacy of entry as a “remedy” to merger-related competitive concerns.

Another view is that although the Coate paper provides insight into the specific arguments relied on by the FTC staff, overall, there is nothing new here. These are the kinds of factors that have played a role in evaluating antitrust policy and specific matters for years. What would have been

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\(^3\) With respect to likelihood of entry, the paper observes that in one matter, the staff considered historical entry in narrow geographic markets and, in a number of matters, the staff estimated minimum viable scale by using “net present value to determine the profitability of entry with the sunk costs defined as initial investments that could not be recovered by exit.” (p. 32.) It would have been useful to know if the FTC staff did a minimum viable scale analysis only for de novo entry or whether some of these analyses focused on expansion of existing facilities by a fringe or by a firm in an adjacent market.
helpful is a deeper understanding of, for example, the kind of evidence that staff “typically” relied on when evaluating timeliness or in concluding that input scarcity undermined the likelihood or sufficiency of entry or the kind of recent entry or evidence of future entry that the agency staff apparently found persuasive. On this score, as in other dimensions discussed at the outset of this note, the paper fails to realize its potential. My recommendation: Revise and re-submit.

—JRW