

# Antitrust and the Crisis of '07

## Marc Winerman

The current financial crisis is not without precedent. In the past, as now, financial panics and developing crises can require that actions be taken in haste. The response to one such crisis, during antitrust's formative era, shows that actions taken in emergencies may produce consequences and generate controversy for years to come—however necessary they may be (or appear to be) at the time.

On October 21, 1907, the Knickerbocker Trust failed. Federal insurance was decades away, so depositors who could not withdraw their savings lost them. Other banks and brokerage firms threatened to fail in turn, taking depositors' and investors' assets with them. There was as yet no central bank (the Federal Reserve Board would be created in 1914), so a private financier with no official capacity stepped into the breach; J.P. Morgan organized other financiers and effectively directed the national response. Supporting Morgan in his efforts were President Theodore Roosevelt and TR's Treasury Secretary, George Cortelyou. To stem the crisis, Cortelyou added \$25 million in federal funds (over half a billion current dollars) to a pool of money that Morgan deposited in threatened institutions to prop them up.<sup>1</sup>

From the perspective of antitrust, the pairing of Presidential trustbuster with private trust builder seems incongruous—particularly since TR's first step toward earning the trustbuster title was his successful challenge, brought in 1902, to Morgan's Northern Securities trust.<sup>2</sup> Because of the actions taken by Morgan that were credited with ending the crisis, moreover, antitrust would be at the core of subsequent controversy. Namely, in early November 1907, Morgan devised a plan that would shore up a tottering investment house, Moore and Schley, by replacing the firm's holdings in the Tennessee Coal & Iron Co. (TC&I) with more solid assets in U.S. Steel. But, this meant the acquisition of TC&I by U.S. Steel, which could raise substantial antitrust concerns. So, on November 4, Morgan sent his representatives to meet TR. Morgan was seeking what TR called a "harbor of safety" for the acquisition, and TR effectively granted that harbor.<sup>3</sup> As a result, the quintessential Morgan trust, U.S. Steel, proceeded to purchase a large Southern competitor.

From the perspective of TR's involvement, as I have explored in greater detail elsewhere,<sup>4</sup> many of the incongruities disappear on closer examination. Yet a broader point still holds: actions authorized in a crisis atmosphere, however merited they may be by actual or perceived circum-

■ **Marc Winerman** is Attorney, Office of Chairman William E. Kovacic, Federal Trade Commission. The views expressed herein are those of the author and do not necessarily represent the views of the Commission or any individual Commissioner.

<sup>1</sup> JEAN STROUSE, MORGAN 573–96 (1999). There has been more than 22-fold inflation since 1913, the first year for which CPI-U data is available. See U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, CONSUMER PRICE INDEX, <ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt> (Nov. 19, 2008).

<sup>2</sup> N. Sec. Co. v. United States, 193 U.S. 197 (1904).

<sup>3</sup> *Hearings before the Committee on Investigation of United States Steel Corporation*, H.R. Rep. No. 12, at 1391 (1911) [hereinafter *1911 Hearings*].

<sup>4</sup> Marc Winerman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. 1, 15–27 (2003).

stances, may have broad ramifications later. The effects of the TC&I acquisition were particularly dramatic; they would ripple, in the next thirteen years, through Presidential politics, Congressional hearings, and, finally, a seminal Supreme Court decision. TR's tacit approval of the TC&I acquisition in 1907 would provide one basis for the Court, in 1920, to reject an important element of the government's broad challenge to U.S. Steel. And the government's loss in the U.S. Steel case at least signaled, and may have contributed to, a significant dampening of merger challenges for years to come.

### TR and Morgan

TR was elected Vice President when William McKinley won his second term in 1900. He became President when McKinley was assassinated seven months into that term; was reelected in 1904 (the first Vice President to thus ascend to the Presidency and later secure reelection in his own right); declined to run in 1908 (in deference to a two-term tradition not yet enshrined in the Constitution); became disillusioned in the years that followed with his hand-picked successor, William Howard Taft; challenged Taft for the Republican nomination in 1912; and, failing in that effort, mounted a third-party challenge under the banner of the newly created Progressive Party, securing more votes than Taft and paving the way for Woodrow Wilson's election.

Throughout, Roosevelt fit curiously into the "trustbuster" title that he earned through his administration's litigation. Congress had passed the Sherman Act in 1890, but its use had been infrequent and often unsuccessful, and, despite the Act, a merger wave had dramatically increased industrial concentration between 1898 and 1902.<sup>5</sup> Roosevelt did expand antitrust prosecutions. The forty-four cases his administration brought in nearly eight years were far more than the eighteen brought by prior administrations (including only three cases during McKinley's tenure), and included broad challenges to the meat packers, the Standard Oil Company, and the American Tobacco Company.<sup>6</sup> Yet Roosevelt repeatedly expressed disdain for "anti-trust" law as he understood it. In his first annual message to Congress, months after taking office, he gave notice that much "legislation directed at the trusts would have been exceedingly mischievous had it not also been entirely ineffective;" his prescription was that "concentration should be, not prohibited, but supervised and within reasonable limits controlled."<sup>7</sup>

If antitrust were the only tool with which TR could address industrial concentration in the short term, he would use it. But, when his administration challenged the Northern Securities consolidation in 1902, TR's underlying goal may well have been to get industry's attention and establish the government's primacy, as a prelude to the supervisory program that he contemplated.<sup>8</sup> Further, the suit against one Morgan interest was soon followed by improved working relations with oth-

*The effects of the TC&I acquisition were particularly dramatic; they would ripple, in the next thirteen years, through Presidential politics, Congressional hearings, and, finally, a seminal Supreme Court decision.*

<sup>5</sup> See *id.* at 6–11.

<sup>6</sup> COMMERCE CLEARING HOUSE, THE FEDERAL ANTITRUST LAWS WITH SUMMARY OF CASES INSTITUTED BY THE UNITED STATES 67–82 (1952) [hereinafter *Federal Antitrust Laws*].

<sup>7</sup> 1901 Annual Message to Congress, 14 COMP. MESSAGES & PAPERS OF THE PRESIDENTS 6641, 6647, 6648 (1909) [hereinafter *MESSAGES*]. This version of the set is available on *HeinOnline*, and the Annual Messages of the Presidents to Congress, in particular, can be accessed at <http://www.presidency.ucsb.edu/sou.php>.

<sup>8</sup> See 1905 Annual Message to Congress, 15 MESSAGES, *supra* note 7, at 6973, 6975–76 (1913) (most marked result of successful antitrust cases was the "moral effect of the prosecutions; but it is increasingly evident that there will be a very insufficient beneficial result in the way of economic change. . . . What is needed is not sweeping prohibition of every arrangement, good or bad, which may tend to restrict competition, but such adequate supervision and regulation as will prevent any restriction of competition from being to the detriment of the public.").

ers. By 1905, Roosevelt, for example, reached a “gentlemen’s agreement” with U.S. Steel’s Elbert Gary at a meeting arranged by James Garfield, the first head of the Bureau of Corporations; the arrangement (which was later extended to Morgan’s International Harvester Company), gave Morgan’s trust a chance to correct problems without court orders.<sup>9</sup>

TR’s hostility to antitrust would, if anything, grow over the years. Although Standard Oil was challenged under his watch, by 1911 (months before the Supreme Court resolved the case) he wrote admiringly about the German government’s thorough regulation of the firms who shared Germany’s monopoly over the world’s known potash deposits—the government regulated price, output, and wages—and he urged that, rather than facing dissolution, Standard Oil could also be placed under comparable government control.<sup>10</sup> By 1912, he named George Perkins, an (admittedly atypical) Morgan partner who had been involved in implementing the “gentleman’s agreements,” as Executive Chairman of his Progressive Party.

### The Tennessee Coal and Iron Takeover

During the 1907 crisis, Morgan sought to prop up Moore and Schley, a large, endangered brokerage house with substantial assets in TC&I, a large Southern competitor to U.S. Steel.<sup>11</sup> Morgan’s plan was that U.S. Steel would acquire TC&I and, thus, Moore and Schley would substitute for its TC&I stock the more solid shares of U.S. Steel. First, though, Morgan sought TR’s acquiescence, and TR, along with his Secretary of State, met with two Morgan representatives. TR memorialized the results of that meeting, in the presence of its participants, in the form of a letter to the absent Attorney General. By 1920, that letter would be reprinted, among other places, in Congressional testimony and a Supreme Court decision. It read as follows:

November 4, 1907

My Dear Mr. Attorney General:

Judge E. H. Gary and Mr. H. C. Frick, on behalf of the Steel Corporation, have just called upon me. They state that there is a certain business firm (the name of which I have not been told) which will undoubtedly fail this week if help is not given. Among its assets are a majority of the securities of the Tennessee Coal Co. Application has been urgently made to the Steel Corporation to purchase this stock as the only means of avoiding a failure. Judge Gary and Mr. Frick informed that as a mere business transaction they do not care to purchase the stock; that under ordinary circumstances they would not consider purchasing the stock, because but little benefit will come to the Steel Corporation from the purchase; that they are aware that the purchase will be used as a handle for attack upon them on the ground that they are striving to secure a monopoly of the business and prevent competition—not that this would represent what could honestly be said, but what might recklessly and untruthfully be said.

<sup>9</sup> Robert H. Wiebe, *The House of Morgan and the Executive, 1905–1913*, 65 AM. HIST. REV. 49, 51–54 (1959). The Bureau of Corporations, and the Department of Commerce and Labor in which it was lodged, were created at TR’s behest in 1903. In 1914, the Bureau would be absorbed into the newly created Federal Trade Commission.

<sup>10</sup> Theodore Roosevelt, *Nationalism and Special Privilege*, 97 OUTLOOK 145, 147–48 (Jan. 28, 1911).

<sup>11</sup> According to Jean Strouse, Moore and Schley “had played a leading role in the promotion of industrial mergers between 1898 and 1902—second in prominence only to the House of Morgan. It was for years the largest brokerage on Wall Street.” STROUSE, *supra* note 1, at 582. TC&I, despite its problems, had been one of the industrials included in the Dow Jones average since that average began in 1896. *Id.* at 585.

They further informed me that, as a matter of fact, the policy of the company has been to decline to acquire more than 60 percent of the steel properties, and that this purpose has been persevered in for several years past, with the object of preventing these accusations, and, as a matter of fact, their proportion of steel properties has slightly decreased, so that it is below this 60 percent, and the acquisition of the property in question will not raise it above 60 percent. But they feel that is immensely to their interest, as to the interest of every responsible business man, to try to prevent a panic and general industry trial smash-up at this time, and that they are willing to go into this transaction, which they would not otherwise go into, because it seems the opinion of those best fitted to express judgment in New York that it will be an important factor in preventing a break that might be ruinous; and that this has been urged upon them by the combination of the most responsible bankers in New York who are now thus engaged in endeavoring to save the situation. But they asserted they did not wish to do this if I stated that it ought not to be done. I answered that while, of course, I could not advise them to take the action proposed, I felt it no public duty of mind to interpose any objections.<sup>12</sup>

*On the political and*

*legal plane, the core*

*of much subsequent*

*controversy regarding*

*the acquisition turned*

*on a simple question:*

*Was TR hoodwinked?*

U.S. Steel's concerns about antitrust were well founded. However uncertain the antitrust enterprise was when U.S. Steel was created in 1901, TR's administration subsequently had sued one Morgan interest in 1902, and, in 1906, it had sued Standard Oil as well. The consolidation that created U.S. Steel had brought together multiple firms, many of which were themselves the product of recent consolidations; it apparently absorbed what had formerly been approximately 180 independent concerns.<sup>13</sup> At the outset, it had a 66 percent share of national ingot production, a percentage that (except during the war years) would decline relatively consistently drop until it reached 33 percent in 1934. Thomas McCraw and Forest Reinhart argue that the firm was "losing to win," deliberately sacrificing market share in an attempt, which ultimately succeeded, to fend off a successful antitrust challenge.<sup>14</sup> In 1907, perhaps as part of the "gentlemen's agreement," U.S. Steel effectively sought a premerger review—something quite rare in the days before the 1976 Hart-Scott-Rodino Antitrust Improvements Act. More to the point, it sought a "harbor of safety." And, though (then as now) the Sherman Act did not give an unchallenged merger legal immunity, TR did what he could.

On the political and legal plane, the core of much subsequent controversy regarding the acquisition turned on a simple question: Was TR hoodwinked? The acquisition was widely credited with stabilizing the market, and to that extent seemed to have served the public well. But it also served Morgan well—and a substantial element of controversy was whether Morgan had known at the time how well it might serve him.

The debate began almost immediately. Congress sought to investigate TR's actions even before he left office in March 1909;<sup>15</sup> that January, a defiant TR reported to his son that he had told Congress to press for TC&I documents only if they were prepared to impeach him.<sup>16</sup> TR was again defiant, but in a different way, when he testified in August 1911 before an investigative committee, headed by Representative Augustus Stanley, that the newly Democratic House had established

<sup>12</sup> *1911 Hearings, supra* note 3, at 1370–71. Roosevelt explained that he had not asked the parties to identify the troubled firm because "in a time of panic merely to have a big financial man name a company that is doubtful, if it is repeated may make that company doubtful; and I thought it was just as well that I should not ask." *Id.* at 1373.

<sup>13</sup> See *United States v. United States Steel Corp.*, 251 U.S. 417, 438–39 (1920).

<sup>14</sup> Thomas K. McCraw & Forest Reinhardt, *Losing to Win: U.S. Steel's Pricing, Investment Decisions, and Market Share, 1901–1938*, 49 J. ECON. HIST. 593, 598, 611–13 (1989).

<sup>15</sup> Until 1937, the Presidential transition took place in March.

<sup>16</sup> Theodore Roosevelt to Kermit Roosevelt, Jan. 23, 1909, 6 LETTERS OF THEODORE ROOSEVELT 1480, 1481 & n.2 (Elting E. Morison ed. 1954).

months before.<sup>17</sup> The Stanley Committee's hearings drew ten page-one headlines in *The New York Times* by the end of summer and, when TR testified, he waded enthusiastically into the confrontation. Defending the confidence he had placed in Morgan, TR declared that, had he acted differently, he would have been "derelict in my duty" and a "timid and unworthy public officer."<sup>18</sup> Further, he volunteered and strongly defended his view that antitrust was a misguided enterprise when it sought to dissolve, rather than control, firms like the Steel Corporation—and, for good measure, TR again expressed his admiration for the German law by which that government managed its potash cartel.<sup>19</sup>

The Taft administration disagreed. Taft was in the midst of an unprecedented antitrust initiative. In the twenty-two months after the Supreme Court decided the Standard Oil case in May 1911, his administration brought fifty-six antitrust cases (more than TR has brought in nearly eight years).<sup>20</sup> As part of this wide-ranging initiative, the United States sued U.S. Steel on October 26, 1911, and a significant part of the case challenged the TC&I acquisition. Among the cascade of headlines in *The New York Times* that day was: "Roosevelt Was Deceived."<sup>21</sup> Taft, curiously, claims not to have read the complaint in advance, and TR, needless to say, was not pleased; indeed, the suit may well have been the decisive factor in his decision to challenge Taft for the White House in the 1912 election.<sup>22</sup>

After a bitter contest and battles through the convention, though, Taft secured the Republican nomination in June 1912. TR then abandoned the Republicans and accepted the Progressive nomination on August 6. With timing that was likely not coincidental, the Stanley Committee issued its report (nearly a year after TR's testimony) on August 2.<sup>23</sup>

The portion of the report directed at TC&I laid out a comprehensive case against Morgan, his partner George Perkins, and TR. It concluded that TC&I had owned iron ore that was suited to technology that emerged in 1906; that TC&I was well positioned to capitalize on its emerging advantages and had become a "new and virile competitor"; and that U.S. Steel's actions before November 1907 showed that it coveted TC&I.<sup>24</sup> Further, the report concluded that any crisis had been resolved before November, and raised the possibility that Perkins (by 1912 actively involved in the Progressive party) had fanned the flames of panic to facilitate the takeover.<sup>25</sup> *The New York*

<sup>17</sup> See *Big Trusts Marked for House Inquiry*, N.Y. TIMES, May 4, 1911, at 1.

<sup>18</sup> *1911 Hearings*, *supra* note 3, at 1372.

<sup>19</sup> *Id.* at 1385–86.

<sup>20</sup> FEDERAL ANTITRUST LAWS, *supra* note 6, at 87–102. For a discussion of Taft and antitrust, see Winerman, *supra* note 4, at 27–32.

<sup>21</sup> *Files Suit to Dissolve Steel Trust*, N.Y. TIMES, Oct. 26, 1911, at 1.

<sup>22</sup> GEORGE E. MOWRY, *THE ERA OF THEODORE ROOSEVELT 288–91* (1958). Mowry concludes that TR, despite his frustration with Taft and his concern that Taft would lead the Republicans to defeat in 1912, was determined to keep out of intraparty hostilities—until the day that the steel suit was filed.

<sup>23</sup> The *Times* had reported in June that the committee was said to be drafting the report, and delaying its release, to use it more effectively against TR if he ran in the general election as a candidate. *Steel Report Held Up*, N.Y. TIMES, June 20, 1912, at 17. In the month that followed the issuance of the report, Representative Stanley garnered further headlines with other attacks on TR. *E.g.*, *Stanley Shot at Colonel; Says Roosevelt Is Carrying Out the Standard Oil's Pet Policies*, N.Y. TIMES, Aug. 25, 1912, at 1; *Chairman Stanley's Reply; Refers to Roosevelt's Speech as Truculent and Boisterous*, N.Y. TIMES, Sept. 2, 1912, at 3.

<sup>24</sup> *Investigation of United States Steel Corporation*, S. Rep. 6-1127, 62d Cong., 2d. Sess. 156–80 (1912).

<sup>25</sup> *Id.* at 180–87. The report attributed a run on the Trust Company of America, which helped trigger the Moore and Schley problems, to Perkins; Perkins who had at the time been on U.S. Steel's finance committee. *Id.* at 183. The report did not propose to analyzing Perkins' motives, it said, then added, "It is scarcely credible that Perkins could have intended the ruin of the trust company, and yet we can not surely interpret his meaning. We leave it where the record leaves it—unexplained." *Id.* at 187.

*Times* reported the challenge in the broadest possible terms: “the insinuation is made that the panic was an artificial one, designed for the benefit of the Steel Corporation.”<sup>26</sup>

In the coming months, TR lost his bid for the White House, though he secured 27 percent of the popular vote to Taft’s 23 percent.<sup>27</sup> He would remain a significant presence on the political scene until he died in 1919, by which time, having returned to the Republican fold, he was a credible contender for the 1920 nomination.<sup>28</sup> Meanwhile, the TC&I controversy now played out primarily in the courts, where, in 1915, a four-judge district court unanimously found for U.S. Steel.<sup>29</sup> As to the merits of the TC&I acquisition, the district court disagreed with the Stanley Committee. The court concluded that

At the time the Steel Company bought the Tennessee Company, the latter’s production of iron and steel was 1.7 per cent. of the production of the country. That up to that time the Tennessee Company had not been a business success. That it was making rails, which was its principal steel product, at a loss. That its ultimate success was problematic. That such success involved an outlay of upwards of \$25,000,000 to put it on a dividend basis. That it had never really earned any dividends up to the time of its sale. That the whole testimony shows its relation as a successful, substantial competitor with the Steel Company in the volume of its business, the character of its product, and the breadth of its market, was negligible. We are warranted by this testimony, and find the fact to be, that its purchase by the Steel Company in no way tended to monopolize the steel and iron trade, and that it was not bought with the purpose or intent of monopolizing, or attempting to monopolize or restrain, that trade.<sup>30</sup>

The district court then turned to TR’s actions, quoting in full TR’s 1907 letter and numerous passages from his 1911 testimony.<sup>31</sup>

The case went directly to the Supreme Court for review, although that review was substantially delayed by World War I. There, the company was vindicated on all points in a 4–3 decision. On the specific question of the TC&I acquisition, the Supreme Court focused exclusively on TR’s role:

We may pause here for a moment to notice illustrations of the government of the purpose of the corporation, instancing its acquisition after its formation of control over the Shelby Steel Tube Company, the Union Steel Company, and, subsequently, the Tennessee Company. There is dispute over the reasons for these acquisitions which we shall not detail. There is, however, an important circumstance in connection with that of the Tennessee Company which is worthy to be noted. It was submitted to President Roosevelt and he gave it his approval. His approval, of course, did not make it legal; but it gives assurance of its legality, and we know from his earnestness in the public welfare he would have approved of nothing that had even a tendency to its detriment, and he testified he was not deceived and that he believed that “the Tennessee Coal & Iron People had a property which was almost worthless in their hands, nearly worthless to them, nearly worthless to the communities in which it was situated, and entirely worthless to any financial institution that had the securities the minute that any panic came, and that the only way to give value to it was to put it in the hands of people whose possession of it would be a guaranty that there was value to it.” Such being the emergency, it seems like an extreme accusation to say that the corporation which relieved it, and, perhaps, rescued the company and the communities dependent upon it from disaster, was urged by unworthy motives. Did illegality attach afterwards and how? And what was the corporation to do with the property? Let it decay in desuetude, or develop its capabilities and resources? In the development, of course, there would be

---

<sup>26</sup> *Steel Report Blames Morgan*, N.Y. TIMES, Aug. 3, 1912, at 5.

<sup>27</sup> The American Presidency Project, Election of 1912, <http://www.presidency.ucsb.edu/showelection.php?year=1912>.

<sup>28</sup> H.W. BRANDS, T.R.: THE LAST ROMANTIC 807 (1920). See also JOHN MILTON COOPER, THE WARRIOR AND THE PRIEST (1983) (parallel biography of Roosevelt and Woodrow Wilson, including TR’s activities during Wilson’s administration).

<sup>29</sup> *United States v. United States Steel Corp.*, 223 F. 55 (D.N.J. 1915), *aff’d*, 251 U.S. 417 (1920).

<sup>30</sup> *Id.* at 148.

<sup>31</sup> *Id.* at 150.

profit to the corporation; but there would be profit as well to the world. For this reason President Roosevelt sanctioned the purchase, and it would seem a distempered view of purchase and result to regard them as violations of law.<sup>32</sup>

TR's acquiescence in the acquisition thus provided a basis for the Court to reject the government's subsequent challenge. William Kovacic has noted that the Court's rejection of the U.S. Steel challenge was one factor, along with a change in executive enforcement policy after 1920, that signaled the end of the first era of deconcentration initiatives.<sup>33</sup>

It is hardly clear that the challenge would have succeeded but for that acquiescence. The Court's majority jumped through some curious hoops to vindicate U.S. Steel.<sup>34</sup> The war had likely increased the public's tolerance for the large enterprises that mobilized to help win it. Finally, U.S. Steel had a piece of incredible luck. Justice Louis Brandeis was a longstanding adversary of U.S. Steel before he joined the Court,<sup>35</sup> and Justice James McReynolds had been Wilson's first Attorney General, while the case was being prosecuted. Neither participated in the decision; had they done so, U.S. Steel almost certainly would have lost.

The TC&I story had unique aspects, and TR's continuing prominence on the political scene after 1907 doubtlessly magnified the continuing importance of the TC&I controversy in the political arena. Still, while the specific importance of the TC&I controversy may have been extended by extraordinary factors, the continuing controversy (now relegated to the realm of historians)<sup>36</sup> shows the significance that actions taken in financial crises may assume after the crisis has passed. ●

---

<sup>32</sup> United States v. United States Steel Corp., 251 U.S. 417, 446–47 (1920).

<sup>33</sup> William E. Kovacic, *Failed Expectations: The Troubled Past and Uncertain Future of the Sherman Act as a Tool for Deconcentration*, 74 IOWA L. REV. 1105, 1112, 1115–16 (1989). Change may have been somewhat delayed at the Federal Trade Commission because Wilson's appointees (one of them a lame duck Senator confirmed in 1921) were slow to leave; nonetheless, many FTC efforts that began in the early 1920s were later abandoned or rejected by the courts. See Marc Winerman, *History Through Headlines*, 72 ANTITRUST L.J. 871, 877, 878 (2005).

<sup>34</sup> Consider the so-called Gary dinners, collective meetings of U.S. Steel and its competitors that began in 1907 and clearly involved unlawful agreements. The court actually cited the existence of illegal conspiracies as favorable to U.S. Steel's position, in that they showed that "[m]onopoly . . . was not achieved" without them. *U.S. Steel*, 251 U.S. at 444. Further, while it then noted that various anticompetitive conspiracies that U.S. Steel organized were, "all of them, it may be, violations of the law," *id.* at 445, the Court dismissed the relevance of those conspiracies because they were abandoned nine months before the suit began.

<sup>35</sup> See *Control of Corporations, Persons and Firms Engaged in Interstate Commerce, Report of the Committee on Interstate Commerce, U.S. Senate*, 62d Cong., Pursuant to S. Res. 98 (1911), at 1151–57. Brandeis had listened to George Perkins testify just before his own testimony, and he went on the refute Perkins' glowing characterization of U.S. Steel.

<sup>36</sup> See, e.g., Wiebe, *supra* note 9, at 56 ("Caught in a politically and economically dangerous panic he did not understand, he allowed the Morgan men to assume the initiative and therefore lost control of" his agreements with the Morgan interests); STROUSE, *supra* note 1, at 585 (Morgan's efforts to fight the panic generally served his own interests and those of the people he represented, though they also served the interests of others; and, though she does not suggest that Morgan conspired to acquire TC&I, once he was persuaded that the acquisition was worthwhile, and in turn persuaded U.S. Steel's executives, he took care "not to make it a commercial sacrifice."); GABRIEL KOLKO, *THE TRIUMPH OF CONSERVATISM* 114–17 (1963) (Though some doubts needed to be resolved before U.S. Steel officials would commit to the transaction, U.S. Steel "increased its ore reserves by 40 per cent and acquired a company worth, at the time, at least four times the purchase price.").

# Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review “Shotgun Marriages”?

**Jonathan M. Rich and Thomas G. Scriven**

The consolidation of large financial institutions was thrust into the spotlight repeatedly in the last few months as the government arranged a series of “shotgun marriages” to save the financial system. This wave of consolidation will continue if institutions continue to deteriorate and the government must act quickly to stave off bank failures.

The Department of Justice’s Antitrust Division faces a fundamental problem when considering a transaction that must be consummated quickly—proper review of a transaction that raises competition issues takes much more time than is available when a quick closing is necessary to protect depositors, minimize the cost to the government and, in some cases, protect the financial system. As the nation will be better served by competitive banking and financial markets, it would be unfortunate if policy makers found they had no alternative but to disregard competition issues because of the urgency of the situation.

Fortunately, the antitrust enforcement agencies have tools with sufficient flexibility to cope with such exigent circumstances—the “pocket decree” or “blank check” that both the Antitrust Division and the Federal Trade Commission have used when a transaction had to close before the agencies could complete a full investigation. Such a solution could work well in an emergency situation if all parties are willing to be sufficiently flexible and if competition problems and the potential solutions are clearly defined.

■ **Jonathan M. Rich** is a partner in the Antitrust Practice Group of Morgan Lewis and Bockius, LLP and was the Assistant Chief in the Communications and Finance Section of the Antitrust Division of the Department of Justice from 1991 to 1994, where he supervised the Division’s enforcement efforts in financial markets and the bank merger program.

**Thomas G. Scriven** is an associate in Morgan Lewis’s antitrust group.

## The Bank Merger Review Process

The review process for bank mergers differs from that for other transactions. As a general rule, bank mergers are exempt from the Hart-Scott-Rodino Act.<sup>1</sup> Instead, for any particular transaction, one of four banking agencies (the Federal Reserve Board (Fed), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS) or the Office of the Comptroller of the Currency (OCC)) shares jurisdiction with the Antitrust Division.<sup>2</sup> Because the Fed has jurisdiction

<sup>1</sup> 15 U.S.C. §§ 18a(c)(7) and 18a(c)(8). Bank holding company acquisitions of non-banking operations and financial holding companies remain subject to the HSR Act.

<sup>2</sup> Banking industry-specific statutes, including the Bank Merger Act (BMA), 12 U.S.C. § 1828(c)(4), the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1828 (c)(2), the Home Owners’ Loan Act, 12 U.S.C. §§ 1461–1700, and the Change in Bank Control Act, 12 U.S.C. § 1817(j), govern most bank merger reviews. The BMA requires that, except where the relevant banking agency determines that “it must act immediately in order to prevent the probable failure of one of the banks . . . involved,” both the banking agency and the Antitrust Division assess the competitive impact of the transaction. 12 U.S.C. § 1828(c)(6). The Fed reviews transactions involving bank holding companies and banks that are members of the Federal Reserve System, 12 U.S.C. § 1842(a)(3)–(4); the FDIC reviews transactions in which the acquirer is a state bank that is not a member of the Federal Reserve System, 12 U.S.C. § 1828(c)(2)(C); the OTS reviews acquisitions of savings associations and savings and loan holding companies (unless the acquirer is a bank holding company, in which case the Fed is responsible), 12 U.S.C. § 1828(c)(2)(D); and the OCC reviews transactions in which the acquirer is a national bank, 12 U.S.C. § 1828(c)(2)(A).

over bank holding company acquisitions, it is the agency most likely to review a large crisis-induced acquisition. Indeed, the Fed reviewed Wells Fargo's application to acquire Wachovia Corporation<sup>3</sup> and Bank of America's acquisition of Countrywide.<sup>4</sup> The FDIC handled the JP Morgan Chase acquisition of Washington Mutual because the bank was in FDIC receivership.<sup>5</sup> The Fed's role in financial institution mergers will only increase as investment banks, such as Goldman Sachs and Morgan Stanley, become bank holding companies to qualify for a portion of the \$700 billion TARP bailout.<sup>6</sup>

After an acquirer files an application with the appropriate banking agency, the agency forwards it to the Antitrust Division and the two agencies analyze the competitive effects of the transaction concurrently.<sup>7</sup> The agencies' statutory standards differ. While the Antitrust Division applies Section 7 of the Clayton Act, the Fed must consider, in addition to competitive effects, "the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served."<sup>8</sup> Generally, the Fed waits for the Antitrust Division to submit a report on the likely competitive effects of the transaction before reaching its own conclusion.

The banking agencies and the Antitrust Division begin their review of a transaction with the Bank Merger Guidelines, which were developed by the Antitrust Division, the Fed and the OCC. The Fed's analysis of competitive effects under the Bank Merger Guidelines relies largely on the so-called 1800/200 test applied to deposits. If, with respect to deposits, a transaction does not cause the Herfindahl-Hirschman Index (HHI) to exceed 1800 and to increase more than 200 points in any relevant banking market, the Fed is unlikely to challenge the transaction.<sup>9</sup> When the Fed finds that a transaction would exceed those thresholds, it often will approve the transaction contingent upon divestiture of branches with sufficient deposits to reduce the HHI change to less than 200 points. The Antitrust Division uses the 1800/200 as a screen to determine which transactions require further review and relies on the Horizontal Merger Guidelines to analyze transactions that exceed the threshold.

In applying the 1800/200 test, the two agencies define relevant geographic and product markets differently, with the banking agencies using pre-determined market definitions, such as "traditional banking," as the relevant product market and standard metropolitan statistical areas as

---

<sup>3</sup> See Press Release, Federal Reserve Board, Approval of Proposal by Wells Fargo & Company to Acquire Wachovia Corporation (Oct. 12, 2008), available at <http://www.federalreserve.gov/newsevents/press/orders/20081012a.htm>.

<sup>4</sup> See Press Release, Federal Reserve Board, Approval of Proposal by Bank of America (June 5, 2008), available at <http://www.federalreserve.gov/newsevents/press/orders/20080605a.htm>.

<sup>5</sup> The FDIC, after being appointed by the OTS as receiver of Washington Mutual and acting pursuant to its responsibility to resolve the problems of failing insured depository institutions, approved JP Morgan Chase's acquisition of WaMu. See 12 U.S.C. § 1831o(a); Press Release, FDIC, JPMorgan Chase Acquires Banking Operations of Washington Mutual (Sept. 25, 2008), available at <http://www.fdic.gov/news/news/press/2008/pr08085.html>.

<sup>6</sup> See Press Release, Federal Reserve Board, Board Announces that Goldman Sachs and Morgan Stanley Transactions May Be Consummated Immediately (Sept. 22, 2008), available at <http://www.federalreserve.gov/newsevents/press/orders/20080922a.htm>. The Troubled Asset Relief Program—part of the Emergency Economic Stabilization Act of 2008—authorizes the Treasury Department to purchase or insure a financial institution's troubled assets. 12 U.S.C. §§ 5201–5261.

<sup>7</sup> See 12 U.S.C. § 1828(c)(4).

<sup>8</sup> 12 U.S.C. § 1828(c)(5)(B).

<sup>9</sup> See Bank Merger Competitive Review—Introduction and Overview § 1 (1995), available at <http://www.usdoj.gov/atr/public/guidelines/6472.pdf>.

**The Antitrust Division has challenged few bank mergers, with the last contested action dating back more than fifteen years, and has lost most of the bank merger cases that have gone to trial.**

the relevant geographic markets. The Antitrust Division defines relevant markets under the Horizontal Merger Guidelines in terms of consumer demand.<sup>10</sup>

The Antitrust Division has concluded that the provision of banking services to small and medium-sized businesses can comprise a relevant product market because those businesses tend to rely on relationships with a local bank, which in many communities is likely to be a local branch of one of the few large banks present in the area.<sup>11</sup> According to the Antitrust Division, small and medium-sized businesses have “fewer credit alternatives and options available than retail consumers or large businesses.”<sup>12</sup> Such middle market consumers require expertise and services that small banks may not be able to provide, including payroll, collection, and disbursement services; business expertise and advice; international banking services; and trade financing services.<sup>13</sup> Those customers’ credit needs, however, are unlikely to be sufficient to attract interest from distant banks.<sup>14</sup> When the Division concluded its review of the PNC Financial Services Group acquisition of National City Corporation just this month, they found that the relevant product market was retail banking, small business banking, and middle market banking services and that the relevant geographic market was eight counties in Western Pennsylvania.<sup>15</sup>

The analytic framework that the banking agencies apply when they assess the likely competitive effects of a combination dates back to the *Philadelphia National Bank* case of 1963.<sup>16</sup> Antitrust case law and enforcement have, of course, evolved substantially since then. The sudden increase in concentration caused by the “shotgun marriages” of the financial crisis provides a welcome opportunity for the banking agencies and the Antitrust Division to retool their approach to competitive effects analysis to incorporate concepts such as the impact of potential entry, and the risk of coordinated or unilateral anticompetitive effects.

If the Fed approves a transaction that the Antitrust Division believes will be anticompetitive, the Antitrust Division can challenge the transaction in federal district court.<sup>17</sup> Under the Bank Merger Act, the court must automatically stay the transaction, giving the Antitrust Division enormous leverage in settlement negotiations.<sup>18</sup> The Antitrust Division has challenged few bank mergers,

<sup>10</sup> U.S. Dep’t of Justice and Federal Trade Comm’n, Horizontal Merger Guidelines § 1.0 (1992, revised 1997), 4 Trade Reg. Rep. (CCH) ¶ 13,104, available at <http://www.ftc.gov/bc/docs/horizmer.htm>. See also Robert Kramer, Chief, Litigation II Section, Antitrust Div’n, U.S. Dep’t of Justice, Mega-Mergers in the Banking Industry, Address Before ABA Section of Antitrust Law 2 (Apr. 14, 1999), available at <http://www.usdoj.gov/atr/public/speeches/2650.htm>.

<sup>11</sup> Kramer, *supra* note 10, at 2. See also Notice of a Proposed Final Judgment, Stipulation and Competitive Impact Statement in United States v. Fleet/Norstar Financial Group, Inc., 56 Fed. Reg. 33,458–02, 33,464 (DOJ July 22, 1991) (“Many other financial institutions compete with Fleet and NMNB in the provision of consumer banking services. Only commercial banks and state chartered savings banks, however, are competitors for business customers in Maine.”).

<sup>12</sup> Kramer, *supra* note 10, at 2.

<sup>13</sup> See, e.g., Notice of a Proposed Final Judgment, Stipulation and Competitive Impact Statement in United States v. Fleet/Norstar Financial Group, Inc. 17–18 (DOJ July 22, 1991).

<sup>14</sup> See Kramer, *supra* note 10, at 2. See also Proposed Final Judgment, Stipulation and Competitive Impact Statement, First Hawaiian, Inc., and First Interstate of Hawaii, Inc., 56 Fed. Reg. 10,916–02, 10,922 (DOJ Mar. 14, 1991).

<sup>15</sup> Press Release, U.S. Dep’t of Justice Requires Divestitures in Acquisition of National City Corporation by the PNC Financial Services Group (Dec. 11, 2008), available at [http://www.usdoj.gov/atr/public/press\\_releases/2008/240315.htm](http://www.usdoj.gov/atr/public/press_releases/2008/240315.htm).

<sup>16</sup> United States v. Phila. Nat’l Bank, 374 U.S. 321 (1963).

<sup>17</sup> See 12 U.S.C. § 1828(c)(7)(A).

<sup>18</sup> See *id.* After a transaction has been approved, the Justice Department is estopped from seeking to unwind it. 12 U.S.C. § 1828(c)(7)(C).

with the last contested action dating back more than fifteen years,<sup>19</sup> and has lost most of the bank merger cases that have gone to trial.<sup>20</sup>

### How Should the Antitrust Division Apply the Failing Firm Doctrine?

Many of the recent transactions occurred when an institution faced imminent failure—its capital was deteriorating rapidly and the firm was in danger of failing in a matter of days. In these instances, “failure” means that the institution is unable to meet its obligations, such as repayment of short term loans or withdrawals. Absent government involvement in a disposition of the assets, such a situation could very well meet the test for a “failing firm” under the Horizontal Merger Guidelines. Under the Guidelines, a failing firm is one that: (1) “would be unable to meet its financial obligations in the near future,” (2) “would not be able to reorganize successfully” in Chapter 11 bankruptcy, (3) has in good faith, but unsuccessfully, tried to find an alternative purchaser that would “pose a less severe danger to competition,” and (4) the assets of which would exit the relevant market absent the acquisition.<sup>21</sup> When the Antitrust Division concludes that a firm satisfies all four elements of the test, it will permit a transaction to proceed, even if it would otherwise attempt to block it.<sup>22</sup>

*Virtually every one of the recent transactions would meet at least three of the four elements of the failing firm test.*

Virtually every one of the recent transactions would meet at least three of the four elements of the failing firm test:

**1. The institution will be unable to meet its obligations in the near future.** Several recent examples have shown how rapidly an institution can fail. Bear Stearns’ liquidity deteriorated in a matter of days as the market speculated that it would not be able to make delivery of securities or cash; counterparties and customers began withdrawing assets and refusing to extend credit to or trade with the firm. Just three days earlier the firm appeared to have sufficient capital to continue operating,<sup>23</sup> but once it lost the confidence of investors and trading counterparties, the firm was no longer able to do business.<sup>24</sup> Likewise, Washington Mutual was unable to continue as a going concern when it experienced a “run on the bank”—when depositors grew concerned that their funds were endangered and they began to withdraw money rapidly. After eight days, the government had to step in and put the bank in FDIC receivership because the bank had lost so much capital that it faced a liquidity crisis and imminent failure.<sup>25</sup>

<sup>19</sup> See John M. Nannes, Deputy Ass’t Att’y Gen., Antitrust Division, U.S. Dep’t of Justice, Mergers in the Financial Services Industry, Statement before the Committee on the Judiciary, U.S. House of Representatives 2, 6–8 (June 3, 1998), available at <http://www.usdoj.gov/atr/public/testimony/1787.pdf>; United States v. Texas Commerce Bankshares, Inc., No. 93-368, 1993 U.S. Dist. LEXIS 11698 (N.D. Tex. Aug. 10, 1993).

<sup>20</sup> See, e.g., United States v. Central State Bank, 817 F.2d 22 (6th Cir. 1985), aff’g United States v. Central State Bank, 621 F. Supp. 1276 (W.D. Mich. 1985); United States v. First Nat’l State Bank Corp., 499 F. Supp. 793 (D.N.J. 1980).

<sup>21</sup> Horizontal Merger Guidelines, *supra* note 10, § 5.1.

<sup>22</sup> *Id.*

<sup>23</sup> Landon Thomas, *Run on Big Wall St. Bank Spurs Rescue Backed by U.S.*, N.Y. TIMES, Mar. 15, 2008, at A1, available at <http://www.nytimes.com/2008/03/15/business/15bear.html>.

<sup>24</sup> Floyd Norris, *The Regulatory Failure Behind the Bear Stearns Debacle*, N.Y. TIMES, Apr. 4, 2008, at C1, available at <http://www.nytimes.com/2008/04/04/business/04norris.html>.

<sup>25</sup> Robin Sidel et al., *WaMu Is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History*, WALL ST. J., Sept. 26, 2008, at A1, available at <http://online.wsj.com/article/SB122238415586576687.html>. Most depositors need not have been so concerned because their deposits were insured by the FDIC, but the bank nonetheless lost so much capital so quickly that it could no longer survive on its own.

**2. Chapter 11 reorganization is not feasible.** Lehman Brothers, the only institution actually allowed to fail, moved directly into Chapter 7 liquidation.<sup>26</sup> Chapter 11 was not feasible because financial institutions rely heavily on short term loans to fund their day-to-day business. When a highly leveraged institution (as financial institutions all are) cannot meet its obligations (or even if counterparties become concerned that it is unlikely to meet its obligations), it immediately loses access to funding and can no longer trade securities, make loans or undertake any business that requires capital. Chapter 11 would not rescue such an institution because once the business has moved elsewhere it need not come back, especially when counterparties cannot be confident that they will receive delivery or be paid in full. Similarly, depositors would see no reason to put their funds at risk when they have any other options.

**3. There is no identifiable purchaser that would not pose antitrust concerns.** This element could arguably be harder to satisfy than the other three in some instances. When the Fed or FDIC is willing to take over some of an institution's bad assets, there could be many firms that would be interested in buying the business. Several recent "fire sales" have attracted multiple bidders, but might have attracted fewer or none in the absence of government willingness to take on the bad assets. Thus, several bidders were interested in purchasing Lehman Brothers, but they ultimately declined to do so because the government was unwilling to assume or guarantee any of Lehman's holdings, some of which had the potential to decline substantially in value.<sup>27</sup> Citigroup was similarly interested in purchasing Wachovia only if the FDIC would assume some of its bad assets<sup>28</sup> and JP Morgan Chase's interest in Bear Stearns was contingent on the Fed assuming some of the bad assets held in Bear Stearns's portfolio.<sup>29</sup> The Antitrust Division could be faced with a situation in which a transaction fails to satisfy this prong of the test solely because the FDIC or Fed is willing to assume bad assets. Alternative purchasers could, however, appear to be less attractive to the banking agencies, however, for reasons unrelated to competition. For example, the FDIC could prefer a purchaser that might create a competition issue because alternative purchasers would require a greater commitment of FDIC funds, when its insurance fund is already challenged.

**4. The assets would likely exit the market, absent the transaction.** In the case of Chapter 7 liquidation or a shutdown by the FDIC, an institution's ability to compete instantly evaporates—the portfolio is sold, the people are laid off and the deposits are returned to individual depositors or transferred to another institution. The assets that previously constrained competition disappear.

---

<sup>26</sup> Some Lehman divisions remained viable and were sold as going concerns as part of the liquidation. C. Mollenkamp et al., *Lehman Files for Bankruptcy, Merrill Sold, AIG Seeks Cash*, WALL ST. J., Sept. 16, 2008, available at <http://www.gmjobs.net/article/SB122145492097035549.html>. Prior to Lehman's collapse, Barclays (which bought the investment banking and capital markets business) made clear that it would only purchase the Lehman Brothers holding company with government assistance. David Teather & Jill Treanor, *Barclays Pulls Out of Move to Rescue Ailing US Banking Giant*, GUARDIAN, Sept. 14, 2008, at 2, available at <http://www.guardian.co.uk/business/2008/sep/14/lehmanbrothers.barclay>. As the problematic assets were owned by the holding company, Barclay's was able to buy the investment banking and capital markets business without taking on the risks they identified in the holding company. Randall Smith et al., *Lehman, Workers Score Reprieve*, WALL ST. J., Sept. 17, 2008, at C1, available at <http://online.wsj.com/article/SB122163100282247355.html>.

<sup>27</sup> Mollenkamp et al., *supra* note 26.

<sup>28</sup> David Enrich & Dan Fitzpatrick, *Wachovia Chooses Wells Fargo, Spurns Citi*, WALL ST. J., Oct. 4, 2008, at A1, available at <http://online.wsj.com/article/SB122303190029501925.html>. Wells Fargo, as it turned out, was willing to purchase Wachovia with no government help, reducing pressure on the FDIC's insurance fund. *Id.*

<sup>29</sup> Landon Thomas Jr., *Bear Stearns Gets a Lifeline from Fed and a Rival*, INT'L HERALD TRIB., Mar. 14, 2008, at <http://www.ihf.com/articles/2008/03/14/business/bear.php>.

### How Can the Antitrust Division Address a Competition Issue?

When a firm is not “failing” as defined by the Merger Guidelines simply because of government willingness to participate in the transaction, the Antitrust Division has a challenge when the transaction poses a competition issue: rather than accept the transaction or try to block it (and endanger the government’s bailout) is there a way that it can help the transaction to close while still addressing the competition concern? Such a situation can arise even though banking is not terribly concentrated nationwide (the Reigle-Neal Act limits concentration by barring any transaction that would cause an institution to hold more than 10 percent of deposits nationwide or 30 percent of the deposits in a single state).<sup>30</sup>

*A shaky institution that is in imminent danger of collapse must be sold in a matter of days or weeks, not the months that an antitrust review normally requires.*

A transaction could raise competition issues in two ways. First, a transaction could result in the combined firm’s share of deposits exceeding the Fed’s statutory thresholds.<sup>31</sup> Second, the Antitrust Division might identify a specific area of competitive concern, such as lending or credit card processing services or other business banking services for small and medium-sized businesses.<sup>32</sup>

In either case, it is likely that a divestiture of a clearly defined set of assets that are a small portion of the acquired institution could address the concern. The history of bank mergers shows that divestitures designed to reduce the increase in concentration in a discrete geographic area can be a small fraction of the total transaction. There would, however, be a legitimate concern that the timetable for investigating an issue and reaching a resolution could be too long to prevent an institution from collapsing.<sup>33</sup> A shaky institution that is in imminent danger of collapse must be sold in a matter of days or weeks, not the months that an antitrust review normally requires. Even the lightning-quick pace of the Antitrust Division’s investigation of PNC Financial Services Group’s acquisition of National City Corp.—completed just seven weeks after the merger was announced—may be too slow when the target institution is in imminent danger of collapse, as was the case with Bear Stearns and Washington Mutual. There was less urgency to close the PNC-National City Corp. merger as compared to other recent shotgun mergers because National City, while shaky, reportedly was adequately capitalized at the time PNC announced the merger, which is backed by \$7.7 billion in TARP funds. The PNC-National City transaction does, however, show the potential impact of a government-assisted transaction—the government’s involve-

<sup>30</sup> 12 U.S.C. § 1842 (d)(2)(A).

<sup>31</sup> For example, press reports have speculated that the Wells Fargo acquisition of Wachovia could raise issues in California, where both institutions have a substantial presence. See, e.g., Victoria Collier & James Temple, *Wells Fargo, Citigroup Vie for Wachovia*, SAN FRAN. CHRON., Oct. 8, 2008, at C1. Bank of America currently already controls 10.9 percent of U.S. bank deposits following its acquisition of Countrywide Financial Corp. in June 2008. See Federal Reserve System, Order Approving the Acquisition of a Savings Association and Other Nonbanking Activities 5 n.13 (June 5, 2008) (order approving Bank of America’s acquisition of Countrywide), available at <http://www.federalreserve.gov/newsevents/press/orders/orders20080605a1.pdf>. The 10 percent limit did not apply to this acquisition because the Reigle-Neal Act exempts acquisitions of federally chartered savings associations and savings banks. See *id.* Presumably, if a transaction would violate the statutory limit, the Fed would be unable to approve it and, therefore, would search for another option in the first instance.

<sup>32</sup> The Antitrust Division has made clear that lending to smaller-sized commercial customers is likely to remain an area of concern. See Kramer, *supra* note 10, at 2; Gregory J. Werden, *Perceptions of the Future of Bank Merger Antitrust: Local Areas Will Remain Relevant Markets*, 13 FORDHAM J. CORP. & FIN. L. 581 (2008). See also DOJ Press Release, *supra* note 15; Press Release, U.S. Dep’t of Justice, Justice Department Reaches Agreement Requiring Divestitures in Merger of First Busey Corporation and Main Street Trust Inc. (June 12, 2007), available at [http://www.usdoj.gov/opa/pr/2007/June/07\\_at\\_426.html](http://www.usdoj.gov/opa/pr/2007/June/07_at_426.html) (concluding that the merger would “adversely affect competition in the local markets for commercial banking and retail banking services”).

<sup>33</sup> Because the Bank Merger Act requires a court to stay a transaction upon the filing of suit by the United States, the Division could, at least theoretically, “sue first and investigate later” during discovery, but such a course of action likely would doom a transaction that the banking agencies consider essential—a step the Division would understandably be very reluctant to take.

ment alone can reduce the urgency of closing and can give the Antitrust Division enough time if they are willing to move extremely quickly.<sup>34</sup>

Antitrust enforcement and competition policy generally, nonetheless, can and should be relevant. They can be relevant because the existing framework and practices are flexible enough to enable the Antitrust Division to do more good than harm and should be relevant because a rapid and potentially substantial increase in concentration in a vital part of the economy creates the opportunity for anticompetitive effects in an area in which the economy can ill afford them.

The Antitrust Division's first option is likely to be discussion with the banking agencies to find a solution that does not interfere with their goals, but which also does not raise competition problems. A tool for the Antitrust Division to consider in conjunction with the inter-agency approach is the so-called "pocket decree," which permits a transaction to close immediately, but, within limits, permits the Antitrust Division to file a consent decree and require a divestiture at a later date if it concludes that a remedy is necessary. There is precedent for such a solution. In 2006, the Antitrust Division permitted Mittal Steel Company to pursue a hostile takeover of Arcelor S.A. before the expiration of the initial HSR waiting period and the conclusion of the Antitrust Division's investigation because Mittal entered into a letter agreement with the Antitrust Division in which it agreed to divest specific assets if the Antitrust Division concluded that the acquisition was likely to result in a substantial lessening of competition.<sup>35</sup> The letter agreement required Mittal to hold those assets separate while the Antitrust Division investigation was pending.<sup>36</sup>

Then-Assistant Attorney General Thomas O. Barnett described some of the circumstances in which the Antitrust Division is likely to use a pocket decree, noting particularly those circumstances in which the Antitrust Division's review process "itself can affect the outcome of the marketplace competition for control of companies."<sup>37</sup> Barnett cited as an example certain tender offers in which the Antitrust Division's issuance of a second request would trigger foreign regulatory notice or filing requirements that would automatically foil the tender offer.<sup>38</sup> Preservation of the FDIC insurance fund or Fed capital would certainly be analogous—the banking agencies cannot wait for the Antitrust Division to complete an investigation without endangering depositors or the system generally, and they will have to move on to another bidder, at a greater cost to taxpayers.<sup>39</sup>

---

<sup>34</sup> DOJ Press Release, *supra* note 15; *La Tourette Asks Paulson to Reconsider National City Bailout Snub*, STATES NEWS SERVICE, Nov. 18, 2008.

<sup>35</sup> See Press Release, U.S. Dep't of Justice, Justice Department Requires Divestiture in Mittal Steel's Acquisition of Arcelor (Aug. 1, 2006), available at [http://www.usdoj.gov/atr/public/press\\_releases/2006/217516.htm](http://www.usdoj.gov/atr/public/press_releases/2006/217516.htm).

<sup>36</sup> *United States v. Mittal Steel Co.*, No. 06-1360, 2007 U.S. Dist. LEXIS 45386, at \*25 (D.D.C. May 23, 2007).

<sup>37</sup> Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Dep't of Justice, *Merger Review: A Quest for Efficiency*, Address Before N.Y. State Bar Ass'n, Antitrust Section 9 (Jan. 25, 2007), available at <http://www.usdoj.gov/atr/public/speeches/221173.htm>.

<sup>38</sup> *See id.*

<sup>39</sup> The FTC used a similar device in 1995 when Hoechst gave the Commission a "blank check" to proceed with the purchase of Marion Merrell Dow before the Commission completed its investigation. Hoechst agreed that when the FTC completed its investigation, Hoechst would take the actions the Commission concluded would be necessary to address any competitive problem the Commission found in four specific areas (four specified drugs) up to and including divestiture of one company's products in that area. The agreement required Hoechst to hold Marion Merrill Dow separate while the FTC investigation was pending. Hoechst AG; Proposed Consent Agreement with Analysis to Aid Public Comment, 60 Fed. Reg. 49,609, 49,615 (FTC Sept. 26, 1995). Then FTC-Director of the Bureau of Competition William Baer set out the conditions that a party would need to satisfy to employ the blank check option: (1) the "relevant markets must be easily defined," (2) the maximum necessary relief must be readily identifiable with specificity, and (3) the parties must be willing to let the agency decide unilaterally how much of the maximum remedy is necessary ("you have to leave your negotiating leverage at the door"). William Baer, Director, Bureau of Competition, Fed. Trade Comm'n, *A Report on Recent Antitrust Developments at the FTC, Remarks Before the ABA Section of Antitrust Law* (Aug. 9, 1995), available at <http://www.ftc.gov/speeches/other/baersp.shtm>.

*The pocket decree or  
blank check option  
could work well for  
an urgent merger of  
financial institutions  
that raises competition  
issues . . .*

The pocket decree or blank check option could work well for an urgent merger of financial institutions that raises competition issues because in many instances, the lines of business that raise issues can be defined readily—such as banking in a geographic area—and could be a reasonably small part of the troubled institution.<sup>40</sup> The maximum relief would likely be a divestiture of that portion of the business, which the Division likely would require the purchaser to hold separate pending the completion of its investigation.<sup>41</sup> Those assets might not be difficult to sell at a later date (without the burden of bad assets) and in a reasonable auction, unlike the institution as a whole. Finally, because of the often extremely low prices in these transactions, giving an agency a blank check might not be an unreasonably high price.

The pocket decree might not always present a viable solution (if, for example the competition problem relates to a substantial portion of the target), and there could be times when the Antitrust Division will have to rely solely on moral suasion to persuade the banking agencies to avoid options that pose threats to competition at the banking agencies. There is also a danger that even a pocket decree could cause unacceptable delay. In those situations the Antitrust Division's options might be limited. Finally, the Antitrust Division would have to be careful to implement the approach in a manner that would not deter potential bidders—it would have to show a willingness and ability to move quickly, a willingness to put clear limits on the extent of relief that it could demand, and a commitment to navigate the Tunney Act process successfully. Absent such flexibility and assurances, the Antitrust Division could find itself with the unpalatable choice of thwarting a much-needed transaction in a vital sector of the economy or standing aside when it is concerned that a transaction could pose long term harm to competition. ●

<sup>40</sup> The PNC acquisition of National City shows that a transaction can work for a purchaser even when the divestiture is large. Although PNC agreed to divest sixty-one branches (in a geographic area in which PNC already has numerous branches) with \$4.1 billion of deposits, the combined institution will have about \$180 billion of deposits. See DOJ Press Release, *supra* note 15.

<sup>41</sup> Holding the entire target institution separate, as the FTC required Hoechst to do with Marion Merrill Dow, would not likely be feasible in a forced sale of a bank because the troubled institution would have immediate capital needs and rapid cost cutting would likely be necessary. But it is possible that the part of the business that raises the competitive issue could be held separate, even if the entire institution could not, particularly if the parties agree to shift certain assets that need immediate attention to other parts of the institution.

## linkLine: Supreme Court Weighs Survival of Price-Squeeze Claims

**Aryeh Friedman and Joyce Choi**

Then-Chief Judge Stephen Breyer, writing for the First Circuit in *Town of Concord v. Boston Edison Co.*,<sup>1</sup> in 1990 held that a price squeeze occurring in a fully regulated industry generally will not violate Section 2 of the Sherman Act. Whether a price squeeze in a partially regulated industry would violate Section 2 was left “for another day.”<sup>2</sup>

That day may have arrived with the Supreme Court’s granting certiorari in *Pacific Bell Telephone Co. d/b/a AT&T California v. linkLine Communications, Inc.*<sup>3</sup> The Supreme Court can decide whether price-squeeze claims survive the recent Supreme Court decisions in *Trinko*<sup>4</sup> and *Brooke Group*,<sup>5</sup> and, if so, in what form.<sup>6</sup> The circuits have split on this issue, divided over whether recognizing a price-squeeze claim conflicts with modern antitrust jurisprudence or comports with sound antitrust policy.<sup>7</sup>

### The Margin-Based Price Squeeze Claim

The “traditional” or “margin-based” price-squeeze claim, classically articulated in Judge Learned Hand’s Supreme Court certified opinion in *United States v. Aluminum Co. of America*,<sup>8</sup> arises

<sup>1</sup> 915 F.2d 17 (1st Cir. 1990) (Breyer, C.J.), *cert. denied*, 499 U.S. 931 (1991).

<sup>2</sup> *Id.* at 43.

<sup>3</sup> 128 S. Ct. 2957 (2008) (No. 07-0512) (granting certiorari in *linkLine Commc’ns v. SBC Cal., Inc.*, 503 F.3d 876 (9th Cir. 2007)).

<sup>4</sup> *Verizon Commc’ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

<sup>5</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

<sup>6</sup> The formal issue is framed as “[w]hether a plaintiff states a claim under Section 2 of the Sherman Act, 15 U.S.C. 2, by alleging that the defendant—a vertically-integrated retail competitor with an alleged monopoly at the wholesale level but no antitrust duty to provide the wholesale input to competitors—engaged in a “price squeeze” by leaving an insufficient margin between wholesale and retail prices to allow the plaintiff to compete.” Petition for Certiorari, *Pac. Bell Tel. Co. d/b/a AT&T Cal. v. linkLine Commc’ns, Inc.*, 128 S. Ct. 2957 (2008) (07-0512), available at [http://www.scotusblog.com/movabletype/archives/07-512\\_pet.pdf](http://www.scotusblog.com/movabletype/archives/07-512_pet.pdf).

<sup>7</sup> Our discussion will primarily address price-squeeze claims as applied to markets that are partially or fully regulated, such as the telecommunications industry. An open issue is whether a margin-based price-squeeze claim should be limited in unregulated markets. Price-squeeze claims have been alleged in the context of unregulated industries, including the seminal price squeeze case, *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945) (*Alcoa*) unregulated aluminum sheet industry). See *Schor v. Abbott Labs.*, 457 F.3d 608, 611 (7th Cir. 2006), *cert. denied*, 127 S. Ct. 1257 (2007) (price-squeeze claim made in pharmaceutical industry where defendant had monopoly over patented input for HIV treatment); Case L-284/41, *Napier Brown-British Sugar*, 1988 O.J. (L 284) 41 at ¶¶ 3–6, 4 C.M.L.R. 196 (1990) (European Commission decision re: price squeeze in granulated beet sugar industry), available at <http://eur-lex.europa.eu/smartapi/cgi/sgadoc?smartapi!celexplus!CELEXnumdoc&lg=en&numdoc=388D0518>. Abbott Laboratories, a pharmaceutical company, submitted a brief as amicus curiae in *linkLine*. Brief for Abbott Labs as Amicus Curiae Supporting Petitioners, *Pac. Bell Tel. Co. d/b/a AT&T Cal. v. linkLine Commc’ns, Inc.*, 128 S. Ct. 2957 (2008) (No. 07-512).

<sup>8</sup> 148 F.2d 416, 437–38 (2d Cir. 1945). *Alcoa* has special precedential value because the Supreme Court certified the case to a panel of judges of the Second Circuit Court of Appeals on the basis that the number of Justices qualified to hear the case was insufficient for a quorum. *Am. Tobacco Co. v. United States*, 328 U.S. 781, 812–13 & n.10 (1946) (Second Circuit decided *Alcoa* “under a new statute authorizing it to render a decision ‘in lieu of a decision by the Supreme Court’ and providing that such decision ‘shall be final and there shall be no review of such decision by appeal or certiorari or otherwise.’”). The origins of the price-squeeze claim can be traced back to *United States v. Corn Products Refining Co.*, 234 F. 964 (S.D.N.Y. 1916).

**Aryeh Friedman** was Senior Competition Counsel for BT Americas Inc. until November 2008, and is now Chief Counsel, Antitrust, for Wyeth Pharmaceuticals. **Joyce Choi** is an associate at Freshfields Bruckhaus Deringer LLP in Washington, D.C. The views expressed here are those of the authors and not those of their employers.

when: (1) a firm has a monopoly over an upstream product; (2) its wholesale price for that product is “higher than a ‘fair price;’” (3) that firm’s downstream rivals require that product to compete in the downstream market where the monopolist itself competes; and (4) the monopolist’s retail price for the downstream, competitive product is so low that competitors cannot match it and still earn a “living profit.”<sup>9</sup> Determining whether these elements were present has proved challenging for the courts, and lower courts in the United States principally resorted to three tests to determine if a price squeeze claim was shown. Under the “transfer price test,” a price squeeze is presumed to exist if the monopolist could not have made a profit by selling at its retail rates if it had purchased at its own wholesale rates.<sup>10</sup> This test is similar to the “equally efficient competitor” test used in Europe.<sup>11</sup> The other two tests are the “comparative billing” test and the “comparative rate of return” test.<sup>12</sup>

After the Supreme Court decisions in *Brooke Group* and *Trinko*, however, two circuits differed as to whether those decisions limited or precluded margin-based price-squeeze claims.<sup>13</sup> In *Brooke Group*, the Supreme Court held that a predatory pricing claim under Section 2 of the Sherman Act could only be asserted against a firm with monopoly power or one with a dangerous probability of obtaining monopoly power, if (1) “the prices complained of are below an appropriate measure of its rival’s costs” and (2) that firm “had . . . a dangerous probability [ ] of recouping its investment in below-cost prices.”<sup>14</sup> In its later *Trinko* decision, the Supreme Court ruled that even incumbent monopolists generally had no antitrust duty to cooperate with potential rivals, whether or not they had to provide such cooperation under other statutes governing telecommunication utilities. Absent conduct amounting to an independent antitrust violation, the Court declined to impose an expanded duty to aid competitors under the antitrust laws in light of the

<sup>9</sup> *Alcoa*, 148 F.2d at 437–38.

<sup>10</sup> See 1 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 271 (5th ed. 2002) (citing *Ray v. Indiana & Mich. Elec. Co.*, 606 F. Supp. 757, 776–77 (N.D. Ind. 1984)) [hereinafter ANTITRUST LAW DEVELOPMENTS]. As discussed more fully below, Petitioners in *linkLine* argue that the “transfer price test” is inconsistent with the monopolist’s right to charge monopoly prices and will discourage investment in the upstream market. Reply Brief for Petitioners at 13, *linkLine*, 128 S. Ct. 2957 (2008) (No. 07-512) [hereinafter Petitioners’ Reply Brief].

<sup>11</sup> Case COMP/C-1/37.451, 35.578, 37.579, *Deutsche Telekom AG*, 2003 O.J. (L 263) 9 at ¶¶ 140–141, (a margin squeeze was present because DT “would have been unable to offer its own retail services without incurring a loss if . . . it had had to pay the wholesale access price as an internal transfer price for its own retail operations”), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:263:0009:0041:en:PDF>, *aff’d*, Case T-271/03, *Deutsche Telekom AG v. Comm’n* (Apr. 10, 2008); Case COMP/38.784, *Wanadoo España v. Telefónica*, 2008 O.J. (C 83) 5 (summary of Commission decision). The full text of the Commission’s *Wanadoo* decision is available at the DG Comp’s Web site. See *Wanadoo*, Case COMP/38.784, op. at 83, available at [http://ec.europa.eu/competition/antitrust/cases/decisions/38784/dec\\_en.pdf](http://ec.europa.eu/competition/antitrust/cases/decisions/38784/dec_en.pdf) (Commission held that a margin squeeze “can be demonstrated by showing that the dominant company’s own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company. . .”).

<sup>12</sup> See ANTITRUST LAW DEVELOPMENTS, *supra* note 10, at 271.

<sup>13</sup> See *Covad Commc’ns Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004) (price squeeze survives *Trinko* but must be pled under *Brooke Group*); *Covad Commc’ns v. Bell Atl. Corp.*, 398 F.3d 666 (D.C. Cir. 2005), *reh’g denied*, 407 F.3d 1220 (D.C. Cir. 2005) (price squeeze not pled under *Brooke Group* does not survive *Trinko*). The D.C. Circuit may actually allow a price-squeeze claim to proceed under *Brooke Group*. *Bell Atlantic*, 407 F.3d at 1222. Denying a petition for rehearing in *Bell Atlantic*, the D.C. Circuit rejected the argument that the court’s decision “eliminate[d]” price-squeeze claims, emphasizing that in its initial decision, the D.C. Circuit had not discussed the possibility of a *Brooke Group* price-squeeze claim because the plaintiffs had not made that claim. *Id.*

<sup>14</sup> *Brooke Group*, 509 U.S. at 222–24.

telecommunications regulatory structure and the practical obstacles that would attend judicial oversight of any order granting compulsory access.<sup>15</sup>

### The *linkLine* case

In *linkLine*, the plaintiff linkLine, an Internet Service Provider (ISP), purchased access to a vertically integrated incumbent local exchange carrier's (ILEC) digital service line (DSL) facilities. The DSL market was only partially regulated, because the FCC and state regulators regulated only wholesale DSL sales, leaving the ILECs with retail price discretion.<sup>16</sup> linkLine claimed that the ILEC's DSL facility was a "bottleneck"—an essential facility—which any ISP would have to interconnect with in the ILEC's service area to serve end-user customers. linkLine contended that the defendant ILEC (AT&T) had engaged in a price squeeze by charging linkLine a wholesale price for DSL transport that was so high at times that it exceeded AT&T's retail price for bundled DSL service to end-user consumers.<sup>17</sup> linkLine further alleged that AT&T's retail arms would not be able to cover their costs by buying wholesale DSL at AT&T's wholesale prices and selling retail DSL at AT&T's low retail prices.

In a 2004 Order, the district court denied AT&T's motion to dismiss the price-squeeze claim, holding that *Trinko* did not preclude such a claim.<sup>18</sup> Subsequently, the district court held that linkLine's allegations could satisfy the below-cost and dangerous probability of recoupment prongs of *Brooke Group*.<sup>19</sup> The district court then certified its 2004 Order for interlocutory appeal to the Ninth Circuit.<sup>20</sup>

The Ninth Circuit affirmed the district court's order in a 2–1 decision, beginning by recognizing the price squeeze as a traditional antitrust claim that survived *Trinko*.<sup>21</sup> Citing *City of Anaheim v. Southern California Edison*,<sup>22</sup> a Ninth Circuit decision predating *Brooke Group* and *Trinko*, the court held that a price-squeeze claim based on a showing of specific intent to monopolize could be viable even in a fully regulated industry.<sup>23</sup> By requiring specific intent to monopolize, the court of appeals found the *City of Anaheim* standard addressed *Trinko*'s point that overlapping telecommunications regulation should weigh against imposing antitrust liability for regulated conduct.<sup>24</sup>

*By requiring specific intent to monopolize, the court of appeals found the City of Anaheim standard addressed Trinko's point that overlapping telecommunications regulation should weigh against imposing antitrust liability for regulated conduct.*

<sup>15</sup> *Trinko*, 540 U.S. at 412–16 (holding that an antitrust "problem should be deemed irremedia[ble] by antitrust law when compulsory access requires the court to assume the day-to-day controls characteristic of a regulatory agency") (quoting Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841, 853 (1989)). The Court also cited *Spectrum Sports v. McQuillan*, 506 U.S. 447, 459 (1993), in reaffirming that a monopoly leveraging claim could not be asserted absent a showing of a dangerous probability of success in monopolizing the second market. *Trinko*, 540 U.S. at 415 n.4.

<sup>16</sup> Pac. Bell Tel. Co. d/b/a AT&T Cal. v. linkLine Commc'ns, Inc., 503 F.3d 876, 885 (9th Cir. 2007), *cert. granted*, 128 S. Ct. 2957 (2008).

<sup>17</sup> linkLine Commc'ns, Inc. v. SBC Cal., Inc., No. CV 03-5265 SVW, at 6 (C.D. Cal. Apr. 1, 2005) (order denying AT&T's motion to dismiss and certifying for interlocutory review).

<sup>18</sup> linkLine Comm'ns, Inc. v. SBC Cal., Inc., No. CV-03-5265 SVW, 2004 U.S. Dist. LEXIS 30761 (C.D. Cal. Oct. 25, 2004).

<sup>19</sup> linkLine Commc'ns, Inc. v. SBC Cal., Inc., No. CV 03-5265 SVW, at 6 (C.D. Cal. Apr. 1, 2005) (order denying AT&T's motion to dismiss and certifying for interlocutory review).

<sup>20</sup> *Id.* at 32–33 & n.22.

<sup>21</sup> *linkLine*, 503 F.3d at 880, 885 ("For over six decades, federal courts have recognized price squeeze allegations as stating valid claims under the Sherman Act.").

<sup>22</sup> *City of Anaheim v. S. Cal. Edison*, 955 F.2d 1373 (9th Cir. 1992).

<sup>23</sup> *City of Anaheim* held that a price squeeze could be viable against a regulated monopolist because the presence of multiple regulators regulating at different levels of the market could produce disharmonious rate regulation. *Id.* at 1377.

<sup>24</sup> *linkLine*, 503 F.3d at 883.

The Ninth Circuit distinguished *linkLine* on the grounds that the industry was only partially regulated, unlike in previous price-squeeze cases, such as *City of Anaheim*, where the industry at issue was fully regulated.<sup>25</sup> The antitrust laws thus presented the primary check against consumer harm from AT&T's alleged anticompetitive conduct at the unregulated retail level.<sup>26</sup>

Judge Ronald Gould, in dissent, asserted that *linkLine* should not have been able to base its price-squeeze claim on AT&T's allegedly high wholesale price because that claim would have amounted to a refusal to deal precluded by *Trinko*.<sup>27</sup> According to the dissent, *Trinko* prevented *linkLine* from proceeding on any claims other than a downstream predatory pricing claim that could satisfy *Brooke Group*.<sup>28</sup>

AT&T petitioned for certiorari, urging the Supreme Court to reject the Ninth Circuit's articulation of the price-squeeze doctrine. *linkLine* opposed AT&T's petition, arguing that the Court should allow the Ninth Circuit's decision to stand.<sup>29</sup> The 2005 district court Order, dealing with the applicability of *Brooke Group* to price squeezes, *linkLine* argued, was not within the scope of the interlocutory appeal to the Ninth Circuit of the distinct Court's 2004 Order, and thus was not within the certiorari petition. The Supreme Court nevertheless granted certiorari and permitted an amicus group, the American Antitrust Institute, to participate in oral argument in order that the *Trinko* questions framed by the 2004 district court order and the Ninth Circuit's majority ruling can be addressed. The Supreme Court heard oral arguments on this issue on December 8, 2008. Given the odd procedural posture, it is unclear whether the Supreme Court will ultimately reach the merits. However, the briefing and arguments have illuminated the issues well.<sup>30</sup>

## The Issues

***Does the Existence of a Regulatory Duty Preclude a Price Squeeze Claim?*** Petitioner AT&T and amici supporting its position have challenged the price squeeze's status as a standalone antitrust claim, arguing that it is simply a variation of a refusal to deal claim.<sup>31</sup> In *Trinko* the Supreme Court held that a refusal to deal claim exists only where: (1) the parties had "voluntarily engaged in a course of dealing"; (2) the defendant refused to sell to its competitor even at retail rates; and (3) the services it was withholding were "otherwise marketed or available to the public."<sup>32</sup> AT&T argues that it had no antitrust duty to deal with *linkLine* because the source of that duty was sole-

---

<sup>25</sup> *Id.* at 885.

<sup>26</sup> *Id.* ("All of this regulation, however, applies only to wholesale prices the SBC Entities charged *linkLine*: there is no comparable regulatory attention paid to the retail market. Any restrictions on pricing at the retail level derive primarily from the antitrust laws.")

<sup>27</sup> *linkLine*, 503 F.3d at 886–87 (Gould, J., dissenting).

<sup>28</sup> *Id.* at 885.

<sup>29</sup> Brief in Opposition at 14–15, *linkLine*, 128 S. Ct. 2957 (2008) (No. 07-512), available at [http://www.scotusblog.com/movabletype/archives/07-512\\_bio.pdf](http://www.scotusblog.com/movabletype/archives/07-512_bio.pdf). During its oral argument, however, *linkLine* later argued that the Supreme Court should vacate the Ninth Circuit's opinion and remand the case back to the district court for consideration of the *Brooke Group* issues.

<sup>30</sup> This discussion is not intended to be exhaustive, and will be limited to the issues raised by the parties and their amici at the *linkLine* oral arguments and what we found were the most critical issues raised by the parties and their amici, the American Antitrust Institute, COMPTEL, the United States, and a group of law professors and economists, in briefs filed with the Court. These briefs and those briefs filed by other amici are available at [http://www.scotuswiki.com/index.php?title=Pacific\\_Bell\\_Telephone\\_Co.%2Cdba\\_AT%26T\\_California\\_v.\\_linkLine\\_Communications](http://www.scotuswiki.com/index.php?title=Pacific_Bell_Telephone_Co.%2Cdba_AT%26T_California_v._linkLine_Communications).

<sup>31</sup> Brief for Petitioners at 13–16, *linkLine*, 128 S. Ct. 2957 (2008) (No. 07-0512) (U.S. Aug. 28, 2008).

<sup>32</sup> See *Trinko*, 540 U.S. at 409–10.

ly regulatory. AT&T has never voluntarily dealt with the plaintiff, at a retail rate or otherwise.<sup>33</sup> And if AT&T had no antitrust duty to deal with rivals, then AT&T had no antitrust duty to deal on any particular terms that would assist its rivals to compete.<sup>34</sup>

*The issue in linkLine is whether a regulatory duty to deal with respect to the regulated aspect of the parties' relationship is relevant to an antitrust claim based on its impact in the unregulated aspect of their relationship.*

As a threshold matter, the reference to an “antitrust duty to deal” is a misnomer. Antitrust law imposes no general affirmative duty to deal with anyone.<sup>35</sup> Nevertheless, antitrust cases have recognized in special circumstances that a firm can be liable for an anticompetitive “refusal to deal.”<sup>36</sup> The issue in *linkLine* is whether a regulatory duty to deal with respect to the regulated aspect of the parties’ relationship is relevant to an antitrust claim based on its impact in the unregulated aspect of their relationship. Professor J. Gregory Sidak has argued that when an upstream price regulator can consider downstream competition,<sup>37</sup> a court should not consider the margin between upstream and downstream prices.<sup>38</sup> On the other hand, if that regulator can consider only one of the two affected markets (or lacks authority to consider either market, leaving a regulatory gap), then the court can consider whether the price charged constitutes a refusal to deal violating that antitrust laws.<sup>39</sup> Professor Sidak is of the view that a court may consider whether the monopolist’s unregulated retail price is predatory even if an upstream price regulator could consider downstream competition.<sup>40</sup> He argues, however, that a price squeeze should be understood as a “rule of price regulation” arising in the context of an already regulated industry,<sup>41</sup> and permitting courts to inject themselves based on antitrust law would result in inappropriate overlap because (1) courts should not re-regulate an unregulated or lightly regulated market, and (2) courts lack the institutional competence to act as public utility regulators.<sup>42</sup>

<sup>33</sup> Brief for the United States as Amicus Curiae Supporting Petitioners at 9, *linkLine* 128 S. Ct. 2957 (2008) (No. 07-512) [hereinafter U.S. Amicus Brief]; see also Brief for Petitioners, *supra* note 31, at 19–20 (“no allegation that AT&T ever refused to provide to respondents any product ‘that it already sold at retail’ to other customers”).

<sup>34</sup> Brief for Petitioners, *supra* note 31, at 20 (“*Trinko* . . . establishes that where AT&T has no duty to deal with respondents, it likewise has no duty to deal with them in a manner that would promote their success in the alleged downstream market for DSL-based Internet-access service.”).

<sup>35</sup> *United States v. Colgate Co.*, 250 U.S. 300, 307 (1919) (“In the absence of any purpose to create or maintain a monopoly, the [Sherman] [A]ct does not restrict the long recognized right of trader or manufacturer . . . to exercise his own independent discretion as to parties with whom he will deal. . . .”).

<sup>36</sup> *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 483 n.32 (1992) (stating that though a firm generally can refuse to deal with its competitors, it must have a legitimate competitive reason for doing so”); *Trinko*, 540 U.S. at 408 (“[T]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified.”) (quoting *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 601 (1985)); *Lorain Journal Co. v. United States*, 342 U.S. 143, 155 (1951).

<sup>37</sup> In response to Justice Stephen Breyer’s query of whether there was an alternative forum where *linkLine* could bring its margin-based price-squeeze claim, AT&T argued that *linkLine* could have brought such a complaint to the FCC, the wholesale DSL transport price regulator. Transcript of Oral Argument, *linkLine*, at 16, 128 S. Ct. 2957, No. 07-0512 (Dec. 8, 2008), available at [http://www.supremecourtus.gov/oral\\_arguments/argument\\_transcripts/07-512.pdf](http://www.supremecourtus.gov/oral_arguments/argument_transcripts/07-512.pdf).

<sup>38</sup> J. Gregory Sidak, *Abolishing the Price Squeeze as a Theory of Antitrust Liability*, 4 J. COMPETITION L. & ECON. 279, 282 (2008).

<sup>39</sup> *Id.* at 282.

<sup>40</sup> *Id.* at 294.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* Indeed, the FCC has entertained (and rejected) price-squeeze claims made under the 1996 Telecommunications Act, although it seems that no plaintiff has made a price-squeeze claim to the DSL-market regulators. See, e.g., *In re Application of Verizon New England Inc.*, CC No. 01-9 (Feb. 20, 2004) (NYNEX Section 271 proceeding), available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DA-04-422A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-04-422A1.pdf).

The antitrust laws, however, especially in the telecommunications space, have historically coexisted with overlapping regulatory regimes.<sup>43</sup> Moreover, *Trinko* held that Congress intended the antitrust laws and telecommunications laws to coexist, because the antitrust-specific saving clause in the Telecommunications Act of 1996 precluded an interpretation of implied antitrust immunity.<sup>44</sup>

In its brief supporting *linkLine*, COMPTTEL, an industry association representing communications service providers and their supplier partners, argues that the monopolist could have an incentive to seek any uncaptured monopoly profit from the regulated market level.<sup>45</sup> COMPTTEL also argues that even in industries where one or both of the relevant markets are regulated, regulation may be lax, imperfect, or unable to prevent a predatory price squeeze.<sup>46</sup> As emphasized by the Ninth Circuit, regulatory imperfections can enable a price squeeze.<sup>47</sup>

Petitioners respond that to the extent there is effective upstream regulation, the regulator can protect consumers by considering whether it enables a price-squeeze claim in the downstream unregulated market. To the extent such upstream regulation is ineffective, a downstream price-squeeze claim makes little economic sense because the ineffectively regulated monopolist would have no need to evade upstream regulation by capturing some of its monopoly rents downstream.<sup>48</sup>

Petitioners argue that, in any case, there is “no incremental harm from price squeezes as distinct from an outright refusal to deal.”<sup>49</sup> A contrary view, however, is that a price squeeze may actually be a more refined anticompetitive tool than an outright refusal to deal because a price squeeze allows the monopolist to win the sales of those downstream customers it prefers. The monopolist can supply preferred customers, presumably the lowest-cost and most profitable customers, by pricing below the wholesale price plus the additional costs that its most efficient competitor would incur. A price squeeze also allows the monopolist to let its wholesale customer win those high-cost or lower-profit downstream customers the monopolist does not wish to serve.<sup>50</sup> A lost sale is a win because it allows the monopolist to (1) utilize its spare capacity in the upstream market, (2) realize lower costs through greater economies of scale, and (3) share in the proceeds of those sales through the inflated portion of the wholesale price. With a refusal to deal, on the

---

<sup>43</sup> See *Phonetele, Inc. v. AT&T Co.*, 664 F.2d 716 (9th Cir. 1989) (holding no implied immunity because no “actual repugnancy” between telecommunications regulation and antitrust laws).

<sup>44</sup> *Trinko*, 540 U.S. at 406–07 (holding that antitrust-specific savings clause in section 601(b)(1) of the Telecommunications Act of 1996 barred finding of implied antitrust immunity from coexisting telecommunications regulation) (citing 47 U.S.C. § 152 (2007)). The European Commission (EC) similarly views regulation and antitrust as complements, and not substitutes. Joachim Luecking, Head of Unit Antitrust: Telecoms, DG Competition, European Comm’n, Remarks at Teleseminar, *The Supreme Court’s Pending Review of linkLine: The Death Knell for Price Squeeze Claims in the U.S. and Another Basis for Divergence with the E.U.?* (Nov. 18, 2008). In the European Union, regulation and competition share the same frameworks of analysis and can be applied in parallel.

<sup>45</sup> Brief of Amicus Curiae COMPTTEL in Support of Respondents at 20, *linkLine*, 128 S. Ct. 2957 (No. 07-512) (2008) [hereinafter COMPTTEL Amicus Brief].

<sup>46</sup> *Id.* at 21; *linkLine*, 503 F.3d 876 (noting that courts find agency attentiveness to alleged anticompetitive conduct as “relevant” to determining whether judicial intervention through the antitrust laws is necessary to remedy such conduct). *linkLine* also recognized the possibility of regulatory failure, stating that “[w]here the regulatory agencies have failed to prevent or remedy anticompetitive conduct, the balance may tilt in favor of judicial intervention. *Id.* at 885 n.12.

<sup>47</sup> *linkLine*, 503 F.3d at 885 n.12. See 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 767a at 139 (3d ed. 2008) (acknowledging that “[t]he most difficult [price-squeeze] case” arises where a monopolist’s pricing is regulated at the wholesale, but not the retail level”).

<sup>48</sup> Petitioners’ Reply Brief, *supra* note 10, at 20–21.

<sup>49</sup> *Id.* at 12.

<sup>50</sup> A monopolist may incur higher costs serving these customers because, for example, they are small or are located in costly-to-serve geographical areas.

other hand, the monopolist must serve all end users, even those higher-cost, lower-margin, end-user customers.

***The Below-Cost Price-Squeeze Claim and the Equally Efficient Rival Standard.*** Those supporting Petitioners argue that even in an unregulated market a margin-based price-squeeze claim should not lie,<sup>51</sup> and that if such a claim survives *Trinko*, it must be alleged as predatory pricing under *Brooke Group*. Amici supporting Petitioners cite Judge Gould's dissent, arguing that a plaintiff must show that (1) "the prices complained of are below an appropriate measure of its rival's costs," and (2) "the competitor had . . . a dangerous probability of recouping its investment in below cost prices."<sup>52</sup>

Amici supporting linkLine argue that contrary to these assertions, a price squeeze cannot be subsumed under the predatory-pricing rubric. Indeed, predatory pricing may not even be relevant to a price-squeeze claim<sup>53</sup> because the monopolist can maintain a squeeze on its competitors by charging an above-cost retail price so long as its wholesale price is sufficiently high—that is, a price-squeeze monopolist could simply raise its wholesale prices to cross-subsidize its low (but not necessarily below-cost) retail rates.<sup>54</sup> Moreover, the amici submit that meeting the *Brooke Group* recoupment prong is not necessary in determining whether a price squeeze has occurred. Unlike in predatory pricing, a price-squeeze monopolist can simultaneously lose profits at the retail end, while compensating for lost retail profits on the wholesale end.<sup>55</sup> In other words, recoupment in a price squeeze is comparatively easy, because a price-squeezing monopolist need not sacrifice profits in the short or long run.<sup>56</sup> Also, whereas many predatory-pricers could face renewed competition during the recoupment period after having priced the competition out of the market, a price-squeezing monopolist will be relatively safe from such competition.<sup>57</sup>

Even if *Brooke Group* applies, the applicable measure of cost may vary depending on the antitrust violation at issue. In a predatory pricing case, the price would be predatory only if it was below an appropriate threshold, such as below short-term average variable cost or average-avoidable cost.<sup>58</sup> Stated more generally, however, as to any particular antitrust claim the appropriate cost threshold should be one that prevents a monopolist from excluding an equally efficient single-product competitor. In price-squeeze cases, the appropriate measure of cost may therefore be the imputed wholesale price to independent purchasers: the European Union's measure

---

<sup>51</sup> Transcript of Oral Argument, *linkLine*, at 10–11, 128 S. Ct. 2957, No. 07-0512 (Dec. 8, 2008), available at [http://www.supremecourtus.gov/oral\\_arguments/argument\\_transcripts/07-512.pdf](http://www.supremecourtus.gov/oral_arguments/argument_transcripts/07-512.pdf).

<sup>52</sup> U.S. Amicus Brief, *supra* note 33, at 15–16 (internal citations and quotations omitted).

<sup>53</sup> COMPTEL Amicus Brief, *supra* note 45, at 4.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 12 (arguing that while predatory pricing may decrease the monopolist's revenues, a price squeeze can increase those revenues or at least reduce them less than a predatory pricing strategy, because the monopolist "can compensate for lost wholesale volume by selling the same products at the retail level") (citing 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 767c5, at 141 & n.15 (3d ed. 2008)).

<sup>57</sup> A price-squeezing monopolist will likely face less competition during the recoupment period because unlike the predatory-pricer that is attempting to monopolize what was once a competitive market, the price-squeezing monopolist has a durable monopoly in the bottleneck input, and may be acting to maintain that monopoly by pricing such that only a downstream competitor with access to an independent input would be able to compete. In other words, margin-based price-squeeze claims can be based on a monopoly maintenance theory, as opposed to a predatory-pricing price-squeeze claim, which would be based on an attempted monopolization theory.

<sup>58</sup> See *United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003); *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005); Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

of cost.<sup>59</sup> That is, for a price squeeze, the monopolist's retail price violates *Brooke Group* if it is below the opportunity cost of a forgone wholesale sale.

Where the monopolist is a multiproduct firm, a price squeeze might more properly be analyzed as a bundled discount or tying claim. A price-squeeze claim typically focuses solely on the upstream and downstream prices of a single product, when "the firm faces the challenge . . . of recovering not only the costs incurred in common among all products made by the firm, but also each mathematical combination of two or more products."<sup>60</sup> Analyzing a price squeeze as a bundled discount could focus instead on the ultimate retail bundle sold to consumers and whether that bundle is preventing equally efficient competitors from competing.

Bundling is common in telecommunications, and it may explain why an ILEC would prefer not to deal with its rivals.<sup>61</sup> DSL service, for example, is really just one product in a vertical bundle, within which an ILEC can incorporate DSL transport, necessary DSL equipment and services, Voice over Internet Protocol (VoIP), wireline and wireless telephone service, video, and a host of other ancillary services.<sup>62</sup>

Providing DSL service as part of a multiproduct bundle permits the ILEC more pricing flexibility. For example, the ILEC can selectively distribute common costs among the products in the bundle. The access price that would give a monopolist an incentive to deal with a rival would have to compensate the monopolist not only for investment and maintenance of its network and the cost of service provision, but also the opportunity costs.<sup>63</sup> By giving network access to an ISP, the ILEC loses not only revenue from displaced retail DSL sales, but also revenue from both advertisers and subscribers "associated with voice telephony and with ancillary products generating substantial net revenues—such as vertical services (caller ID, voicemail, call forwarding, and the like) Internet advertising, and value-added services generally."<sup>64</sup> The ILEC may also be more likely to lose primary-product sales to a competitor if the product is unbundled.<sup>65</sup>

The challenge in all of this is to determine when firms are "equally efficient." Professor Sidak argues that a multiproduct firm should not be penalized because its rival lacks the economies of scope and scale necessary to allocate its common costs among bundled products.<sup>66</sup> Though an ISP might be equally efficient at providing DSL service as a standalone product, it is arguably not equally efficient in the sense that it cannot supply an equivalent multiproduct bundle to con-

**Where the monopolist is a multiproduct firm, a price squeeze might more properly be analyzed as a bundled discount or tying claim.**

<sup>59</sup> See *supra* note 11 and accompanying text.

<sup>60</sup> Sidak, *supra* note 38, at 300.

<sup>61</sup> AT&T argues that "a wholesale monopolist already earns monopoly profits, and, in general, benefits from the presence of efficient downstream rivals, not from their absence." Petitioners' Reply Brief, *supra* note 10, at 15. While an upstream monopolist can earn revenue from selling to downstream competitors, it must balance those revenues against the costs of dealing with those competitors. That AT&T previously dealt with linkLine only under regulatory compulsion suggests that AT&T decided that it would profit more by refusing to deal with its downstream rivals.

<sup>62</sup> It is possible that these ancillary services are not actually "ancillary" because these often competitive products could be higher-value and more profitable for the defendant monopolist to provide than the monopolist's monopoly services, such as wireline telephone service. The bundle can assist the monopolist also by allowing it to increase the transaction costs for a customer to switch to another provider for any single product.

<sup>63</sup> Sidak, *supra* note 38, at 302–03.

<sup>64</sup> *Id.*

<sup>65</sup> Petitioners' Reply Brief, *supra* note 10, at 19 ("[A] customer who purchases voice service and DSL-based broadband service from a single provider may be less likely to switch *both* voice and broadband service to a competing provider. . .").

<sup>66</sup> Sidak, *supra* note 38, at 301.

sumers.<sup>67</sup> Professor Sidak questions whether it possible for any firm to profitably offer a service on a standalone basis when competitor multiproduct firms bundle, even when there is no price squeeze.<sup>68</sup>

The Supreme Court in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,<sup>69</sup> however, held that a defendant had injured its smaller rival and competition by refusing to deal with the plaintiff in selling a bundled all-access skiing pass.<sup>70</sup> The Court found that competition had been harmed in part because the defendant's smaller rival could not profitably sell a standalone skiing pass, and was losing market share to the defendant.<sup>71</sup> The view of consumer welfare expressed in a recent appellate court bundling case,<sup>72</sup> by the Antitrust Modernization Commission,<sup>73</sup> and even by the DOJ<sup>74</sup> suggests that the equally efficient competitor standard should compare competitors on a standalone basis. For example, the DOJ Section 2 Report proposes evaluating a bundled discount claim involving a plaintiff and defendant that compete against one another by offering comparable bundles as being closer to a predatory pricing claim, such that *Brooke Group* would apply. In situations where a plaintiff is not able to compete with a defendant on a bundle-to-bundle basis, however, the DOJ Section 2 Report would analyze the bundled discount as being closer to a tying claim.<sup>75</sup> Equal efficiency, in other words, should be measured by referring to the competitive bundled or tied product, and not the entire bundle of products including the tying or bundling or monopoly product.

In a bundled discount, the DOJ Section 2 Report suggests that a court should allocate all relevant discounts applying to a bundle of products to the competitive product before determining whether the monopolist was pricing below incremental cost.<sup>76</sup> Applying *Brooke Group's* predatory pricing analysis to a price squeeze would instead allocate the discount to the entire bundle rather than just the competitive product, which would result in underdeterrence and false negatives.

***Administrability and Effect of Price-Squeeze Liability on Business Incentives.*** AT&T argues in *linkLine* that *Alcoa's* price-squeeze standard of ensuring that competitors can purchase a bottleneck input at a "fair price" and "living profit" is not administrable.<sup>77</sup> The Department of Justice, in an amicus brief supporting AT&T, argues that remedying a price squeeze would require judicial inter-

---

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> 472 U.S. 585, 601 (1985).

<sup>70</sup> See *id.* at 607–11. In *Aspen Skiing*, the Court found that the defendant skiing company was "willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival." *Id.* at 610–11. The Court in *Trinko*, however, held that "*Aspen Skiing* is at or near the outer boundary" of Section 2 liability. *Trinko*, 540 U.S. at 409.

<sup>71</sup> *Id.* at 607–08.

<sup>72</sup> See *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2007) (equally efficient competitor standard applies to bundled-discount claims).

<sup>73</sup> ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 83 (2007) (relevant cost measure for competitive product is the firm's cost of producing the competitive product after all discounts and rebates attributable to a bundle of products is allocated to the competitive product), available at [http://govinfo.library.unt.edu/amc/report\\_recommendation/amc\\_final\\_report.pdf](http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf).

<sup>74</sup> U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 101 (2008) (where bundle-to-bundle competition is not possible, relevant cost measure is imputed cost proposed by Antitrust Modernization Commission) [hereinafter DOJ SECTION 2 REPORT], available at <http://www.usdoj.gov/atr/public/reports/236681.htm>.

<sup>75</sup> *Id.* at 101–02.

<sup>76</sup> *Id.*

<sup>77</sup> Brief for Petitioners, *supra* note 31, at 31 ("the *Alcoa* price-squeeze test . . . is famously difficult to administer").

vention in free-market pricing.<sup>78</sup> To remedy a high wholesale price, a court would have to intervene to depress that price. And to remedy an allegation of a low retail price, a court would have to require a firm to maintain a supracompetitive price downstream, which would harm consumers, who would pay higher prices for the same product.<sup>79</sup> The United States questions whether a court would be more effective than the market at setting prices and then supervising those prices.<sup>80</sup> The argument is that a court may be incapable of remedying an anticompetitive price squeeze.<sup>81</sup> And AT&T argues that the transfer-price test is not a solution because examining the monopolist's wholesale price to determine whether the monopolist is pricing below cost is an imputation exercise that courts are unable to implement, and as such is better left to a regulator.<sup>82</sup>

A group of law professors and economists in their amicus brief supporting AT&T similarly argue that the European experience shows that a U.S. court would have to grapple with an economically and factually complex imputation analysis.<sup>83</sup> To apply the equally efficient competitor standard in *Alcoa*, and in the European Union, the economists argue, a court would have to determine what the costs of an equally efficient competitor would be, and then determine whether the monopolist's upstream-downstream price differential would allow the hypothetical firm to compete. The judge's job as de facto rate regulator will be continuous because market forces will change wholesale and retail prices over time, such that a given profit margin may shrink and jeopardize the survival of competitors. The perverse outcome is that price-squeeze litigation becomes a kind of enduring cost-of-service regulation that taxes the resources of a district judge.

In its brief supporting *linkLine*, however, COMPTTEL argues that the imputation of an equally efficient competitor's costs will not always be necessary because a court can use the comparative billing test, when a monopolist's retail price is higher than its wholesale price, for example, to conclude a price squeeze has occurred without undergoing an imputation exercise.<sup>84</sup> Moreover, COMPTTEL urges that administrable remedies could be implemented by taking the monopolist's retail price as the benchmark for determining a wholesale price and directing the incumbent to charge a wholesale price below its retail price. A court could also impose semi-structural relief, such as functional (not structural) separation, which has the benefit of allowing the market to continue to control prices, and preserving innovation and investment incentives. This remedy also retains bona fide vertical efficiencies.

AT&T has argued that *Trinko's* concern that "enforced sharing" discourages investment applies to price squeeze as well as refusals to deal, because a price squeeze is nothing more than a refusal to deal.<sup>85</sup> By capping the wholesale price a monopolist may charge for its bottleneck input, AT&T argues, a court will reduce the funds available to the monopolist to invest in innovative technologies.<sup>86</sup>

---

<sup>78</sup> U.S. Amicus Brief, *supra* note 33, at 24.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at 24–26.

<sup>83</sup> Brief of Amici Curiae Professors and Scholars in Law and Economics in Support of the Petitioners at 7, *linkLine*, 128 S. Ct. 2957 (2008) (No. 07-512) [hereinafter Economists' Amicus Brief].

<sup>84</sup> COMPTTEL Amicus Brief, *supra* note 45, at 16.

<sup>85</sup> *Trinko*, 540 U.S. at 408. See Brief for Petitioners, *supra* note 31, at 29–30; Petitioners' Reply Brief, *supra* note 10, at 13.

<sup>86</sup> Brief for Petitioners, *supra* note 31, at 29–30 (arguing that price squeeze claims could "undermine incentives for 'innovation and economic growth'" by stifling opportunities for monopoly pricing).

At issue is whether monopoly or competition is more conducive to market-driven innovation.<sup>87</sup> If competition promotes market-driven innovation, then innovative investment is not encouraged by allowing the upstream monopolist sufficient monopoly revenues to invest in monopoly-determined, but not market-driven, innovation. It is possible that because of persistent market dominance in the broadband access market, for example, the United States continues to lag behind the developed world in broadband penetration, speed, and pricing.<sup>88</sup> A price-squeeze monopolist could reduce both downstream and upstream innovation by eliminating rivals, or by appropriating a competitive rival's productivity gains. AT&T's argument overlooks the possibility that, as discussed below, a competitor could use its downstream position to enter the upstream market.

Focusing on the harm posed by exiting competitors, the United States argues a price squeeze is just a result of vertical integration, which can be "adverse, neutral, or beneficial."<sup>89</sup> Thus, the United States reasons, the price squeeze is a claim used to protect competitors rather than consumers. Agreeing with the United States, the economists use the EU margin-squeeze cases as an example of how the transfer-price test primarily protects competitor welfare by considering what prices a monopolist would have to charge to enable its downstream, equally efficient competitors to compete.<sup>90</sup> Those favoring the European Community's approach, however, argue that its standard does not protect competitors, but prevents harm to consumers that results from the loss of equally efficient competitors.

COMPTEL argues that application of the *Brooke Group* standard would ignore the fact that a price squeeze is more effective than predatory pricing because the monopolist excludes downstream rivals even as it minimizes its own revenue losses.<sup>91</sup> A price squeeze also allows a monopolist to realize the same end as predatory pricing without having to endure the same amount of cost and pain to itself as it would by having to reduce its own prices. And as then-Chief Judge Breyer recognized in *Town of Concord*, COMPTEL argues that a price squeeze can create barriers to entry into the upstream and downstream markets and eliminate non-price competition in the downstream market.<sup>92</sup>

Another argument is that a price squeeze can harm consumers because a monopolist could use a price squeeze to maintain an upstream monopoly through margin-based exclusionary pricing so that nascent upstream entrants cannot realize minimum viable scale. Price squeezes can also create a dangerous probability of monopolization in a downstream market like DSL service that, until the premature deregulation of the upstream market, was a viable, standalone competitive market. An ILEC derives control of the bottleneck facilities not so much by virtue of using superior skill, foresight, or industry as by benefiting from the legacy of a state-sanctioned monopoly. A price squeeze could allow equally efficient downstream competitors that lack access to the

**A price-squeeze**

**monopolist could**

**reduce both**

**downstream and**

**upstream innovation**

**by eliminating rivals,**

**or by appropriating a**

**competitive rival's**

**productivity gains.**

<sup>87</sup> See, e.g., Sherman Act Section 2 Joint Hearing: Empirical Perspectives Session, Sept. 26, 2007. (presentation materials of Michael Scherer), available at [http://www.usdoj.gov/atr/public/hearings/single\\_firm/docs/218696.htm](http://www.usdoj.gov/atr/public/hearings/single_firm/docs/218696.htm); F.M. Scherer, *Technological Innovation and Monopolization* (Mar. 2006) (unpublished draft article), available at [http://www.usdoj.gov/atr/public/hearings/single\\_firm/docs/218697.htm](http://www.usdoj.gov/atr/public/hearings/single_firm/docs/218697.htm).

<sup>88</sup> Organization for Economic Cooperation and Development, Broadband Portal, available at <http://www.oecd.org/sti/ict/broadband> (May 19, 2008) (the United States remains fifteenth in the number of broadband subscribers per 100 inhabitants).

<sup>89</sup> U.S. Amicus Brief, *supra* note 33, at 19 (citing 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 767c, at 126 (2d ed. 2002)).

<sup>90</sup> *Id.* at 7.

<sup>91</sup> *Id.* at 12 ("in a price squeeze, the upstream monopolist can reduce downstream competitors' profit margins not only by effectively reducing competitors' revenues (i.e. lowering retail prices), but also by increasing their costs (i.e., raising wholesale prices).")

<sup>92</sup> COMPTEL Amicus Brief, *supra* note 45, at 12–15 (citing *Town of Concord*, 915 F.2d at 28–29).

input because they were not the prior state-sanctioned monopolist, to be foreclosed from competing on price and innovative services.

Professor Sidak argues that if a court were to require a monopolist to maintain a specific retail rate based on an equally efficient competitor's costs, the result would be the same as that achieved by an unlawful cartel of downstream competitors. The concern is that an erroneous finding of liability in cases involving "price cutting" would "chill the very conduct the antitrust laws are designed to protect."<sup>93</sup> If a firm must reduce its wholesale prices lockstep each time that it reduces its retail prices to preserve a specific cost-based profit margin for its downstream competitor-customers, then price-based competition will be chilled.<sup>94</sup> A monopolist may want to reduce retail prices because of changing market demand conditions, yet may not because the specter of price-squeeze liability would compel it to simultaneously lower wholesale prices.

But AT&T and its amici have not cited any empirical or anecdotal evidence that possible price-squeeze liability has deterred vertically integrated monopolists from legitimate price cutting. Also, price-squeeze theory posits the downstream market is competitive, so that competition ought to reduce retail prices to cost regardless of the conduct of the monopolist. In a price-squeeze case, it is the wholesale price that is set at the monopoly profit-maximizing level. The focus should arguably be on creating an administrable, judicially imposed remedy that would create incentives for the monopolist to reduce the wholesale rate to cost.

### What Is the Supreme Court Likely to Do?

The Court has a number of possible paths it can take in *linkLine*. Perhaps the Supreme Court should simply decide that certiorari was improvidently granted, not only because *linkLine* has decided not to challenge the petition, but also because the second district court Order, dealing with the applicability of *Brooke Group*, was not within the scope of the interlocutory appeal to the Ninth Circuit and thus within the certiorari petition. Or, the Court could decide in favor of AT&T and preclude margin-based price squeeze claims in unregulated and regulated markets by overturning *linkLine* and *Alcoa*. Rather than issue a broad ruling on the margin-based price squeeze by overturning *linkLine* and *Alcoa*, however, the Court might tailor its decision to the particular circumstance presented by this case. For instance, the Court could vacate *linkLine* and decide that in a market with even partial regulation, if a complainant can seek a remedy for anticompetitive conduct under existing regulatory procedures, then the intrusion of judicially imposed antitrust remedies might do more harm than good. On the other hand, if a market is unregulated or even very lightly regulated, it is possible that the Court would, and in our view should, hold that the margin-based price-squeeze claim—and *Alcoa*—survive *Trinko*. ●

---

<sup>93</sup> *Town of Concord*, 915 F.2d at 23.

<sup>94</sup> Sidak, *supra* note 38, at 294.

## FTC Hospital Merger Challenges: Is a “Fast-Track” Administrative Trial the Answer To the FTC’s Federal Court Woes?

**Robert C. Jones and Aimee E. DeFilippo**

When former FTC Chairman Timothy J. Muris began his tenure as Chairman of the FTC in 2001, federal antitrust enforcement agencies had lost a staggering seven consecutive hospital merger cases over an eight-year period.<sup>1</sup> Determined to reinvigorate the Commission's hospital merger program, the FTC embarked on a retrospective review of consummated hospital mergers in several cities across the country with an eye toward determining whether those mergers had, in fact, been anticompetitive. The plan was to publish the results in a report, with the expectation that those published results could be used as the foundation for reinvigorated enforcement.<sup>2</sup> The retrospective investigations were completed four years ago, but with one recent exception no report has thus far been issued, let alone vetted publicly. Consequently, we do not know which, if any, of the mergers the FTC challenged unsuccessfully actually harmed competition.<sup>3</sup>

One of the mergers the FTC investigated during the pendency of its retrospective evaluations was a consummated merger of two hospitals in Evanston, Illinois. The Evanston merger was not a true retrospective evaluation because it had not been investigated or challenged before consummation. Nevertheless, armed with post-acquisition evidence that the FTC believed showed the transaction had resulted in supracompetitive prices, the FTC brought an administrative complaint challenging the merger on February 10, 2004.<sup>4</sup> Twenty months later, an administrative law judge (ALJ) issued a decision concluding that the transaction had been anticompetitive.<sup>5</sup> The case was

<sup>1</sup> *FTC v. Tenet Healthcare Corp.*, 186 F.3d 1045 (8th Cir. 1999); *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121 (E.D.N.Y. 1997); *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996), *aff'd mem.*, 121 F.3d 708 (6th Cir. 1997); *United States v. Mercy Health Servs.*, 902 F. Supp. 968 (N.D. Iowa 1995), *vacated as moot*, 107 F.3d 632 (8th Cir. 1997); *FTC v. Freeman Hosp.*, 911 F. Supp. 1213 (W.D. Mo. 1995), *aff'd*, 69 F.3d 260 (8th Cir. 1995); *FTC v. Hosp. Bd. of Directors of Lee Cty.*, 1994-1 Trade Cas. (CCH) ¶ 70,593 (M.D. Fla.), *aff'd*, 38 F.3d 1184 (11th Cir. 1994). The California Attorney General also failed in a hospital merger challenge in the Oakland-Berkeley area of California. *California v. Sutter Health Sys.*, 84 F. Supp. 2d 1057 (N.D. Cal.), *aff'd mem.*, 217 F.3d 846 (9th Cir. 2000).

<sup>2</sup> Timothy J. Muris, *Everything Old Is New Again: Health Care and Competition in the 21st Century*, Remarks Before the 7th Annual Competition in Health Care Forum (Nov. 2002), available at <http://www.ftc.gov/speeches/muris/murishhealthcarespeech0211.pdf>.

<sup>3</sup> In August 2007, FTC spokesman Mitchell Katz stated that the FTC will eventually issue a report summarizing the results of the retrospective study. He noted that the Commission “is working on it now.” Greg Blesch, *Finding Victory in Legal Defeat*, MODERN HEALTHCARE, Aug. 13, 2007, at 6. While this article was being prepared, the FTC published a Bureau of Economics working paper on the 1999 acquisition of Summit Medical Center by Sutter Health, a transaction that was challenged unsuccessfully by the California Attorney General's Office but not by the FTC. (Author Robert Jones was part of the Jones Day team that represented Sutter Health in that litigation.) This preliminary working paper states that the merger may have been anticompetitive but notes that a full determination would require analysis of additional issues not addressed in the paper. See Steven Tenn, *The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction* 2 n.3 (Fed. Trade Comm'n Bureau of Econ. Working Paper No. 293, Nov. 2008), available at <http://www.ftc.gov/be/workpapers/wp293.pdf>.

<sup>4</sup> *Evanston Nw. Healthcare Corp.*, FTC Docket No. 9315 (Feb. 10, 2004) (complaint), available at <http://www.ftc.gov/os/caselist/0110234/040210emhcomplaint.pdf>.

<sup>5</sup> *Evanston Nw. Healthcare Corp.*, FTC Docket No. 9315 (Oct. 21, 2005) (initial decision), available at <http://www.ftc.gov/os/adjpro/d9315/051021idtextversion.pdf>.

■ **Robert C. Jones** is a Partner and **Aimee DeFilippo** is an Associate in the Washington office of Jones Day.

appealed to the Commission, and twenty-two months later the Commission affirmed the ALJ's conclusion.<sup>6</sup>

As soon as the Commission announced its decision in *Evanston*, antitrust practitioners began debating what influence the case would have on future FTC federal court challenges of prospective hospital transactions. Due to the Commission's retrospective review, its heavy reliance on postmerger pricing evidence, and its decision to forgo divestiture, the *Evanston* decision left many open questions about future merger enforcement. Thus, when the FTC announced in early May of 2008 that it was challenging the proposed merger of Inova Health Foundation and Prince William Health System (PWHS) in federal court,<sup>7</sup> it was widely expected that at least some of those questions would finally be answered.

*[T]he Commission engaged in a series of unusual procedural steps in an effort to move the case into its administrative process promptly, with a much more limited federal court review.*

As the first FTC challenge to a hospital merger in federal court since 1998, and the first since the Commission's *Evanston* decision, it was reasonable to expect that the FTC had chosen the long-awaited *Inova* case carefully (i.e., that it had chosen what it believed was a strong substantive case with robust evidence of anticompetitive effects) to convince a federal district court to enter a preliminary injunction. The FTC staff had ample time to prepare their merger challenge given that the pre-complaint investigation had been ongoing for one-and-a-half years.<sup>8</sup> Indeed, the FTC staff claimed to have a strong case against the merging hospitals, supported by over seventy signed fact affidavits and five experts ready to testify.<sup>9</sup>

But the FTC was not satisfied to rely upon that evidence and pursue a preliminary injunction in the type of federal court evidentiary hearing that had occurred in past hospital merger cases. Instead, the Commission engaged in a series of unusual procedural steps in an effort to move the case into its administrative process promptly, with a much more limited federal court review.<sup>10</sup> One conclusion clearly reached by the FTC from its history of failure in federal court was that the legal standard courts had been imposing on the FTC for a preliminary injunction was too high. The FTC wanted to lower that standard and move the *Inova* case quickly to an accelerated Commission administrative process.

<sup>6</sup> *Evanston Nw. Healthcare Corp.*, FTC Docket. No. 9315 (Aug. 6, 2007) (Commission opinion), available at <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf>. However, instead of affirming the ALJ's divestiture order, the Commission required the hospitals to establish separate managed care negotiating teams so that the merger efficiencies could be maintained but the ability of the hospitals to coordinate pricing would be constricted.

<sup>7</sup> *FTC v. Inova Health Sys. Found.*, No. 1:08CV460-CMH/JFA (E.D. Va. May 12, 2008) (complaint).

<sup>8</sup> In *Inova*, the parties took an unusually long period of time to respond to the Request for Additional Information and Documentary Material issued pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (Second Request). The parties announced the proposed transaction in April 2006 but did not file their premerger notification submissions until September 29, 2006. They then took fourteen months to comply with the Second Request, certifying substantial compliance in mid-November 2007. See Plaintiffs' Memorandum of Points and Authorities in Opposition to Defendants' Motion for a Scheduling Order and an Expedited Status Conference, *Inova*, No. 1:08-cv-460-CMH/JFA, at 5–6 (E.D. Va. May 20, 2008). By contrast, the FTC had just under four months to review the *Whole Foods* transaction before filing its complaint. See *Whole Foods Market, Inc.*, FTC Docket. No. 9324 (June 27, 2008) (complaint), available at <http://www.ftc.gov/os/adjpro/d9324/070628admincmplt.pdf> (announcing the merger challenge on June 27, 2007, and noting the merger's announcement in late February 2007).

<sup>9</sup> See Memorandum in Support of Motion for a Scheduling Order and an Expedited Status Conference, *Inova*, No. 1:08CV460-CMH/JFA (E.D. Va. May 16, 2008); Transcript of Hearing Before the Honorable Claude M. Hilton, *Inova*, No. 1:08CV460-CMH/JFA (E.D. Va. May 30, 2008).

<sup>10</sup> The FTC has the authority to initiate administrative proceedings under which it adjudicates whether the effect of a particular merger is to substantially lessen competition in a relevant market. But the FTC's general practice for mergers that have not been consummated is to seek a preliminary injunction in federal court pending a full evidentiary trial in an agency administrative proceeding. See FTC Rules of Practice, 16 C.F.R. §§ 3.1–3.72 and discussion *infra* pp. 3–7.

However, the FTC's efforts did not result in an administrative trial on the merits as the FTC said it had contemplated. While the FTC was successful in curtailing the federal court proceeding—the federal court decided to grant only a one-hour hearing, with no discovery—the prospect of thirteen months of administrative litigation on top of the twenty-one months of investigation that already had occurred in the case proved too much for Inova and Prince William. The parties abandoned their merger without a trial.<sup>11</sup> *Inova* thus potentially creates a new example, to be added to past cases, of what may happen if a federal court enters a preliminary injunction or defers judicial review of a pending merger in anticipation of the FTC's administrative process.

### Evolution of FTC Injunctive Authority

When the FTC was established over ninety years ago, Congress envisioned an antitrust agency with the ability to function “not simply as an antitrust prosecutor or analytical ‘think tank,’ but also as an adjudicator trying its own cases and rendering its own decisions.”<sup>12</sup> The FTC was thus empowered with an adjudicative function in which it files and litigates cases before agency administrative judges.

The FTC's enabling statutes, however, provided no mechanism for the agency to obtain an injunction to stop a merger before it was consummated. Given the well-recognized problems obtaining effective relief for consummated mergers (particularly when assets are scrambled after the merger)<sup>13</sup> and the potential harm to consumers while litigation challenging a consummated merger is pending,<sup>14</sup> the FTC had attempted to seek injunctions using existing authority, with mixed results.<sup>15</sup> Finally, in 1973, Congress enacted Section 13(b) of the FTC Act, which empow-

<sup>11</sup> See Joint Motion to Dismiss Complaint, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326 (June 11, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080611jointmodismisscmplt.pdf>; Press Release, *Inova Health System & Prince William Health System* (June 6, 2008), available at <http://www.inova.org/news/2008/inovapwhsmergerstatement.jsp> (citing as the reason for dissolving the merger the FTC's “unusual process changes . . . [which] threatened to prolong completion of the merger by as much as two years”).

<sup>12</sup> D. Bruce Hoffman & M. Sean Royall, *Administrative Litigation at the FTC: Past, Present, and Future*, 71 ANTITRUST L.J. 319 (2003).

<sup>13</sup> See, e.g., *FTC v. Nat'l Tea Co.*, 603 F.2d 694, 697 (8th Cir. 1979) (“[a]dministrative experience shows that the Commission's inability to unscramble merged assets frequently prevents entry of an effective order of divestiture”). In the *Inova* case, the FTC itself acknowledged the challenge that the Commission has faced in fashioning effective relief after the parties are allowed to consummate their merger:

During the course of the post-merger litigation, the acquired firm's assets, technology, marketing systems, and trademarks are replaced, transferred, sold off, or combined with those of the acquiring firm. Similarly, its personnel and management are shifted, retrained, or simply discharged. In these ways, the acquiring and acquired firms are, in effect, irreversibly “scrambled” together. The independent identity of the acquired firm disappears. “Unscrambling” the merger, and restoring the acquired firm to its former status as an independent competitor is difficult at best, and frequently impossible.

Complaint Counsel's Opposition to Respondents' Motion to Stay Discovery and All Other Aspects of this Proceeding, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326, at 4 (May 27, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080527ccopprespmostaydiscov.pdf> (citing William J. Baer, Remarks Before The Conference Board (Oct. 29, 1996)). See also Statement of Chairman Steiger in Support of Final Issuance of Consent Order, *Dominican Santa Cruz Hosp.*, 118 F.T.C. 382, 391 (1994) (concluding that divestiture was not an “appealing remedy” in the case of a consummated hospital merger where the acquired hospital had been converted to a skilled nursing facility and “the costs of conversion back to a hospital would, even under the best of circumstances, be substantial, with no guarantee of success”).

<sup>14</sup> See, e.g., FED. TRADE COMM'N, A STUDY OF THE COMMISSION'S DIVESTITURE PROCESS 3–4, 11 (1999), available at <http://www.ftc.gov/os/1999/08/divestiture.pdf>; see also Statement of Chairman Timothy J. Muris on Closing of Investigation of Genzyme Corporation Acquisition of Novazyme Pharmaceuticals, Inc. FTC File No. 021 0026, at 20 (Jan. 13, 2004), available at <http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf> (concluding that litigating a challenge to the consummated merger of Genzyme and Novazyme raised significant possibilities that the remedy may cause more harm to consumer welfare than the merger itself).

<sup>15</sup> Until Section 13(b) was enacted, the FTC could obtain preliminary injunctions only through a federal appellate court via the All Writs Act, 28 U.S.C. § 1651(a), or through one of three labeling statutes. See, e.g., *FTC v. Dean Foods Co.*, 384 U.S. 597 (1966).

ers the Commission to obtain injunctive relief in federal court for violations of any provision of law that the Commission enforces.<sup>16</sup> Under this authority, the FTC can temporarily halt consummation of a proposed merger or acquisition pending completion of an administrative proceeding at the Commission. Under Section 13(b), a district court may grant a preliminary injunction “[u]pon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest.”<sup>17</sup>

Courts usually have interpreted Section 13(b) to impose a fairly stringent standard on the FTC, requiring the Commission to “raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.”<sup>18</sup> While the FTC often argued that it need only show a “fair and tenable chance of success on the merits,” courts generally held that such a standard would not suffice for injunctive relief because it effectively reduces the judicial function “to a rubber stamp procedure” in violation of the congressional intent that courts exercise their “independent judgment” in reviewing the FTC’s preliminary injunction applications.<sup>19</sup> These courts also insisted that the FTC identify a credible relevant market and raise questions going to the “ultimate merits in a Clayton Act case—the lessening of competition,” in order to demonstrate to the court that the Commission will likely prevail on its challenge to the proposed acquisition.<sup>20</sup>

In adopting and applying these interpretations of Section 13(b), courts have recognized that the preliminary injunction hearing would ultimately decide the case because of the notoriously slow pace of FTC administrative proceedings.<sup>21</sup> In reality, if a party loses at the preliminary injunction stage, it “very often means the proposed deal will be scuttled, given the costs, delay, and uncertainty of a full-blown Section 7 trial.”<sup>22</sup> Many courts themselves have acknowledged that “[a] preliminary injunction may kill, rather than suspend, a proposed transaction.”<sup>23</sup> Indeed, no firm has continued to litigate a merger against the FTC after losing the preliminary injunction motion and

*Indeed, no firm has continued to litigate a merger against the FTC after losing the preliminary injunction motion and its appeal, if any.*

<sup>16</sup> H.R. Rep. No. 624, 93d Cong., 1st Sess. 116 (1971) (Conference Report).

<sup>17</sup> 15 U.S.C. § 53(b).

<sup>18</sup> *National Tea*, 603 F.2d at 698 (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978)); see also *Tenet Health Care*, 186 F.3d at 1051; *FTC v. Freeman Hosp.*, 69 F.3d 260, 267 (8th Cir. 1995); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1217–18 (11th Cir. 1991).

<sup>19</sup> *Tenet Health Care Corp.*, 186 F.3d at 1051. See also *Freeman Hosp.*, 69 F.3d at 267; *National Tea*, 603 F.2d at 698.

<sup>20</sup> *University Health*, 938 F.2d at 1217–18; see also *Tenet Health Care*, 186 F.3d at 1051 (noting that “Section 7 [of the Clayton Act] deals in probabilities not ephemeral possibilities”); *Freeman Hosp.*, 69 F.3d at 267 (requiring the FTC to actively define the relevant market instead of just raising serious or substantial questions about that market).

<sup>21</sup> See, e.g., *FTC v. Occidental Petroleum Corp.*, No. 86-900, 1986 WL 952, at \*13 (D.D.C. Apr. 29, 1986) (“No substantial business transaction could ever survive the glacial pace of an FTC administrative proceeding.”).

<sup>22</sup> ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS 547 (3d ed. 2008). See, e.g., *Mo. Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 870 (2d Cir. 1974) (“Experience seems to demonstrate that . . . the grant of a temporary injunction in a Government antitrust suit is likely to spell the doom of an agreed merger.”); *FTC v. Exxon Corp.*, 636 F.2d 1336, 1343 (D.C. Cir. 1980) (“[T]he issuance of a PI blocking an acquisition or merger may prevent the transaction from ever being consummated.”). In fiscal year 2005, the Commission authorized FTC staff to seek one preliminary injunction, which was later dismissed at the Commission’s request when the parties entered into a consent decree alleviating the Commission’s concerns. In 2003, FTC staff sought three preliminary injunctions; none of these cases made it to trial. In 2002, FTC staff sought five preliminary injunctions. Only one made it to trial, and the parties abandoned the transaction after entry of the preliminary injunction. ABA SECTION OF ANTITRUST LAW, FTC PRACTICE & PROCEDURE MANUAL 131 (2007) [hereinafter *FTC PRACTICE & PROCEDURE MANUAL*].

<sup>23</sup> *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1087 (D.C. Cir. 1981). See also *United States v. Syufy Enters.*, 903 F.2d 659, 663 (9th Cir. 1990) (noting that in antitrust cases, “a court ought to exercise extreme caution because judicial intervention in a competitive situation can itself upset the balance of market forces, bringing about the very ills the antitrust laws were meant to prevent”); *FTC PRACTICE & PROCEDURE*

its appeal, if any. The results of preliminary injunction proceedings effectively have been outcome determinative. Parties routinely argue that they must abandon their transaction if a preliminary injunction is granted.<sup>24</sup>

Because of the critical importance of preliminary injunction motions for the merging parties, courts traditionally have given the parties in FTC injunction cases considerable opportunity to present the merits of their cases. In one hospital merger, for example, the district court entered a preliminary injunction only after conducting a five-day evidentiary hearing and receiving the live or sworn written testimony of more than forty witnesses and approximately one hundred documentary exhibits.<sup>25</sup> Such cases are not isolated. In fact, preliminary injunction motions have effectively become mini-trials on the merits, with fact witnesses, expert testimony, and multiple-day proceedings in federal court.<sup>26</sup>

Given the magnitude of the preliminary injunction process, and the resources needed to litigate the motion, the FTC's administrative review traditionally has been stayed until resolution of the 13(b) action. In a recent speech, however, Commissioner Rosch lamented the emphasis on preliminary injunctions in merger cases at the expense of the FTC's administrative review, noting that such cases as *Arch Coal*<sup>27</sup> and *Western/Giant*<sup>28</sup> have resulted in federal courts making the

---

MANUAL, *supra* note 22, at 131 ("Due to the time sensitive nature of mergers and acquisitions, a preliminary injunction may have the effect of permanently terminating a transaction."); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1093 (D.D.C. 1997) ("This decision [to grant a preliminary injunction] will most likely kill the merger.").

<sup>24</sup> See, e.g., *FTC v. Arch Coal Inc.*, 329 F. Supp. 2d 109, 160 (D.D.C. 2004) ("If this court issues a preliminary injunction, on the other hand, Arch and Triton will abandon the transaction rather than undergo an administrative proceeding."). While the rationales are different, the FTC, for its part, has opted to dismiss the administrative complaint in every case since 1995 where a preliminary injunction was not issued and sustained on appeal. See Respondent's Motion to Stay Discovery and All Other Aspects of this Proceeding, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326 (May 23, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmo-staydiscov.pdf> (citing Statement of the Commission Concerning Dismissal of the Administrative Complaint, *Foster*, FTC Docket No. 9323 (Oct. 3, 2007); Statement of the Commission, *Arch Coal Inc.*, FTC Docket No. 9316 (June 13, 2005); Order Dismissing Complaint, *Tenet Healthcare Corp.*, FTC Docket No. 9289 (Dec. 23, 1999); Order Granting Motion to Dismiss, *Butterworth Health Corp.*, FTC Docket No. 9283 (Sept. 25, 1997); Order Dismissing Complaint, *Freeman Hosp.*, FTC Docket No. 9273 (Nov. 30, 1995)). In *Whole Foods*, the Commission stayed the administrative proceedings while it appealed the district court's denial of a preliminary injunction. It rescinded the stay in August 2008 after the appellate court reversed the district court's decision and remanded the case. See *Whole Foods Market, Inc.*, FTC Docket No. 9324, available at <http://www.ftc.gov/os/adjpro/d9324/index.shtm>.

<sup>25</sup> Brief for Plaintiff-Appellee Federal Trade Commission, *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045 (8th Cir. 1999) (No. 98-3123).

<sup>26</sup> FTC PRACTICE & PROCEDURE MANUAL, *supra* note 22, at 134 (citing Redacted Memorandum Opinion, *FTC v. Swedish Match*, No. 00-1501 (TFH), slip op. (D.D.C. Dec. 14, 2000) (granting preliminary injunction motion after five days of hearings and consideration of briefs, exhibits, and witnesses); *Butterworth Health Corp.*, 946 F. Supp. 1285 (denying preliminary injunction motion by FTC to block hospital merger after review of five full days of testimony and more than 900 exhibits)). Most recently, the FTC's challenges of *Arch Coal's* acquisition of *Triton Coal Company*, *Western Refining's* acquisition of *Giant Industries*, and *Whole Food's* acquisition of *Wild Oats Market* each involved extensive hearings in federal court. See *Arch Coal*, 329 F. Supp. 2d 109 (district court conducted ten days of preliminary injunction hearings, including testimony from eighteen witnesses, five experts, 1,067 exhibits, and seven substantive briefs); *FTC v. Foster*, 2007-1 Trade Cas. (CCH) ¶ 75,725 (D.N.M. May 29, 2007) (district court conducted four and one-half days of hearings and received into evidence numerous documents, declarations, and deposition transcripts); *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007) (district court conducted two days of hearings and received into evidence numerous transcripts, declarations, expert reports, exhibits, and the examination and cross-examination of two expert witnesses in court), *rev'd*, 533 F.3d 869, *reh'g denied en banc*, No. 07-5276, *op. amended & superceded*, 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008). In each preliminary injunction action lost by the FTC, the district court concluded that the FTC had failed to demonstrate a likelihood of success in proving that the proposed merger may substantially lessen competition or tend to create a monopoly. *But see* *FTC v. Whole Foods Market, Inc.*, 533 F.3d 869 (D.C. Cir. 2008) (reversing district court's ruling), *reh'g denied en banc*, No. 07-5276, *op. amended & superceded*, 2008 WL 5101226 (D.C. Cir. Nov. 21, 2008).

<sup>27</sup> *Arch Coal*, 329 F. Supp. 2d 109.

<sup>28</sup> *Foster*, 2007-1 Trade Cas. (CCH) ¶ 75,725.

Commission's likelihood of success on the merits the ultimate issue, rather than focusing on whether it is in the public interest for the FTC to review the case further.<sup>29</sup>

In keeping with Commissioner Rosch's comments, the FTC itself recently has voiced its unhappiness with the 13(b) standard used by the courts. In its challenge of the Inova/PWHS merger, the FTC urged the federal court to adopt a deferential view of the 13(b) standard the FTC was obliged to meet, arguing that the merits of the case should not be seriously addressed at the preliminary injunction stage but should instead be taken up by the FTC in its administrative trial.<sup>30</sup> The FTC insisted that merger challenges are best resolved through administrative litigation, and that the federal court action need only be a summary proceeding, based on the preexisting evidentiary record, to preserve the status quo pending the administrative review. By deciding to deny the merging parties' discovery request, granting only a one-hour hearing, and announcing that he was declining Inova's "invitation for me to get involved in trying this case" as it "needs to be tried before the Commission," the federal court in *Inova* made it clear that the FTC's petition would get only a cursory review and likely would be granted.<sup>31</sup>

Since the *Inova* case, Judges Brown and Tatel of the U.S. Court of Appeals for the D.C. Circuit separately have adopted a substantially reduced standard for preliminarily enjoining a merger under Section 13(b) that is consistent with the standard advocated by the FTC in *Inova*.<sup>32</sup> In the much publicized *Whole Foods* case, these two judges emphasized that the district court's obligation in a 13(b) case is not to demand that the FTC prove that a merger will undoubtedly violate the antitrust laws, but rather to weigh the Commission's chances of succeeding based on the evidence presented.<sup>33</sup> The judges concluded that, under Section 13(b), the FTC creates a presumption in favor of an injunction just by raising serious and substantial questions going to the merits of the case.<sup>34</sup> According to both judges, the FTC is entitled to this presumption unless it fails to show a likelihood of success, and the court can say with certainty that the merger would not substantially lessen competition.<sup>35</sup> *Whole Foods* petitioned the D.C. Circuit on August 26, 2008,

*Since the Inova case, Judges Brown and Tatel of the U.S. Court of Appeals for the D.C. Circuit separately have adopted a substantially reduced standard for preliminarily enjoining a merger under Section 13(b) that is consistent with the standard advocated by the FTC in Inova.*

<sup>29</sup> J. Thomas Rosch, Commissioner, FTC, A Peek Inside: One Commissioner's Perspective on the Commission's Roles as Prosecutor and Judge, Remarks Before the NERA 2008 Antitrust and Trade Regulation Seminar 13 (2008) available at <http://www.ftc.gov/speeches/rosch/080703nera.pdf> (asserting that courts in such cases "essentially turned proceedings on the Commission's application for a preliminary injunction into plenary trials on the merits").

<sup>30</sup> Complaint Counsel's Opposition to Respondents' Motion to Stay Discovery and All Other Aspects of This Proceeding, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326 (May 27, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080527ccopprespmostaydiscov.pdf>.

<sup>31</sup> See Transcript of Hearing at 12–13, *Inova*, No. 1:08-cv-460-CMH/JFA (E.D. Va. May 30, 2008). Indeed, the court refused to allow live testimony or cross-examination of experts in the federal court proceeding.

<sup>32</sup> The court of appeals originally issued an opinion with one judge dissenting. But in November, the court amended and reissued its July 2008 opinion to reflect that Judge David S. Tatel—while still concurring with Judge Janice Brown in her judgment to reverse the trial court's ruling and in her articulation of a lower legal standard for the FTC to obtain a preliminary injunction—no longer concurred with her opinion in support of that judgment. *FTC v. Whole Foods Market, Inc.*, 533 F.3d 869 (D.C. Cir. 2008), *reh'g denied en banc*, No. 07-5276, *op. amended and superceded*, 2008 WL 510226 (D.C. Cir. Nov. 21, 2008). As a result, there is no single opinion of the court.

<sup>33</sup> *Whole Foods Market*, 2008 WL 510226 at \*4 ("If, and only if, the district court's certainty was justified, it was appropriate for the court not to balance the likelihood of the FTC's success against the equities. However, the court's conclusion was in error."). See also *id.* at \*10–\*11 (concurring opinion).

<sup>34</sup> *Id.* at \*3. See also *id.* at \*10–\*11 (concurring opinion).

<sup>35</sup> *Id.* at 877. The *Whole Foods* majority even concluded that the FTC need not "settle on a market definition at this preliminary stage" because preliminary injunctions sought under Section 13(b) "are meant to be readily available to preserve the status quo while the FTC develops its ultimate case[.]" *Id.* at \*5. See also *id.* at \*10–\*11 (concurring opinion).

for a rehearing en banc; the court declined Whole Foods' request on November 21, 2008.<sup>36</sup> While there may be no citable opinion of the court in either instance, it appears there is an inclination of some judges in the D.C. Circuit and the Eastern District of Virginia to lower the bar for the FTC to obtain preliminary injunctions to block mergers.

The lower legal threshold for a preliminary injunction advocated by the Commission raises the issue of whether the FTC can provide the parties to an enjoined merger with a practical opportunity to address the merits in the FTC's administrative process. The *Inova* case was the first test of the FTC's new efforts to do so, and—as the parties abandoned their transaction in response to the anticipated delay—it seems to have failed.

### The FTC's Process Innovations in *Inova*

The procedures adopted by the FTC in the *Inova* case appeared to have had two objectives. First, the FTC wanted to adopt procedures it could use to help convince the federal court that an administrative trial on the merits would occur quickly, so that entry of a preliminary injunction would not automatically spell abandonment of the transaction. Second, independent of any federal court process, the FTC wanted to exercise increased control over the speed and substantive quality of the trial conducted before an administrative law judge. To do so, the FTC adopted procedural positions that departed drastically from past protocol.

**1. Commencing Administrative Litigation While Federal Court Proceeding Pending.** The FTC in *Inova* insisted that its administrative proceeding be commenced right away, rather than waiting for completion of the federal court process. While there have been some past cases in which the administrative process began before the federal court case was completed,<sup>37</sup> these have been rare, and discovery or other significant activity typically has awaited completion of the federal court case. Pressing forward with immediate discovery in the *Inova* administrative proceeding while the federal court action was pending may have helped the FTC convince the district court to severely limit its own review of the merits, but the court never said so.

It is not obvious, however, how moving forward immediately in the administrative case would move the administrative process to a quicker resolution, given that the common practice is for discovery conducted in the federal court proceeding to be available in the follow-on administrative trial. If that is done, waiting for completion of the preliminary injunction proceeding need cause no delay in the administrative litigation. Of course, it is possible that a district court would limit discovery more than the FTC administrative law judge, but that could be handled by supplementing the federal court discovery. Indeed, the FTC's existing fast-track procedures (discussed below)

---

<sup>36</sup> Order Denying Reh'g En Banc, *FTC v. Whole Foods Market, Inc.*, No. 07-5276 (D.C. Cir. Novv. 21, 2008). In denying the petition for a rehearing en banc, two circuit judges expressly stated that the judgment sets no precedent beyond the facts of the case. *Id.* at 2. Two weeks after the D.C. Circuit's refusal to rehear the case en banc, Whole Foods filed a lawsuit against the FTC, asking for an injunction barring the FTC from holding an administrative trial or from reviewing the case further. In the complaint, Whole Foods argues that the Commission violated Whole Foods' due process rights to a fair and impartial proceeding based on the Commission's "prejudgment biases," as well as its "unreasonable scheduling order" and failure to disqualify itself. Complaint, *Whole Foods Market, Inc. v. FTC*, No. 1:08-cv-02121, at 27–34 (D.D.C. Dec. 8, 2008).

<sup>37</sup> For example, the respondents in *Arch Coal* filed their answers, submitted declarations, negotiated a protective order and scheduling order, and engaged in preliminary discovery with the Commission during the pendency of the federal court action. *Arch Coal*, FTC Docket No. 9316, available at <http://www.ftc.gov/os/adjpro/d9316/index.shtm>.

explicitly contemplate administrative discovery conducted *after* completion of the preliminary injunction case to supplement the federal court discovery.<sup>38</sup>

The merging parties in the *Inova* case, for their part, sought to put more importance on the preliminary injunction hearing before the district court. They moved for a stay of the administrative proceedings pending the outcome of the preliminary injunction action, and they sought additional discovery and a three-day evidentiary hearing in federal court.<sup>39</sup> But Commissioner Rosch, sitting as ALJ, denied the parties' motion and insisted upon dual track proceedings.<sup>40</sup> The FTC staff took full advantage of Commissioner Rosch's decision, serving upon the merging parties "numerous deposition notices (one for nearly every business day in the first three weeks of June), requests for production, and requests for inspection,"<sup>41</sup> despite the lengthy and extensive investigation already conducted by FTC staff.<sup>42</sup>

**2. Imposition of Fast-Track Schedule.** The Commission also sought to assure the district court that the administrative action would move quickly, at least compared to the normal pace of Commission cases. Indeed, even before proceedings in front of Commissioner Rosch commenced, it was clear that the FTC had decided to accelerate the administrative process. In its press release announcing the filing of its complaint against Inova, the FTC pledged to accelerate the timing of its administrative hearing and the Commission appeal process. Specifically, the Commission committed to "make every effort" to review the initial decision, if appealed, within ninety days of its issue.<sup>43</sup> This commitment is particularly interesting in light of Commission history. A review of the last seven matters in which the Commission issued a decision reveals that the average time on appeal—from the initial decision to the Commission's final order—has been 21.6

---

<sup>38</sup> 16 C.F.R. § 3.11A (a) ("Scope and applicability. This section governs the availability of fast-track procedures in administrative cases where the Commission files a collateral district court complaint that seeks preliminary injunctive relief . . ."). To qualify for a fast-track proceeding, there must either be a preliminary injunction already entered in the case, or there must be an evidentiary record developed *in a federal court proceeding* in which an injunction was not entered, that is sufficient to facilitate expedited review at the Commission. *Id.* § 3.11A (b)(1) (emphasis added). Either way, it seems clear that the fast-track rules contemplate on their face that the administrative case starts after the preliminary injunction is concluded.

<sup>39</sup> See Respondents' Motion to Stay Discovery and All Other Aspects of this Proceeding Pending Resolution of Preliminary Injunction Action, Inova Health Sys. Found. & Prince William Health Sys. Inc., FTC Docket No. 9326 (May 23, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmostaydiscov.pdf>.

<sup>40</sup> Rosch stated that the Commission's Rules of Practice "encourage an expeditious resolution of administrative proceedings" and that moving forward with the administrative action was in the public interest and would benefit the parties regardless of the outcome of the federal court proceeding. Order Denying Respondent's Motion to Stay Administrative Proceedings, Inova Health Sys. Found. & Prince William Health Sys. Inc., FTC Docket No. 9326 (May 29, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmorecuseroschasalj.pdf> ("The Rules governing these proceedings begin by articulating the Commission's policy that '[administrative] proceedings shall be conducted expeditiously.' 16 C.F.R. § 3.1."). See also Rules of Practice Amendments, 61 Fed. Reg. 50,640, 50,640 (Sept. 26, 1996) ("The agency's longstanding policy has been that, to the extent practicable and consistent with requirements of law, adjudicative proceedings shall be conducted expeditiously and that both the Administrative Law Judge and litigants shall make every effort to avoid delay at each stage of a proceeding.").

<sup>41</sup> Joint Case Management Statement, Inova Health Sys. Found. & Prince William Health Sys. Inc., FTC Docket No. 9326, at 3 (May 28, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080528jointcasemngmntstmnt.pdf>.

<sup>42</sup> See *supra* note 9.

<sup>43</sup> Press Release, Fed. Trade Comm'n, FTC and Virginia Attorney General Seek to Block Inova Health System Foundation's Acquisition of Prince William Health System (May 9, 2008), available at <http://www.ftc.gov/opa/2008/05/inova.shtml> ("Should there be an appeal, the commissioners commit to make every effort to issue an appellate decision approximately 90 days after receiving a notice of appeal (assuming no cross-appeal) or 120 days (assuming a cross-appeal).")

months, and the shortest took a full year.<sup>44</sup> Thus, the Commission in *Inova* was promising dramatic improvement over its actual prior performance. Considering that the parties would need to be given time to prepare their briefs on appeal and to ready themselves for oral argument before the Commission—and considering that the Commission hears all appeals *de novo*—the Commission’s ninety-day promise seems particularly ambitious.

At the commencement of the *Inova* administrative proceeding, Commissioner Rosch ordered that the FTC’s fast-track schedule be used in the case.<sup>45</sup> Under fast track, the ALJ must file an initial decision within fifty-six days following the conclusion of the evidentiary hearing and no later than 195 days after a “triggering event.”<sup>46</sup> The Commission must issue its final order within thirteen months after the triggering event.<sup>47</sup>

*The fast-track*

*procedure adopted by*

*Commissioner Rosch*

*in Inova was a hybrid*

*procedure that was*

*actually contrary to*

*FTC rules.*

Fast-track proceedings are not automatic. To qualify for a fast-track proceeding under the Commission’s existing rules, one of two conditions must be met: (1) a federal court enters a preliminary injunction, or (2) a federal court proceeding results in an evidentiary record that facilitates expedited review.<sup>48</sup> If either of these conditions is satisfied, a respondent may elect to proceed under the fast-track rules.<sup>49</sup> The Federal Register entry codifying fast track explicitly states that a fast-track proceeding is appropriate in cases where both parties have obtained full discovery through the preliminary injunction proceeding, and the incorporation of the district court’s evidentiary record “is likely materially to facilitate prompt resolution of the adjudicatory proceeding.”<sup>50</sup>

The fast-track procedure adopted by Commissioner Rosch in *Inova* was a hybrid procedure that was actually contrary to FTC rules. First, as explained above, fast track was intended to speed up administrative review by giving the ALJ the discretionary authority to accept “discovery from

<sup>44</sup> See Schering-Plough Corp., FTC Docket No. 9297, available at <http://www.ftc.gov/os/adjpro/d9297/> (18 months between initial decision and Commission’s final order); PolyGram Holding, Inc., FTC Docket No. 9298, available at <http://www.ftc.gov/os/adjpro/d9298/index.shtml> (13 months between initial decision and Commission’s final order); Chicago Bridge & Iron Co., FTC Docket No. 9300, available at <http://www.ftc.gov/os/adjpro/d9300/index.shtml> (26 months between initial decision and Commission’s final order); Rambus Inc., FTC Docket No. 9302, available at <http://www.ftc.gov/os/adjpro/d9302/> (38 months between initial decision and Commission’s final order); Ky. Household Goods Carriers Ass’n, FTC Docket No. 9309, available at <http://www.ftc.gov/os/adjpro/d9309/index.shtml> (12 months between initial decision and Commission’s final order); N. Tex. Specialty Physicians, FTC Docket No. 9312, available at <http://www.ftc.gov/os/adjpro/d9312/index.shtml> (14 months between initial decision and Commission’s final order); Evanston Nw. Healthcare Corp., FTC Docket No. 9315, available at <http://www.ftc.gov/os/adjpro/d9315/> (30 months between initial decision and Commission’s final order).

<sup>45</sup> The FTC’s fast-track rules were adopted in 1995 in response to criticisms regarding the slowness of the FTC administrative process. Then-FTC Chairman Robert Pitofsky established a Special Task Force on Administrative Adjudication in an effort to find ways to streamline the adjudicative process, and the result was the decision to afford respondents the opportunity to have their administrative trial proceed under a fast-track procedure. 61 Fed. Reg. 50,640 (Sept. 26, 1996).

<sup>46</sup> 16 C.F.R. § 3.11A(c)(2)(iii). A triggering event is the latest of (1) the entry of a preliminary injunction, (2) service on the last respondent of the Commission’s determination with respect to whether there is an adequate evidentiary record, (3) service on the first respondent of the Commission’s administrative complaint, or (4) filing with the Secretary by the last respondent of a notice electing fast-track procedures. *Id.* § 3.11A(c)(1). Once the ALJ has issued his initial decision, parties must notify the Commission of an intent to appeal within three days after service of the ALJ’s decision. The appellant then has twenty-one days to file its appeal brief; reply briefs are due within fourteen days from the filing of the appeal brief. *Id.* § 3.11A(c)(2)(iv)–(vi).

<sup>47</sup> *Id.* § 3.11A(c)(3). The Commission may extend its thirteen-month deadline if (1) it intends to disclose in camera material in its opinion, or (2) it determines that adhering to the deadline would “result in a miscarriage of justice due to circumstances unforeseen at the time of the respondent’s election of the fast-track proceeding.” *Id.* § 3.11A(2)(c)(3).

<sup>48</sup> *Id.* § 3.11A(b)(1). Respondents must make this election within three days after the latest of (1) entry of a preliminary injunction, or (2) being served with notice of the Commission’s determination with respect to whether there is an adequate evidentiary record, or (3) being served with the Commission’s administrative complaint. *Id.* § 3.11A(b)(2).

<sup>49</sup> FTC PRACTICE & PROCEDURE MANUAL, *supra* note 22, at 136.

<sup>50</sup> 63 Fed. Reg. 7526, 7527 (Feb. 13, 1998).

*Notably, despite being available to respondents in merger cases for almost a decade, no respondent has ever elected the fast-track process. Perhaps this is because fast track is not fast enough to make a meaningful difference.*

the preliminary injunction hearing . . . as if the material had been discovered and presented in the administrative proceeding;” it was never intended by the FTC to be a substitute for a preliminary injunction.<sup>51</sup> Indeed, entry of a preliminary injunction is identified in the rules as the “triggering event” if one is entered.

Additionally, the fast-track process was set up to be an alternative that respondents in FTC proceedings could elect, not a process that would be forced upon them. The rules are clear that only the respondents in an FTC administrative proceeding are permitted to elect the fast-track schedule.<sup>52</sup> Indeed, to emphasize the elective nature of the fast-track process, the rules provide that—in cases where there are multiple respondents—each and every respondent must elect to proceed under fast track in order for a case to be subject to such expedited proceedings.<sup>53</sup> Commissioner Rosch, however, imposed fast-track procedures on the *Inova* respondents over their objections,<sup>54</sup> insisting that fast track was in the hospitals’ best interest because it would expedite, rather than delay, the proceedings.<sup>55</sup>

Notably, despite being available to respondents in merger cases for almost a decade, no respondent has ever elected the fast-track process. Perhaps this is because fast track is not fast enough to make a meaningful difference. Even under fast track, thirteen months would pass before the Commission renders a decision, and only then would the parties have an opportunity to present their case to a neutral trier of fact on appeal to a federal appellate court. By contrast, the preliminary injunction process—despite often functioning as a full trial on the merits—has generally proceeded rather quickly in FTC merger cases. In the last three preliminary injunction hearings sought by the Commission, the district court issued its decision an average of eighty-four days after the FTC filed its complaint in federal court.<sup>56</sup>

<sup>51</sup> 16 C.F.R. § 3.11A(b)(1)(ii).

<sup>52</sup> *Id.* § 3.11A(a). (“The Commission will afford the respondent the opportunity to elect such fast-track procedures . . .”). The FTC effectively acknowledged that the merging parties must elect a fast-track proceeding in their press release announcing the merger challenge. *See* Press Release, *supra* note 4 (“*Inova* and PWHS will be offered FTC’s ‘Fast Track’ administrative trial procedure.”) (emphasis added).

<sup>53</sup> 61 Fed. Reg. 50,640, 50,641 n.3 (Sept. 26, 1996).

<sup>54</sup> Order Denying Respondents’ Motion to Stay Administrative Proceedings, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326 (May 29, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080530orderdenying.pdf>. The merging parties in *Inova* argued that only they had the right to elect a fast-track proceeding, and that they had not chosen to do so in this case. Respondents’ Motion to Stay Discovery and All Other Aspects of this Proceeding Pending Resolution of Preliminary Injunction Action, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326 (May 23, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmostaydiscov.pdf>.

<sup>55</sup> Joint Case Management Statement, *Inova Health Sys. Found. & Prince William Health Sys. Inc.*, FTC Docket No. 9326, at 3 (May 28, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080528jointcasemngmntstmnt.pdf>.

<sup>56</sup> In *Whole Foods*, the district court opinion was issued seventy-two days after the FTC filed its complaint in federal court. *Whole Foods*, 502 F. Supp. 2d 1. In *Western/Giant*, the district court opinion was issued forty-seven days after the filing of the complaint in federal court. *Foster*, 2007-1 Trade Cas. (CCH) ¶ 75,725. Finally, in *Arch Coal*, the district court opinion was issued 134 days after the FTC filed its complaint. 329 F. Supp. 2d 109. In DOJ cases, the timing for a preliminary injunction is similar, but often slightly longer due to the fact that the DOJ often agrees at the outset to consolidate proceedings on its preliminary injunction motion with a trial on the merits of its demand for a permanent injunction. *See, e.g.*, *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004) (district court opinion issued 196 days after filing of the complaint); *United States v. UPM-Kymmene Oyj*, No. 03-C-2528, 2003 WL 21781902 (N.D. Ill. 2003) (district court opinion issued 101 days after filing of the complaint); *United States v. Sungard Data Sys. Inc.*, 172 F. Supp. 2d 172 (D.D.C. 2001) (district court opinion issued 23 days after filing of the complaint on account of acquired party in bankruptcy, thus necessitating an expedited trial).

The Commission, for its part, seems committed to applying the *Inova* schedule to future cases.<sup>57</sup> In a recent speech, Commissioner Rosch suggested that the FTC should play more of a judicial role in trying merger cases in administrative litigation before the FTC, regardless of the result of any preliminary injunction motion.<sup>58</sup> The FTC is now going forward with administrative proceedings at the Commission in the *Whole Foods* matter despite the fact that the case has been remanded to (and is now pending before) the district court to determine if enjoining the now-consummated merger is in the public interest.

Recently, the FTC proposed amendments to its rules to speed administrative discovery and hearings before ALJs, without regard to the pendency of federal court proceedings.<sup>59</sup> These rule changes should make the Commission's rules consistent with its practice in *Inova* and *Whole Foods*. However, the most significant problem with the Commission's attempt to impose an accelerated administrative proceeding as a substitute for a meaningful preliminary injunction hearing in federal court is that there is no evidence that it will work. No studies, reports, or analyses have been conducted (at least publicly) to support the conclusion that the sort of accelerated process attempted in the *Inova* case or proposed under the new rules is fast enough to enable parties to mergers to have their day in court at all. Instead, *Inova* stands as an example of the failure of the process contemplated by the FTC.

**3. Appointment of Commissioner Rosch as Administrative Law Judge.** The third unusual procedure in the *Inova* case was the appointment of Commissioner Rosch, a sitting Commissioner, as the administrative law judge. It appears that this was done, at least in part, to assure that the fast-track schedule would be imposed and the case would proceed rapidly. The *Inova* case represented the first time the FTC has taken the extraordinary step of designating a sitting Commissioner as the

---

<sup>57</sup> See Rosch, *supra* note 29, at 15 (“the Commission must somehow institutionalize the expertise and timing that occurred in the *Inova* matter”); Matthew Reilly, Comments at ABA Section of Antitrust Law Brown Bag Teleconference, An Autopsy of the FTC’s Challenge to the *Inova* Deal (July 22, 2008).

<sup>58</sup> See Rosch, *supra* note 29, at 16.

<sup>59</sup> Notice of Proposed Rulemaking and Request for Comment, Federal Trade Commission Rules of Practice 16 CFR Parts 3 and 4, 73 Fed. Reg. 58,832 (proposed Oct. 7, 2008). The proposed new rules would significantly affect the litigation schedule of merger and non-merger cases that come before the Commission. Included among the proposed changes are requirements that trials occur five months after the complaint is filed in merger cases, that respondents file an answer within fourteen days of service of the complaint, that the Commission—not the ALJ—decide dispositive pre-hearing motions, and that the length of trial be limited to the equivalent of thirty trial days. *Id.* Notably, the proposed rule changes do nothing to curtail the length of time that the Commission has to issue decisions on appeal, which is typically the most significant source of delay in Part 3 litigation. The new rules seem likely to disadvantage respondents in Commission administrative cases. See Geoffrey D. Oliver & Robert C. Jones, *FTC Rule Changes Would Squeeze Litigants*, COMPETITION LAW 360, Oct. 10, 2008, available at <http://competition.law360.com/articles/72262>.

Part of the problem with the use of fast track as an alternative to a federal court preliminary injunction process is that it typically follows a lengthy Hart-Scott-Rodino investigation. See Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a. The HSR Act requires that most mergers be notified to the FTC and the DOJ, and the merging firms are precluded from closing their transaction until thirty days after such notification. If the investigating agency asks for more information (i.e., the agency issues a Second Request), then the merging firms may not close their transaction until thirty days after substantially complying with the request. Compiling a Second Request response often takes several months and several million dollars, during which FTC staff has ample time to prepare a case properly for presentation to a federal district court in a preliminary injunction proceeding. Indeed, FTC staff working on *Inova* acknowledged having compiled “tens of thousands of pages of documents” from third parties during the pendency of the Second Request response. Plaintiffs’ Memorandum of Points and Authorities in Opposition to Defendants’ Motion for a Scheduling Order and an Expedited Status Conference, *FTC v. Inova Health Sys. Found.*, No. 1:08-cv-460-CMH/JFA, at 14 (E.D. Va. filed May 20, 2008). Unlike the FTC, the first opportunity for the merging parties to use compulsory process to gather information from the agency and from third parties occurs after the FTC files its motion for a preliminary injunction or its administrative complaint. See FTC PRACTICE & PROCEDURE MANUAL, *supra* note 22, at 132.

presiding ALJ in an FTC administrative proceeding.<sup>60</sup> In a recent postmortem teleconference discussing *Inova*, Inova's attorney contended that appointing a sitting Commissioner to oversee the matter was "inappropriate" and raised questions about the Commissioner's impartiality.<sup>61</sup> Inova also objected that the appointment would leave the Commission short a Commissioner when the case is appealed.<sup>62</sup> FTC staff, however, defended Rosch's appointment as ALJ, saying that—from the Commission's perspective—it was "the only way to reach a quick decision."<sup>63</sup>

Appointment of Commissioner Rosch as administrative law judge in the *Inova* case may well have served the Commission's objective of assuring the federal court that the administrative litigation would move along quickly. An ALJ might have been less likely than Commissioner Rosch to ignore the Commission's own rules to impose fast-track procedures over respondents' objections. However, it would seem more appropriate for the Commission to change its rules to meet its objectives, and that is what the Commission now proposes to do, albeit after the fact.<sup>64</sup>

## Conclusion

The *Inova* case has been touted as a victory by the FTC.<sup>65</sup> It was a victory in the sense that the FTC successfully blocked a hospital merger, something it had been unable to do for many years. Indeed, it may be that consumers are better off as a result, as the FTC claimed in its press release

---

<sup>60</sup> Since *Inova*, the FTC has appeared to be following a similar approach in the *Whole Foods* administrative case that has been in progress while appeals have been pending in federal court. Commissioner Rosch initially acted as the administrative law judge and presided over the case's schedule. Whole Foods opposed Rosch's involvement, arguing that he must recuse himself on account of his vote to investigate the merger in June 2007. Respondent's Motion to Disqualify the Commission as Administrative Law Judge, Whole Foods Market, Inc., FTC Docket No. 9324, at 2 (Aug. 22, 2008), available at <http://www.ftc.gov/os/adjpro/d9324/080822respmodisqualifycomm.pdf>. The Commission, with Commissioner Rosch participating, denied Whole Foods' recusal motion. Order Denying Respondent's Motion to Disqualify the Commission, Whole Foods Market, Inc., FTC Docket No. 9324 (Sept. 5, 2008), available at <http://www.ftc.gov/os/adjpro/d9324/080905order.pdf>. On September 10, in an unprecedented step, the Commission itself set the schedule for the case, requiring—among other things—that the hearing commence on February 16, 2009, and last no more than thirty days. Scheduling Order, Whole Foods Market, Inc., FTC Docket No. 9324 (Sept. 10, 2008), available at <http://www.ftc.gov/os/adjpro/d9324/080910schedulingorder.pdf>. However, a month later, the Commission issued an order designating Acting Chief Administrative Law Judge D. Michael Chappell as the ALJ for the administrative hearing set to begin in February 2009; the Commission also promised to make every effort to issue a decision in the case—if appealed—within forty-five days from the date of oral argument. Order Designating Administrative Law Judge, Whole Foods Market, Inc., FTC Docket No. 9324 (Sept. 5, 2008), available at <http://www.ftc.gov/os/adjpro/d9324/081020order.pdf>.

<sup>61</sup> Deborah Feinstein, Comments at ABA Section of Antitrust Law Brown Bag Teleconference, An Autopsy of the FTC's Challenge to the Inova Deal (July 22, 2008). See also Respondents' Motion to Recuse Commissioner J. Thomas Rosch as Administrative Law Judge, Inova Health Sys. Found. & Prince William Health Sys. Inc., FTC Docket No. 9326 (May 23, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmorecuseroschasalj.pdf>.

<sup>62</sup> Indeed, in *Inova*, the respondents noted that appointing a sitting Commissioner to act as ALJ precludes that Commissioner from further service in the capacity of a Commissioner with respect to that case. Due to a current vacancy at the Commission, Inova concluded that this "creates the distasteful prospect that approval or disapproval of this merger by the Commission might ultimately be determined by a mere two-person majority of three sitting commissioners." Respondents' Motion to Recuse Commissioner J. Thomas Rosch as Administrative Law Judge, Inova Health Sys. Foundation and Prince William Health Sys. Inc., FTC Docket No. 9326, at 4 (May 23, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080523respmorecuseroschasalj.pdf>.

<sup>63</sup> Reilly, *supra* note 57.

<sup>64</sup> Notice of Proposed Rulemaking and Request for Comment, Federal Trade Commission Rules of Practice 16 CFR Parts 3 and 4, 73 Fed. Reg. 58,832 (proposed Oct. 7, 2008).

<sup>65</sup> Press Release, Fed. Trade Comm'n, Statement of FTC's Bureau of Competition regarding Inova Health System's Announced Withdrawal of Plans to Merge with Prince William Health System (June 6, 2008), available at <http://www.ftc.gov/opa/2008/06/inova.shtml> ("We believe our success in stopping this proposed deal is a major victory for Northern Virginia consumers and affirms the critical importance of competition in the health care industry.")

after the transaction was abandoned.<sup>66</sup> But that claim was never proven because there was no trial. However, as an example of how hospital mergers can be challenged and tried administratively before they are consummated, *Inova* was a failure. There was, in fact, no trial under any standard before any trier of fact.

There are a number of potential reasons why the FTC may have lost hospital preliminary injunction cases in the past. Perhaps the theories of anticompetitive harm in those cases were not sound, so that the FTC should have lost them. Or perhaps the FTC staff did a poor job of presenting the cases and convincing the courts of the likely effects of the mergers. It is also plausible that the federal courts put more weight on issues that the FTC believes deserve little or no weight. Former Chairman Muris appears to have concluded that the problem is with the federal judges themselves—that these judges simply have failed to properly analyze the evidence the FTC presented.<sup>67</sup> The present Commission may well agree or may believe, as Commissioner Rosch suggests, that a preliminary injunction process simply provides insufficient time to develop and present the necessary evidence. The Commission's actions in the *Inova* case are a logical response to such perceptions. The goal was to limit the role of the federal court proceeding substantially and to instead try the case at the FTC through various procedural changes that seek to hasten the pace of administrative review. But if anything, the *Inova* case raises more questions than it answers:

- Was there any basis from the hospital merger retrospective study (or otherwise) to conclude that the federal courts in those cases had been wrong? If they were not wrong, then was there a need to change how these cases have been handled and the legal standard used?
- Does the *Inova* case provide any reason to modify the historic view that a preliminary injunction will doom a merger because it will not be able to endure the time required for a full trial on the merits, even under the FTC's fast-track process or its proposed new rules?
- Regardless of the answers to the questions above, is there a good reason for the FTC to commence administrative litigation while a federal court case is pending and discovery is occurring in that case, if the merging parties themselves would prefer to wait?
- Should the FTC evaluate its HSR investigation processes and procedures in conjunction with its administrative litigation rules, considering the combined time a merger would be pending if it is challenged and the extensive combined discovery and trial preparation time available in both steps?
- Why should the legal standard for federal court review of a merger turn on whether the merger happens to be investigated by the FTC rather than the Department of Justice?

The answers to these questions are likely to emerge as the Commission challenges further mergers in federal courts in various circuits, pursues its proposed rule changes, and attempts to conduct administrative hearings on an accelerated schedule. ●

---

<sup>66</sup> *Id.*

<sup>67</sup> See William M. Sage, *Protecting Competition and Consumers: A Conversation with Timothy J. Muris*, 22 HEALTH AFF. 101, 103 (2003) (suggesting that judges do not always understand how to evaluate evidence in hospital merger cases and noting that “[c]ourts have used the Elzinga-Hogarty patient flow test to define geographic markets, which I think doesn’t make a lot of sense in a health care context”). Muris has also noted that the hospital merger retrospective will “allow the Commission to give guidance on what it thinks is the appropriate methodology for evaluating a hospital merger.” *Id.* Additionally, Muris notes that “at the margin, being in front of the local judge [in a preliminary injunction hearing] may make a difference” in the outcome of the case. *Id.* at 104.

## ***Bell Atlantic Corp. v. Twombly:*** **Requiring a Plausible Analysis at the Pleadings Stage**

### **Gerald A. Stein**

The U.S. Supreme Court's decision in *Bell Atlantic Corp. v. Twombly*<sup>1</sup> requires courts and litigants to grapple with a threshold issue at the outset of Sherman Act Section 1 actions: whether the complaint alleges the existence of a plausible and unlawful conspiracy. Prior to *Twombly*, complaints asserting conclusory allegations of an unlawful conspiracy commonly survived the pleadings stage.<sup>2</sup> Many defendants therefore refrained from expending resources on pre-answer motions to dismiss because courts routinely held that evidentiary facts, if any, proving the conspiracy could be established during discovery and adjudicated during summary judgment or trial. Any resources spared by abstaining from pre-answer motion practice, however, were quickly spent many times over during the subsequent discovery phase.

*Twombly* changes all that. District courts are now required to dismiss at the pleadings stage conspiracy allegations that are not plausible. Drawing on the concept of "plus factors" firmly established in the context of summary judgment motions,<sup>3</sup> the Supreme Court held in *Twombly* that a claim under Section 1 must be dismissed when the complaint fails to allege evidentiary facts sufficient to make an inference of a conspiracy plausible. A complaint that merely alleges an opportunity to conspire, or that alleges facts that could support a plausible, non-conspiratorial explanation for the alleged agreement, is not sufficient to permit an inference of conspiracy. Recognizing today's spiraling litigation costs, the Court liberated defendants from the "no set of facts" standard<sup>4</sup> that permitted complaints to proceed to expensive discovery even when they presented only conclusory allegations of conspiracy.

*Twombly*'s plausibility standard was not met with universal fanfare. Dissenting from the majority's opinion in *Twombly*, Justice Stevens argued that the new pleading standard will "invite lawyers' debates over economic theory to conclusively resolve antitrust suits in the absence of any evidence."<sup>5</sup> Justice Stevens reasoned that *Twombly* "permits immediate dismissal based on the

■ **Gerald A. Stein** is counsel at O'Melveny & Myers LLP in New York, and a member of the firm's Litigation Department and Antitrust & Competition Group. The author gratefully acknowledges the extensive contributions of James E. Miller, who will be joining the firm as an associate in the Fall 2009. The views expressed herein are the author's and not necessarily those of the firm.

---

<sup>1</sup> 127 S. Ct. 1955 (2007).

<sup>2</sup> See, e.g., *Hosp. Bldg. Co. v. Trustees of Rex Hosp.*, 425 U.S. 738, 746 (1976) ("in antitrust cases, where 'the proof is largely in the hands of the alleged conspirators,' . . . dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly").

<sup>3</sup> See, e.g., *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984); see also *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954) ("[T]his court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense . . . '[C]onscious parallelism' has not yet read conspiracy out of the Sherman Act entirely.").

<sup>4</sup> *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

<sup>5</sup> *Twombly*, 127 S. Ct. at 1988 (Stevens, J., dissenting).

assurances of company lawyers that nothing untoward was afoot[.]”<sup>6</sup> which he argued ran counter to the purpose of the relaxed pleading standards of the Federal Rules.<sup>7</sup>

Over eighteen months and thousands of citations later, this article now examines how rigorously district courts are analyzing the plausibility of conspiracy claims at the pleadings stage and whether any trends have developed to predict the types of allegations that sufficiently allege a plausible conspiracy.<sup>8</sup>

### ***Twombly* Requires a Plausible Conspiracy**

Section 1 of the Sherman Act prohibits “[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States.”<sup>9</sup> Thus, the fundamental issue that a court must decide in many motions to dismiss is whether the Section 1 complaint contains factual allegations sufficient to support a finding of an unlawful and plausible conspiracy. It is well established that conscious parallelism cannot form the basis of a Section 1 conspiracy.<sup>10</sup>

The plaintiffs in *Twombly* alleged a conspiracy between Bell Atlantic and its competitors, asserting that there was an illegal agreement among them, but they did not allege facts concerning the nature of the agreement, the parties involved, or when the agreement was purportedly formed. The plaintiffs merely alleged “on information and belief” that an agreement could be inferred from the companies’ parallel marketplace conduct. The district court dismissed the complaint finding that plaintiffs’ allegations “provide[d] no reason to believe that defendants’ parallel conduct was reflective of any agreement.”<sup>11</sup> On appeal, the Second Circuit found the pleading sufficient under the controlling precedent of *Conley v. Gibson*, in which the Supreme Court had held that a motion to dismiss could be granted only when there is “no set of facts” that a plaintiff could prove under the allegations of the complaint that would entitle it to relief.<sup>12</sup>

The Supreme Court in *Twombly* overturned its prior precedent to set a more demanding standard for pleading a Section 1 conspiracy: the complaint must allege evidentiary facts that show that the purported conspiracy is not just conceivable, but that it is plausible. Acknowledging the high stakes and expense of complex antitrust litigation, the Court held that a complaint must contain “enough factual matter (taken as true) to suggest that an agreement was made[.]” so as to “raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”<sup>13</sup> As one leading commentator noted, “Although the Court insisted that it was not applying a heightened pleading standard comparable to Federal Rule 9(b), which requires parties to plead fraud or mistake ‘with particularity,’ it did require the plaintiff alleging an agreement to plead enough ‘grounds,’ ‘context,’ ‘circumstance,’ or ‘fact’ to make the claim ‘plausible.’”<sup>14</sup>

***[T]he fundamental issue that a court must decide in many motions to dismiss is whether the Section 1 complaint contains factual allegations sufficient to support a finding of an unlawful and plausible conspiracy.***

<sup>6</sup> *Id.* at 1975 (Stevens, J., dissenting).

<sup>7</sup> *Id.* at 1976 (Stevens, J., dissenting). Justice Stevens more forcefully argued that the majority’s “‘plausibility’ standard is irreconcilable with Rule 8 and with our governing precedents.” *Id.* at 1983.

<sup>8</sup> Although *Twombly* has been cited in numerous other contexts in antitrust cases and in other areas of law, this article focuses only on Section 1 conspiracy claims.

<sup>9</sup> 15 U.S.C. § 1.

<sup>10</sup> See, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

<sup>11</sup> *Twombly v. Bell Atl. Corp.*, 313 F. Supp. 2d 174, 189 (S.D.N.Y. 2003).

<sup>12</sup> 355 U.S. 41, 45–46 (1957).

<sup>13</sup> *Twombly*, 127 S. Ct. at 1965.

<sup>14</sup> William H. Page, *Twombly and Communication: The Emerging Definition of Concerted Action Under the New Pleading Standards* (University of Florida Levin College of Law Research Paper No. 2008-01, Oct. 19, 2008), available at <http://ssrn.com/abstract=1286872> at 10.

The Court reasoned that parallel conduct that is “consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market” is not sufficient to sustain a complaint.<sup>15</sup> Applying that rationale, allegations based only on conduct that may be consistent with conspiracy but also in line with accepted competitive business strategy, such as publicly publishing prices or other information, also would be subject to dismissal.<sup>16</sup>

Antitrust claims arise in a limitless variety of circumstances and industries, so there can be no particular set of allegations that courts will uniformly find sufficient.<sup>17</sup> But recent decisions reveal certain trends in how courts analyze conspiracy claims in light of *Twombly*. Many courts have denied motions to dismiss where plaintiffs plead specific facts to support their conspiracy claims, such as direct communications among competitors and attendance at specific meetings at or around the time of the alleged anticompetitive behavior. Fewer courts have sustained complaints based on parallel conduct supported by generalized, conclusory allegations of “meetings,” “conversations,” and “agreements.” The closer calls are when the alleged conspiracy is challenged on the ground that it is not economically plausible. In those cases, the outcome largely depends on how rigorously the court tests the allegations and understands the economics of the relevant product and geographic markets.

### What Is a Plausible Conspiracy After *Twombly*?

The most obvious and natural course of action for plaintiffs attempting to satisfy *Twombly*'s plausibility threshold is to plead specific facts that demonstrate the existence of an unlawful conspiracy. Plaintiffs' ability to pursue this strategy obviously is constrained by the pre-discovery facts in their possession or facts for which they will likely have evidentiary support after a reasonable opportunity for discovery.<sup>18</sup> The Court acknowledged this reality in *Twombly*: “Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”<sup>19</sup> The Court further explained that, “before proceeding to discovery, a complaint must allege facts suggestive of illegal conduct.”<sup>20</sup>

Not all allegations of conspiratorial conduct are weighed equally in determining whether a conspiracy has been sufficiently alleged. Certain alleged communications among competitors have a higher correlation with success for plaintiffs. For example, a leading commentator explains:

Communication of intent and reliance is a tangible, culpable action that differs from the actions of firms in ordinary competition or in simple conscious parallelism. The character of the communications and their proximity to parallel action in conformity with the communications, distinguishes them from other,

---

<sup>15</sup> *Twombly*, 127 S. Ct. at 1964.

<sup>16</sup> See Page, *supra* note 14, at 18–32 (discussing the legal continuum of the forms of competitor communications).

<sup>17</sup> As one commentator noted: “Taking merely the antitrust context, numerous elements of various claims present potential avenues for ‘plausibility’ arguments at the motion to dismiss stage: market definition, injury and recoupment, to name just a few.” Scott Martin, *One Year Post-‘Twombly,’ Trends Emerge*, N.Y.L.J., Aug. 25, 2008, at S4 (Litigation Special Section).

<sup>18</sup> See also Fed. R. Civ. P. 11.

<sup>19</sup> *Twombly*, 127 S. Ct. at 1965.

<sup>20</sup> *Id.* at 1969 n.8.

benign exchanges. It thus provides a focus for judges and juries at the key decisional stages of the legal process, including pleading.<sup>21</sup>

Our review of post-*Twombly* cases reveals that plaintiffs who pursue three types of pleading strategies generally have been able to demonstrate a plausible conspiracy under *Twombly*.

- First, allegations of private communications between alleged conspirators, such as specific cites to emails, telephone calls, or in-person conversations with competitors, particularly when coupled with direct quotes that make explicit reference to an agreement or to anticompetitive actions taken in furtherance of an agreement.
- Second, allegations that the conspirators are parties to a separate agreement or relationship (often a contract, joint venture, or membership in a trade association) if they assert the opportunity and perhaps the motive to conspire. From this, plaintiffs can allege regular communications between conspirators consistent with an agreement or conspiracy.
- Third, allegations of specific actions taken by defendants pursuant to the alleged agreement or conspiracy, particularly where those actions are inconsistent with past practices or depart from rational business practices.

**Allegations of Communications Among Co-Conspirators.** Not surprisingly, the most persuasive allegations of conspiratorial conduct are specific communications among defendants, particularly where the conspirators allegedly shared non-public or proprietary pricing, strategic, or technical information.<sup>22</sup>

Citing specific communications and alleging details, such as date, message content, or parties involved, is akin to presenting the court with a smoking gun; such an allegation will be a significant factor in the court's decision on a *Twombly* challenge, if not the decisive one. After all, details of specific incriminating communications establishing the existence of an actual agreement is the best evidence that plaintiffs can reasonably be expected to produce, short of an admission from a defendant or an actual signed agreement to violate antitrust laws. Two such cases are discussed below.

In *In re OSB Antitrust Litigation*<sup>23</sup> allegations of a horizontal price-fixing conspiracy among manufacturers of oriented strand board (OSB) were supported by two specific communications by defendant Louisiana-Pacific in which Louisiana-Pacific informed its competitors of planned mill downtime. In addition to the specific private communications among the competitors, the plaintiffs also alleged that the defendants fixed prices by publishing their prices twice a week in an industry periodical and using these published prices to monitor whether any member of the conspiracy cheated by offering significantly different prices. The court found determinative that the plaintiffs specifically alleged that the defendants kept OSB from the market through shutting down mills, delaying or canceling the construction of new OSB mills, purchasing OSB from competitors instead of manufacturing it themselves (which would have been cheaper) and maintain-

Not surprisingly,  
the most persuasive  
allegations of  
conspiratorial  
conduct are specific  
communications among  
defendants, particularly  
where the conspirators  
allegedly shared  
non-public or  
proprietary pricing,  
strategic, or technical  
information.

<sup>21</sup> Page, *supra* note 14, at 17–18. Moreover, “private communications are far more probative of agreement than public ones. . . . Because [public] announcements provide benefits to consumers, and serve a variety of other functions, they do not convey any clear reliance on rivals to follow suit.” *Id.* at 31.

<sup>22</sup> See, e.g., *In re Static Random Access Memory Antitrust Litig. (In re SRAM)*, No. 07- 01819, 2008 U.S. Dist. LEXIS 15826 (N.D. Cal. Feb. 14, 2008) (exchange of technical “product roadmaps” and pricing information); *Hyland v. Homeservices of Am., Inc.*, No. 05-612, 2007 U.S. Dist. LEXIS 65731 (W.D. Ky. Aug. 17, 2007) (exchange of price information and catalogues); *In re OSB Antitrust Litig.*, No. 06-826, 2007 U.S. Dist. LEXIS 56573 (E.D. Pa. Aug. 3, 2007) (announcement of planned “mill downtime,” and exchange of price information via industry periodical).

<sup>23</sup> No. 06-826, 2007 U.S. Dist. LEXIS 56573 (E.D. Pa. Aug. 3, 2007).

ing low operating rates at the mills. The court distinguished the mere parallel conduct alleged in *Twombly* by considering “in combination” plaintiffs’ “explicit allegations of defendants’ agreement to fix prices through [the industry publication], and their price-fixing discussions during industry events.”<sup>24</sup>

Likewise, the plaintiffs in *In re Static Random Access Memory (SRAM) Antitrust Litigation* successfully opposed a motion to dismiss under *Twombly* when they quoted numerous internal and inter-defendant emails sharing technical “product roadmaps” and confidential pricing information.<sup>25</sup> Although the court acknowledged that most of these emails did not independently establish a conspiracy, the court concluded that taken together, the communications were sufficient to satisfy *Twombly*.

In both cases, detailed allegations of defendants’ private communications with each other were decisive for each court in finding that *Twombly*’s plausibility threshold was reached. Another advantage of specific allegations of inter-defendant communications is the dual effect of making the requisite conspiracy more plausible, and of “rais[ing] a reasonable expectation that discovery will reveal [additional] evidence of illegal agreement.”<sup>26</sup> Communication between defendants strongly supports the inference of an agreement either by alluding to the agreement itself or by discussing activity that appears to be pursuant to the agreement.<sup>27</sup> Allegations of such communications may be tantamount to an admission by the speaker that the conspiracy actually exists. Where allegations of the content of communications cannot be made with specificity, references to messages or conversations between defendants may strongly support the inference that discovery will be fruitful—one of the formulations for *Twombly*’s threshold of plausibility—because a court may decide that discovery will reveal the nature of the information exchanged.

In contrast, complaints that allege only unilateral communications will likely not support the inference of a “meeting of the minds” or “conscious commitment to a common scheme” that forms the basis of an adequately pled Section 1 conspiracy. Thus, allegations of internal communications that did not involve other co-conspirators also may not be enough to “nudge” an alleged conspiracy across the line from conceivable to plausible.

It is useful to compare cases like *Twombly*, which contained a unilateral statement,<sup>28</sup> with *In re OSB* and *In re SRAM*, both of which involved allegations of responses by co-conspirators. The *In re SRAM* court cited an “email chain” between codefendants Hitachi and Samsung, as well as an email solicitation to “exchange product roadmaps again” that alludes both to an expected response as well as to past reciprocal exchanges.<sup>29</sup> Similarly, the announcement of its mill downtime by defendant Louisiana-Pacific in *In re OSB* takes on a bilateral character when paired with the allegation that its recipients took specific actions in response—namely that they “began to take production downtime” themselves.<sup>30</sup>

---

<sup>24</sup> *Id.* at \*5.

<sup>25</sup> *In re SRAM*, 2008 U.S. Dist. LEXIS 15826, at \*42–\*44.

<sup>26</sup> *Twombly*, 127 S. Ct. at 1965.

<sup>27</sup> See, e.g., *In re SRAM*, 2008 U.S. Dist. LEXIS 15826, at \*42 (discussing defendant’s email solicitation to “exchange product roadmaps again”).

<sup>28</sup> The CEO of an alleged co-conspirator stated that “competing in the territory of [another competitor] ‘might be a good way to turn a quick dollar, but that doesn’t make it right.’” *Twombly*, 127 S. Ct. at 1962.

<sup>29</sup> *In re SRAM*, 2008 U.S. Dist. LEXIS 15826 at \*42, \*44 (emphasis added).

<sup>30</sup> *In re OSB*, 2007 U.S. Dist. LEXIS 56573, at \*7.

**Allegations of Pre-Existing Relationships Among Co-Conspirators.** Alleging a specific pre-existing relationship between defendants can greatly improve the chances that a court will find a plausible conspiracy in three ways. First, a prior arrangement between defendants can color a court's analysis of parallel conduct alleged in the complaint because a prior relationship between defendants suggests that the parallel conduct may in fact be conspiratorial. Second, it is incrementally easier to demonstrate the existence of an agreement extending into unlawful conduct if plaintiff can demonstrate that defendants already had some form of agreement in place. Third, allegations of pre-existing relationships also assist in convincing the court that discovery will produce additional evidence.

*[I]t is incrementally easier to demonstrate the existence of an agreement extending into unlawful conduct if plaintiff can demonstrate that defendants already had some form of agreement in place.*

Pre-existing relationships between defendants are often alleged in the form of contracts to buy and sell goods or services, as in *Babyage.com, Inc. v. Toys "R" Us, Inc.*,<sup>31</sup> or other business affiliations, such as the joint venture in *Fair Isaac Corp. v. Equifax, Inc.*<sup>32</sup> In both of those cases, the allegations of prior relationships between defendants cast the alleged parallel conduct in a more suspicious light.

In *Babyage.com*, the plaintiff-retailers alleged that a retail price maintenance program imposed by certain manufacturers of baby products was the result of an illegal conspiracy between Babies "R" Us (BRU) and the manufacturers. BRU is one of the largest purchasers of products from those manufacturers. The plaintiff-retailers had attempted to undercut BRU's prices for certain products also sold by BRU. Plaintiffs alleged that BRU used its purchasing power and relationships with manufacturers to insist that the manufacturers impose an RPM policy to prevent the smaller retailers from undercutting BRU's prices.

In *Fair Isaac*, the credit bureau defendants' seemingly coincidental decisions to deny Fair Issac access to credit data were no longer presumed innocent in light of their joint venture to operate VantageScore as Fair Isaac's competitor. Allegations of an existing relationship between defendants can thus make allegations of otherwise isolated activities seem connected, particularly when the relationship gives defendants an economic incentive to coordinate the conduct in question.

In cases where allegations of certain pre-existing relationships between defendants lean toward finding a strong plausibility of a conspiracy, the crucial question becomes whether the conduct was undertaken pursuant to the agreement and whether it was an illegal restraint of trade. For example, plaintiff cable subscribers in *Behrend v. Comcast Corp.* distinguished *Twombly* on the basis that defendant cable companies had actual agreements to swap shares in certain geographic markets.<sup>33</sup> The pivotal question then became whether the swap transactions were illegal under the Sherman Act. Plaintiffs' detailed descriptions of defendants' contracts moved the court substantially closer to sustaining the complaint by clearly demonstrating that the defendants had

<sup>31</sup> 558 F. Supp. 2d 575, 582 (E.D. Pa. 2008) (noting that defendant Babies "R" Us had "significant power" over each manufacturer as a principal retailer).

<sup>32</sup> No. 06-4112, 2008 U.S. Dist. LEXIS 16664, at \*17-\*18 (D. Minn. Mar. 4, 2008) (finding plausible pleading of agreement when codefendant credit bureaus' parallel conduct was taken in light of their "recent agreement to jointly own and control VantageScore").

<sup>33</sup> 532 F. Supp. 2d 735, 738-39 (E.D. Pa. 2007).

an agreement, and by showing that the conduct at issue was unambiguously contemplated by the language of their contract.<sup>34</sup>

Finally, allegations of a contractual relationship between co-defendants can prompt the court to find that *Twombly's* expectation of fruitful discovery threshold has been satisfied.<sup>35</sup> Substantial business relationships are bound to generate discoverable material from the contract itself to the supporting materials and communications that go into its creation and enforcement. For example, in *Transworld Techs., Inc. v. Raytheon Co.*, the plaintiff, a U.S. Navy defense contractor, brought an action against two defendants for allegedly entering into a conspiracy to prevent the plaintiff from bidding on a certain naval contract. The court found sufficient allegations that the defendants had worked together on other aspects of the contract and that enough circumstantial facts had been pled “to raise a reasonable expectation that discovery will reveal an illegal agreement.”<sup>36</sup>

Such allegations, however, were not sufficient in *In re Digital Music Antitrust Litigation*,<sup>37</sup> where the plaintiffs alleged that the defendants conspired to fix prices of digital music through the use of two distribution joint ventures and through defendants’ business dealings with third-party licensees. The joint ventures allegedly operated as a means by which the defendants could impose price and use restrictions and impose restrictive licensing arrangements. The plaintiffs alleged that these arrangements were contrary to the economic self-interest of the individual defendants and were therefore shams. The court disagreed, finding that “the bald allegation that the joint ventures were shams is conclusory and implausible [and] . . . ignores the context in which those entities were created.” The *Digital Music* court reasoned: “In the absence of any formal veil-piercing allegations and without challenging the legality of those joint ventures under the antitrust laws, Plaintiffs cannot now call into question their legitimacy simply by describing conduct consistent with rational business decisions.”<sup>38</sup> The court further reasoned that it “is common sense that some level of information sharing must inevitably occur in the operation of a joint venture.”<sup>39</sup> The court thus rejected as unreasonable the plaintiffs’ argument that the defendants’ subsequent adoption of parallel price and use restrictions resulted solely from an agreement based on their creation of or membership in the joint ventures, in the absence of any other allegations tending to show an illegal agreement.

***Allegations of Actions Taken Pursuant to the Conspiracy.*** Allegations of specific conduct taken pursuant to an alleged conspiracy are a third way in which plaintiffs can demonstrate a plausible con-

---

<sup>34</sup> *Id.* at 741 (discussing plaintiffs’ allegations as “sufficient to show [that] an ‘agreement’ was made . . . and how the terms thereof allegedly eliminated competitors.”); see also *Jabo’s Pharmacy v. Becton Dickenson & Co.* (*In re Hypodermic Prods. Antitrust Litig.*), No. 05-1602, 2007 U.S. Dist. LEXIS 47438, at \*25–\*26 n.12 (D.N.J. June 29, 2007) (finding a plausible complaint based on allegations of contracts between defendant medical device manufacturer and defendant distributors, pursuant to which distributors imposed anticompetitive contract terms on retail purchasers); *Omnicare Inc. v. UnitedHealth Group, Inc.*, 524 F. Supp. 2d. 1031, 1037 (N.D. Ill. 2007) (holding that the “[*Twombly*] test is easily met here[, where plaintiff] has alleged that [defendants] UnitedHealth and PacifiCare entered into an explicit merger agreement which restricted PacifiCare’s ability to enter into contracts.”) *Transworld Techs., Inc. v. Raytheon Co.*, No. 06-5012, 2007 U.S. Dist. LEXIS 82118, at\*11–\*12 (D.N.J. Nov. 1, 2007) (finding assertions that defendant Lockheed Martin was working as defendant Raytheon’s procurement agent to be sufficient circumstantial evidence of an agreement to misuse proprietary information supplied by the plaintiff).

<sup>35</sup> See *Twombly*, 127 S. Ct. at 1965.

<sup>36</sup> *Transworld Techs.*, 2007 U.S. Dist. LEXIS 82118, at \*12. See also *Dahl v. Bain Capital Partners*, No. 07-12388, 2008 WL 5206990, at \*5 (D. Mass. Dec. 15, 2008) (finding allegations of conspiracy plausible where complaint specifically pled nine transactions and the presence of the same defendants in multiple transactions, which “ties the [defendants] together in a way that the *Twombly* defendants were not”).

<sup>37</sup> MDL No. 1780, 2008 U.S. Dist. LEXIS 79764 (S.D.N.Y. Oct 9, 2008).

<sup>38</sup> *Id.* at \*31–\*32.

<sup>39</sup> *Id.* at \*32.

spiracy at the pleadings stage. This is especially true where the conduct is inconsistent with past practices or is economically irrational as an independent business judgment.

*City of Moundridge v. Exxon Mobil Corp.*<sup>40</sup> illustrates how a court can infer an antitrust conspiracy based on the actions of multiple defendants. In *City of Moundridge*, the plaintiffs alleged that defendant gas companies conspired to artificially raise natural gas prices by manipulating market data to create the false impression of a shortage. Although the court found nothing unusual about the parallel nature of the defendants' actual price increases, it determined that the broader allegations that the defendants had agreed to contribute false information regarding gas supply levels to industry reports, withheld supply, and engaged in price fixing were sufficient to show a plausible conspiracy. These broad allegations were made in the context of circumstantial factual allegations, such as historical supply and consumption levels, market prices, profit levels, and the use of industry reports. The court found that in combination, these allegations distinguished the bare parallel conduct in *Twombly* and held that the alleged conspiracy was plausible in the context of the market.

In *Hackman v. Dickerson Realtors, Inc.*,<sup>41</sup> the plaintiff-realtor alleged that other realtors, realty companies, and realty associations conspired to drive him out of business. The plaintiff's amended complaint against one realtor, Licary, was found adequate based on a single act that included Licary into the conspiracy as established by allegations against her co-defendants. The alleged act by Licary taken pursuant to this conspiracy was that she made "a knowingly false statement about [plaintiff] Hackman in order to undermine his deal. . . ." <sup>42</sup> By asserting just this single act in furtherance of the conspiracy, the plaintiffs alleged that Licary had knowledge of and agreement with the conspiracy, and the court held the amended complaint now plausibly pled that the conspiracy encompassed her as well.<sup>43</sup>

In *re Rail Freight Fuel Surcharge Antitrust Litigation*<sup>44</sup> illustrates how an alleged shift in past practices can support an inference of conspiracy. The complaint alleged that defendants controlled approximately 90 percent of all rail freight traffic in the United States and sought to increase their revenues through the use of fuel surcharges. To avoid existing rate escalation provisions contained in standard rail freight transportation contracts, which included a variety of cost factors including fuel, the defendants allegedly conspired to remove fuel as an existing component of the standard index so they could apply a separate "fuel surcharge" as a percentage of the total cost of freight transportation. The plaintiffs alleged that this scheme, which was contrary to prior industry practice, was accomplished in several steps after the defendants met at specifically identified industry meetings. Although the court acknowledged that the plaintiffs had not alleged the precise context of the agreement among the defendants, it reasoned: "Short of being in the boardroom at the meeting, it is hard for the Court to imagine how plaintiffs could more fulsomely allege that defendants entered into an agreement at the [industry] meetings."<sup>45</sup>

---

<sup>40</sup> 250 F.R.D. 1 (D.D.C. 2008).

<sup>41</sup> 557 F. Supp. 2d 938 (N.D. Ill. 2008) (*Hackman II*).

<sup>42</sup> *Id.* at 944.

<sup>43</sup> *Id.* at 944–45.

<sup>44</sup> MDL No. 1869, 2008 U.S. Dist. LEXIS 95456 (D.D.C. Nov. 7, 2008).

<sup>45</sup> *Id.* at \*22–\*23.

*The challenge for defendants, however, is to convince the court to delve into and test the plausibility of the alleged conspiracy theory at the pleadings stage.*

In holding that the plaintiffs had alleged enough to “infer that it is plausible that an actual agreement existed,”<sup>46</sup> the court emphasized that the plaintiffs had alleged the defendants’ attendance at specific meetings, coupled with coordination of fuel surcharges coincident with those meetings. The plaintiffs asserted that it is unlikely that geographically diverse railroads “would independently impose identical fuel surcharges, because fuel cost as a percentage of operating cost and fuel efficiency differed widely among the defendant railroads.”<sup>47</sup> The court also found determinative that the method of surcharge was allegedly “complex and completely new.”<sup>48</sup>

Allegations about other culpable conduct in *In re OSB* and *In re SRAM* bolstered the persuasive value of the inter-defendant communications alleged in those cases.<sup>49</sup> The same argument applies to *Hyland*, in which the plaintiffs survived a *Twombly* motion on the combined allegations of exchange of price information, along with “references to enforcement actions brought by the Department of Justice[,] admissions of price-fixing by [some defendants, and] price increases while Defendants’ costs and non-real estate broker fees declined. . . .”<sup>50</sup> The plaintiffs in *Babyage.com* enhanced their allegations of resale price maintenance agreements with explanations (and supporting data) regarding the market power that Babies “R” Us deployed to compel manufacturers to adopt the desired pricing policy.<sup>51</sup> Alleging that defendants took steps pursuant to an alleged agreement can persuade the court that the alleged conspiracy is plausible and can aid plaintiffs to withstand a *Twombly* challenge.

### Successful Arguments Showing the Absence of a Plausible Conspiracy

*Twombly* removed all doubt that allegations of mere parallel conduct coupled with assertions of vague and generalized communications among the alleged conspirators will not suffice to plead a viable antitrust conspiracy claim. The challenge for defendants, however, is to convince the court to delve into and test the plausibility of the alleged conspiracy theory at the pleadings stage. Two leading circuit court cases demonstrate the extensive analysis that courts should undertake in the context of actual market conditions.

In *Kendall v. Visa U.S.A., Inc.*,<sup>52</sup> the plaintiffs alleged two conspiracies: first, that the Visa and MasterCard consortia had conspired to set the interchange fee charged to member banks, and, second, that the credit-card issuing member banks of those consortia conspired to pass on the interchange fee to merchants in the form of the “merchant discount” charged for credit card transactions.<sup>53</sup> In *Kendall*, the Ninth Circuit began with the assumption that, “[a]t least for the purposes of adequate pleading in antitrust cases, the [Supreme] Court specifically abrogated the usual ‘notice pleading’ rule, found in Federal Rule of Civil Procedure 8(a)(2) and *Conley v. Gibson*.”<sup>54</sup> The Ninth Circuit’s rationale for this heightened pleading standard is rooted in

<sup>46</sup> *Id.* at \*23.

<sup>47</sup> *Id.* at \*25.

<sup>48</sup> *Id.*

<sup>49</sup> See *In re OSB*, 2007 U.S. Dist. LEXIS 56573, at \*7–\*8; *In re SRAM*, 2008 U.S. Dist. LEXIS 15826, at \*47.

<sup>50</sup> *Hyland*, No 3:05-CV-612, 2007 U.S. Dist. LEXIS 65731, at \*10.

<sup>51</sup> See *Babyage.com*, 558 F. Supp. 2d at 582–83.

<sup>52</sup> 518 F.3d 1042, 1048 (9th Cir. 2008) (affirming the dismissal, with prejudice, of antitrust claims that “failed to plead the necessary evidentiary facts” beyond parallel conduct).

<sup>53</sup> *Id.* at 1048.

<sup>54</sup> *Id.* at 1047 n.5.

inescapable realities: “discovery in antitrust cases frequently causes substantial expenditures and gives the plaintiff the opportunity to extort large settlements even where he does not have much of a case.”<sup>55</sup> Then, after thoroughly reviewing the allegations, the Ninth Circuit held that “merely charging, adopting or following the fees set by a Consortium is insufficient as a matter of law to constitute a violation of Section 1 of the Sherman Act.”<sup>56</sup> What seems to set *Kendall* apart from *In re Rail Freight* (which involved the coordinated imposition of novel fuel surcharges) is that in *Kendall* there is no allegation of a sudden shift in practice.

Similarly, in *Transhorn, Ltd. v. United Technologies Corporation (In re Elevator Antitrust Litigation)*,<sup>57</sup> a putative class of purchasers of elevators and/or elevator maintenance and repair services alleged that defendants conspired to fix prices for the sale and maintenance of elevators. Plaintiffs alleged that defendants met in the United States and in Europe to fix prices and allocate markets, rig bids, and exchange price quotes to drive independent repair companies out of business. In affirming the dismissal of the Section 1 claim, the Second Circuit found that the plaintiffs pled only inferences of illegal activity and failed to allege specific conduct sufficient to nudge the allegations from conceivable to plausible. The Second Circuit agreed with the district court that the complaint alleged “‘basically every type of conspiratorial activity that one could imagine . . . . The list is in entirely general terms without any specification of any particular activities by any particular defendant[; it] is nothing more than a list of theoretical possibilities, which one could postulate without knowing any facts whatever.’”<sup>58</sup>

**Establishing That the Allegations Amount Only to Parallel Conduct.** Throughout the cases applying *Twombly*, an allegation’s persuasive effect is directly proportional to the specificity with which it is made. Blanket assertions of parallel conduct coupled with a failure to assert specifics such as “who, what, where, and when” are often dismissed as a mere conclusory statements. Defendants generally win *Twombly* motions when plaintiffs allege only parallel conduct and that defendants met at certain unspecified meetings to further the alleged conspiracy.<sup>59</sup> Courts have also discounted the related charge of membership in trade or industry groups, often passing off these accusations as “opportunities to conspire” rather than evidentiary allegations of an actual conspiracy.<sup>60</sup>

---

<sup>55</sup> *Id.* at 1047.

<sup>56</sup> *Id.* at 1048.

<sup>57</sup> 502 F.3d 47 (2d Cir. 2007).

<sup>58</sup> *Id.* at 50–51 (alteration in original) (quoting *In re Elevator Antitrust Litig.*, 2006 U.S. Dist. LEXIS 34517, at \*2–\*3).

<sup>59</sup> See, e.g., *In re Elevator Antitrust Litig.*, 502 F.3d at 50–51 n.5 (disregarding assertions that defendants “[p]articipated in meetings in the United States and Europe” as “theoretical possibilities, which one could postulate without knowing any facts whatever”); *Arista Records, LLC v. Lime Group LLC*, 532 F. Supp. 2d 556, 577 (S.D.N.Y. 2007) (noting that plaintiff’s complaint does not specify which defendant participated, or where or when meetings allegedly took place); *In re Graphics Processing Units Antitrust Litig.*, 527 F. Supp. 2d 1011, 1021, 1023 (N.D. Cal. 2007) (finding that plaintiffs failed to allege which persons from which company attended the putative meetings, and failed to allege that price fixing was actually discussed).

<sup>60</sup> See *Twombly*, 127 S. Ct. at 1971 n.12 (rejecting alleged membership in trade association as supporting an inference of antitrust conspiracy); *Kendall*, 518 F.3d at 1048 (“[M]embership in an association does not render an association’s members automatically liable for antitrust violations . . . .”); *Schafer v. State Farm Fire & Cas. Co.*, 507 F. Supp. 2d 587, 597 n.33 (E.D. La. 2007) (allegation that defendants “actively coordinated their actions through various organizations and associations” held insufficient under *Twombly*); see also *Am. Channel, LLC v. Time Warner Cable, Inc.*, No. 06-2175, 2007 U.S. Dist. LEXIS 47966, at \*13 (D. Minn. June 28, 2007) (“opportunities to conspire” insufficient to plausibly plead conspiracy).

To a more limited extent, defendants have in some cases persuaded courts to disregard allegations of information sharing as mere conclusory statements.<sup>61</sup> It is worth noting that the success of this argument depends in large part on the specifics of the given complaint. Thus, the general allegations found inconsequential in *In re Elevator*, *In re Insurance Brokerage*, and *In re Travel Agent* were easily distinguishable from the specific communications, including *actual quoted excerpts*, offered by the plaintiffs in *In re SRAM* and *In re OSB*.

**Demonstrating that the Alleged Conspiracy Is Not Plausible.** Even when a plaintiff makes specific allegations of fact, a defendant may still argue that the alleged conduct does not constitute a plausible conspiracy based on the economic realities of the industry.<sup>62</sup> The defendant's success with this argument at the pleadings stage wholly depends on how closely the court will examine the allegations of the complaint in the context of the relevant market. For example, such argument was not successful in *Heartland Payment Systems Inc. v. Micros Systems, Inc.*,<sup>63</sup> where the court rejected the defendants' argument that the conspiracy was not economically plausible. Rather than applying a rigorous analysis, the court merely recited allegations in the complaint and concluded that, "at least at this stage of the proceedings, the Court cannot confidently say that it is implausible" that defendants would have participated in the alleged scheme.<sup>64</sup>

In contrast to *Heartland Payment Systems*, the court in *In re Late Fee and Over-Limit Fee Litigation*,<sup>65</sup> applied a rigorous analysis of the market to dismiss a conspiracy claim because it was not economically plausible. The plaintiffs, a putative class of credit card holders who paid late fees and/or over-limit fees, alleged that the defendants conspired to fix the prices of such fees. Failing to allege any actual agreement among the defendants, the plaintiffs instead alleged that the defendants had engaged in parallel lock-step pricing. The plaintiffs' claim was based on the defendants' alleged "opportunities and incentives" to engage in a conspiracy.

In dismissing the complaint, the court rejected all the conclusory allegations of conspiratorial conduct and found that the complaint itself provided an alternative explanation for the price increases. The court reasoned that the fees were the result of a rational and competitive business strategy unilaterally prompted by common perceptions of the market. Importantly, the court noted that the defendants' similar cost structures would explain why the defendants' prices would naturally be similar without the need for any agreement. Thus, given the "natural explanations"<sup>66</sup> for the increases in late fees, coupled with the absence of any factual allegations of conspiratorial conduct, the complaint was dismissed.

**Plaintiffs' Failure to Allege Facts as to Each Defendant.** A final factor, and one that may have significant impact on a *Twombly* motion's success, is how the court analyzes a complaint where there are strong Section 1 conspiracy allegations against some defendants, but weak and/or generalized allegations as to others. Decisions applying *Twombly* in this situation have been inconsistent.

*Even when a plaintiff makes specific allegations of fact, a defendant may still argue that the alleged conduct does not constitute a plausible conspiracy based on the economic realities of the industry.*

<sup>61</sup> See *In re Elevator Antitrust Litigation*, 502 F.3d at 51 n.5 ; *In re Ins. Brokerage Antitrust Litig.*, MDL No. 1663, 2007 U.S. Dist. LEXIS 64767, at \*67, \*93 (D.N.J. Aug. 31, 2007); *In re Travel Agent Comm'n Antitrust Litig.*, MDL No. 1561, 2007 U.S. Dist. LEXIS 79918, at \*36 (N.D. Ohio Oct. 29, 2007).

<sup>62</sup> See, e.g., *City of Moundridge*, 250 F.R.D. at 5 ("Economic interests and motivations can be relevant to evaluate plausibility, and price increases can be the result of an independent business decision.").

<sup>63</sup> No. 3:07-CV-5629, 2008 U.S. Dist. LEXIS 74972 (D.N.J. Sept. 29, 2008).

<sup>64</sup> *Id.* at \*50.

<sup>65</sup> 528 F. Supp. 2d 953 (N.D. Cal. 2007).

<sup>66</sup> *Id.* at 965.

In *Hackman v. Dickerson Realtors Inc. (Hackman I)*,<sup>67</sup> for example, the trial court carefully evaluated each defendant's alleged connection to the asserted conspiracy and did not allow claims against one defendant to color its analysis of the claims against another. Likewise, in *In re Travel Agent Commission Antitrust Litigation*, the court separated its analysis of the claims raised against each defendant, dismissing some out of hand and subjecting others to a more careful review.<sup>68</sup>

In *In re Parcel Tanker Shipping Services Antitrust Litigation*,<sup>69</sup> the district court dismissed an antitrust conspiracy complaint that "allege[d] general conspiratorial activity without reference to specific actions by a particular defendant at a particular time," gave "no specific examples of the defendants' conduct" in alleged secret meetings, and cited no "specific wrongful acts of specific defendants" to support the conspiracy allegations. As the court found, "[t]his lack of specifics with respect to the acts of a particular defendant or defendants renders the complaint inadequate after" *Twombly*.<sup>70</sup>

In another case, the Second Circuit affirmed the dismissal of a complaint that "enumerate[ed] basically every type of conspiratorial activity that one could imagine . . . without any specification of any particular activities by any particular defendant."<sup>71</sup> The court concluded that plaintiffs' allegations that the defendants participated in meetings to discuss pricing and market divisions, agreed to fix prices, rigged bids, exchanged price quotes, and allocated markets, among other things, were nothing more than "a list of theoretical possibilities, which one could postulate without knowing any facts adequate to show illegality," and that they did not provide plausible ground to support the inference of an unlawful agreement.<sup>72</sup>

In contrast to those cases, some courts have found blanket allegations against large groups of defendants sufficient under *Twombly*, even when the strength of the allegations as to each defendant varies significantly. For example, the court in *In re SRAM* extended its findings against the defendants for whom the allegations were strong to those against whom the allegations were comparably weak.<sup>73</sup> As discussed previously, the court found a conspiracy was sufficiently pled between defendants Hitachi and Samsung, based on their email chain sharing confidential business information.<sup>74</sup> However, the court also found the conspiracy adequately pled as to the

---

<sup>67</sup> 520 F. Supp. 2d 954 (N.D. Ill. 2007). *But see* discussion of *Hackman II*, *supra* text accompanying note 41.

<sup>68</sup> *In re Travel Agent*, 2007 U.S. Dist. LEXIS 79918, at \*17 ("Plaintiffs have not put forth any 'factual matter' suggesting that [certain defendant airlines] engaged in parallel conduct. . . ."); *see also id.* at \*18 (dismissing claim against defendant KLM, finding it based solely on allegations of trade association membership); *see also id.* at \*29–\*38 (dismissing plaintiffs' claims against defendants Northwest, United, and Delta subsequent to a full *Twombly* analysis of parallel conduct, opportunities to conspire, "plus factors," and industry practices).

<sup>69</sup> 541 F. Supp. 2d 487 (D. Conn. 2008).

<sup>70</sup> *Id.* at 491–92. Several pre-*Twombly* cases also support this proposition. *See* *Mountain View Pharmacy v. Abbott Labs.*, 630 F.2d 1383, 1386–87 (10th Cir. 1980) ("To provide adequate notice, a complaint in a complex, multi-party suit may require more information than a simple, single party case."); *In re Ins. Brokerage Antitrust Litig.*, MDL No. 16663, 2007 U.S. Dist. LEXIS 25632 at \*117–\*118 (D.N.J. Apr. 5, 2007); *Jung v. Ass'n of Am. Med. Colls.*, 300 F. Supp. 2d 119, 163 (D.D.C. 2004) ("Plaintiffs cannot escape their burden of alleging that each defendant participated in or agreed to join the conspiracy by using the term 'defendants' to apply to numerous parties. . . .").

<sup>71</sup> *In re Elevator Antitrust Litig.*, 502 F.3d at 50 (internal quotation omitted).

<sup>72</sup> *See also* *Rick-Mik Enters. Inc. v. Equilon Enters., LLC*, 532 F.3d 963, 975–76 (9th Cir. 2008) (dismissing price-fixing allegations that did not allege specific details of an alleged illegal price-fixing scheme); *Total Benefits Planning Agency Inc. v. Anthem Blue Cross & Blue Shield*, No. 1:05-CV-519, 2007 U.S. Dist. LEXIS 53862, at \*17–\*18 (S.D. Ohio 2007) (dismissing complaint that alleged only a general time span during which the defendants' alleged antitrust violations were supposed to have occurred, but failed to allege specific times, places or the parties involved).

<sup>73</sup> *In re SRAM*, 2008 U.S. Dist. LEXIS 15826, at \*49–\*50.

<sup>74</sup> *Id.* at \*42–\*44.

*Demonstrating that an alleged conspiracy is not economically plausible may require the introduction of industry or market facts that were not alleged in the complaint.*

remaining defendants, against whom no comparable transgressions were alleged. In doing so, the court noted that against these additional defendants, plaintiffs “only need to make allegations that plausibly suggest that each [defendant] . . . participated in the alleged conspiracy” already identified by the court as to Hitachi and Samsung.<sup>75</sup>

The court in *In re OSB Antitrust Litigation* relied on pre-*Twombly* jurisprudence to explicitly hold that “[a]ntitrust conspiracies need not be detailed defendant by defendant.”<sup>76</sup> The court applied this rationale in sustaining the complaint against defendant Grant Forest Products, Inc., which was mentioned by name only in “one lone paragraph” and even then only for the blanket “allegation that Grant joined and participated in the alleged price-fixing conspiracy.”<sup>77</sup> Like the court in *In re SRAM*, the court in *In re OSB* essentially subdivided its plausibility analysis into two discrete questions: whether an antitrust conspiracy was adequately pled as to any two defendants, and then whether that conspiracy can be imputed against any other defendants.<sup>78</sup> Having found a conspiracy adequately pled between Grant’s co-defendants (the OSB producers who had planned and executed a coordinated mill shutdown), the court was satisfied by only the incremental allegation that Grant was a party as well.<sup>79</sup>

A court’s willingness to extend the scope of a conspiracy, substantiated only between certain parties, to other defendants against whom there is only the bare assertion of involvement, significantly impairs those additional defendants’ ability to mount a successful challenge under *Twombly*, which held that “bare assertion[s] of conspiracy” and “conclusory allegation[s] of agreement” simply “will not suffice” to sustain a plaintiff’s complaint.<sup>80</sup>

**Judicial Notice and the Inclusion of Publicly Available Facts in Defendants’ Motions.** Two commentators recently noted: “If the Supreme Court’s own analysis in *Twombly* is any indication, an antitrust class action complaint must provide an economic theory which truly hangs together based on plaintiff’s factual allegations in order to survive a motion to dismiss.”<sup>81</sup> Thus, “defendants may want to consider engaging an expert economist at the outset of an antitrust class action to assist in framing for a motion to dismiss any deficiencies with the economic theories advanced in the plaintiff’s complaint.”<sup>82</sup> This is so because the plausibility standard requires the court to determine whether “the economic theory advanced in plaintiff’s complaint is logical and, if so, whether the alleged facts truly support that economic theory.”<sup>83</sup>

Demonstrating that an alleged conspiracy is not economically plausible may require the introduction of industry or market facts that were not alleged in the complaint. Although a motion to dismiss generally is limited to the allegations set forth in the complaint, the court “may consider evidence on which the complaint ‘necessarily relies’ if: “(1) the complaint refers to the document;

<sup>75</sup> *Id.* at \*49.

<sup>76</sup> *In re OSB*, 2007 U.S. Dist. LEXIS 56573, at \*13 (citing *Alaska v. Boise Cascade Corp.* (*In re Fine Paper Antitrust Litig.*), 685 F.2d 810, 822 (3d Cir. 1982)).

<sup>77</sup> See *In re OSB*, 2007 U.S. Dist. LEXIS 56573, at \*12–\*13.

<sup>78</sup> *Id.* at \*13 (“[A]n antitrust complaint should be viewed as a whole, and the plaintiff must allege that each individual defendant joined the conspiracy and played some role in it.”) (citing *Jung*, 300 F. Supp. 2d at 164, n.27).

<sup>79</sup> *In re OSB*, 2007 U.S. Dist. LEXIS 56573, at \*13.

<sup>80</sup> *Twombly*, 127 S. Ct. at 1966.

<sup>81</sup> Wendy L. Bloom & James Langenfeld, *The Potential Impact of Twombly on Antitrust Class Actions*, GLOBAL COMPETITION POL’Y, June 2008, Release Two, at 4.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 8.

(2) the document is central to the plaintiff's claim; and (3) no party questions the authenticity of the copy attached to the 12(b)(6) motion."<sup>84</sup> The court may also rely on facts subject to judicial notice.<sup>85</sup>

Under Rule 201 of the Federal Rules of Evidence, a "judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Judicial notice "may be taken at any stage of the proceeding,"<sup>86</sup> including the pre-answer motion.

Thus, in *Singh v. Memorial Medical Center*,<sup>87</sup> the court took judicial notice of the existence of many other hospitals in the relevant geographical market in determining whether the plaintiffs' claim for exclusion from the dominant hospital stated a cause of action under the Sherman Act. In dismissing their complaint, the court found that "[p]laintiffs have alleged harm to a single competitor at a single hospital rather than an injury to competition. Such harm does not come within the purview of the antitrust laws, and is not the type of harm the antitrust laws intended to prevent."<sup>88</sup> Similarly, in *Arista Records LLC v. Lime Group, LLC*,<sup>89</sup> the court took judicial notice of information publicly announced on a party's Web site when the Web site's authenticity was not in dispute and was capable of accurate and ready determination in granting motion to dismiss antitrust counterclaims. And in *Shames v. Hertz Corporation*,<sup>90</sup> the court took judicial notice of documents related to the legislative history of a statute, concluding that "these are matters of public record suitable for judicial notice."

## Conclusion

*Twombly* requires district court judges to engage in a thorough fact-intensive analysis at the pleadings stage. Decisions entered in *Twombly*'s aftermath show that many courts have adapted to this new standard and have conducted a rigorous analysis of the factual allegations of a complaint. Not surprisingly, these decisions reveal that factual allegations that point to specific communications among alleged conspirators sharing non-public or proprietary pricing, strategic, or technical information, coupled with conduct consistent with those communications, will be highly successful for plaintiffs bringing Section 1 actions. For defendants, a successful *Twombly* motion to dismiss a complaint requires convincing the court to carefully review the allegations of conspiracy in the context of the relevant market, and to demonstrate that the allegations amount to nothing more than mere parallel conduct or that the conspiracy theory makes no economic sense. For the courts and litigators alike, *Twombly* therefore puts at the forefront of Section 1 litigation many complex issues that must be determined at the pleadings stage. Although *Twombly*'s new standard initially was criticized for requiring too much too soon, the post-*Twombly* cases show that the bench and bar have adapted to this rigorous analysis by requiring more detailed and fact-based complaints and dismissing those complaints that fail to meet this standard. ●

---

<sup>84</sup> *Marder v. Lopez*, 450 F.3d, 445, 448 (9th Cir. 2006).

<sup>85</sup> See, e.g., *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003).

<sup>86</sup> Fed. R. Evid. 201(f).

<sup>87</sup> 536 F. Supp. 2d 1244 (D.N.M. 2008).

<sup>88</sup> *Id.* at 1253. But see *Hear-wear Techs., LLC v. Oticon, Inc.*, 551 F. Supp. 2d 1272, 1279 (N.D. Okla. 2008) (denying motion to dismiss antitrust counterclaims and denying motion to take judicial notice of disputed facts to resolve the relevant geographic market inquiry).

<sup>89</sup> *Arista Records*, 532 F. Supp. 2d at 571 n.20.

<sup>90</sup> No. 07-CV-2174, 2008 U.S. Dist. LEXIS 56952, \*32 (S.D. Cal. July 24, 2008).

## Paper Trail: Working Papers and Recent Scholarship

**Editor's Note:** Our editors tackle an array of papers in this edition of The Paper Trail. Bill Page notes four papers that offer related arguments about the proper scope of the U.S. offense of monopolization and the EC offense of abuse of dominance; and John Woodbury describes a paper that proposes a “simple and transparent” formula to replace the market share-based presumption of consumer harm in mergers of producers of differentiated products. Send suggestions for papers to review, and your comments, to: [page@law.ufl.edu](mailto:page@law.ufl.edu) or [jwoodbury@crai.com](mailto:jwoodbury@crai.com).

—WILLIAM H. PAGE AND JOHN R. WOODBURY

### Recent Papers

---

**David S. Evans & Keith N. Hylton, The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1275431](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275431)

**Herbert J. Hovenkamp, Schumpeterian Competition and Antitrust**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1275986](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275986)

**Jonathan B. Baker, “Dynamic Competition” Does Not Excuse Monopolization**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1285223](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1285223)

**Ariel Ezrachi & David Gilo, Are Excessive Prices Really Self-Correcting?**

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1237802](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1237802)

In this *Paper Trail* entry, I note four papers that offer related arguments about the proper scope of the U.S. offense of monopolization and the EC offense of abuse of dominance. The first, by David S. Evans and Keith Hylton, argues that antitrust analysis of dominant firm conduct should more explicitly take account of the special role of monopoly power as an incentive for innovation; the second and third papers, by Herbert Hovenkamp and Jonathan Baker, respectively, critique Evans and Hylton's argument. The fourth paper, by Ariel Ezrachi and David Gilo, seeks to refute a different but related justification for the benign treatment of one form of dominant firm conduct—the claim that “excessive” prices are “self-correcting.”

Evans and Hylton argue that antitrust fosters innovation by actually favoring the acquisition of monopoly power in most circumstances. They observe that U.S. antitrust law has never condemned monopoly in itself, only certain anticompetitive “tactics” in the “game of competition.” U.S. antitrust law, for example, condemns practices, like cartels and mergers to monopoly, but allows individual firms to acquire monopoly power and to charge monopoly prices, even if doing

so reduces short-run consumer welfare. They read *Alcoa*<sup>1</sup> as holding that, in 1945, there was “nothing unlawful about obtaining monopolies by ‘superior skill, foresight and industry.’”<sup>2</sup> They also note the failure over the past century of various proposals for a no-fault monopolization standard or for a program of deconcentration. Evans and Hylton see in these and similar features of antitrust law a “revealed preference” for innovation and dynamic competition, and a recognition that monopoly power, or the prospect of acquiring it, is an important spur to investment in research and development.

Evans and Hylton argue that modern U.S. courts, in evaluating allegedly exclusionary conduct, weigh “the costs that consumers incur over time from the exercise of market power” against “the dynamic social benefits that the economy receives from allowing firms to receive monopoly profits as a reward for successful competition for markets.” This tradeoff, they suggest, is one reason for U.S. law’s tolerance of simple monopoly pricing. EC law nominally condemns excessive pricing, but this prohibition is so narrowly interpreted and rarely applied that, according to Evans and Hylton, “[a]s a practical matter . . . the European Community follows the United States in regulating the boundaries of the game of competition but giving firms wide latitude within those bounds.” The courts’ benign view of lawful monopoly power, according to Evans and Hylton, indicates that the apparent conflict between antitrust and intellectual property law is overdrawn, because both bodies of law allow firms to secure monopoly power “as a reward for expending effort on things that will ultimately benefit society.”

In the latter portions of the paper, Evans and Hylton argue that modern economic analysis is undermining the law’s conditional endorsement of monopoly power as an incentive for innovation. The authors suggest that the antitrust tradeoff between static and dynamic effects occurs in two stages: first, when a court (or Congress) identifies a category of practices as suspicious; and second, when a court determines whether a particular instance of the practice is monopolistic. They argue that courts sometimes err in the second stage by asking whether a practice harms the “competitive process,” a term they dismiss as meaningless. One source of confusion in the second-stage analysis, the authors suggest, is that modern industrial organization economics is unduly focused on static effects because of its “tractability bias” against complex dynamic models. To illustrate how dynamic models might affect antitrust analysis, Evans and Hylton adapt Oliver Williamson’s familiar welfare-tradeoff model to accommodate a case in which an alleged offender creates a new market by investment, but also engages in an exclusionary practice to protect its newfound monopoly power. If the exclusionary practice was necessary to induce the investment that led to the innovation, they argue, the optimal penalty should take account of the “residual consumer surplus” the alleged offender creates, that is, what is left of consumer surplus after the monopolistic output restriction in the newly created market.<sup>3</sup>

---

<sup>1</sup> *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945).

<sup>2</sup> This reading of the case is questionable. Judge Hand ultimately condemned “honestly industrial” business tactics, like “always anticipat[ing] increases in the demand for ingot and be[ing] prepared to supply them” or “doubling and redoubling its capacity before others entered the field.” *Id.* at 431. Evidently, for Judge Hand, superior skill, foresight, and industry did not encompass active competition. It was only in the 1970s that the courts began explicitly to recognize that monopolists need not pull their competitive punches. *See, e.g., Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281 (2d Cir. 1979) (“Because . . . a monopolist is permitted, and indeed encouraged, by § 2 to compete aggressively on the merits, any success that it may achieve through ‘the process of invention and innovation’ is clearly tolerated by the antitrust laws.”) (citation omitted).

<sup>3</sup> Evans and Hylton also suggest that more complete dynamic analysis of the coordinated effects of an acquisition of a maverick firm would take account of the effect of such a merger on incentives for entry.

Evans and Hylton suggest that the bias in academic economics toward static models makes it problematic to turn over antitrust policy to economists. The solution, they propose, is to change “the reward systems in academic economics”:

The economic profession will need to provide a premium to researchers who work on dynamic competition and one that either compensates them for the especially hard mathematical work necessary for robust dynamic models or provides bonus points that skew incentives towards less mathematical dynamic analysis and away from highly technical, clever, and irrelevant static analysis.

In his comment, Herbert Hovenkamp agrees with Evans and Hylton that dynamic effects, especially those that occur through innovation, may have important competitive consequences. He argues, however, that this observation has only limited implications for the decision of antitrust cases, for three reasons. First, he disputes the assumption that modern intellectual property law promotes innovation optimally; consequently, antitrust law should not conform to IP policies. Second, he argues that, in most antitrust contexts, “innovation effects are difficult to assess or even foresee.” Monopoly profits might be invested to promote innovation, but that possibility has few general implications for antitrust policy. If, in a particular case, a restraint actually promotes innovation, the defendant should be able to offer evidence of that in the context of a rule of reason analysis.

Finally, Hovenkamp emphasizes that monopolistic practices may inhibit innovation as often as they promote it. Restraints on innovation inhibit the very dynamic competition that innovation produces. He illustrates this point by adapting Evans and Hylton’s hypothetical of a dominant firm that creates an entirely new product but also engages in an exclusionary practice to protect its monopoly power in the new market. Hovenkamp argues that it is more likely that a smaller rival would be the innovator and that the dominant firm would use the exclusionary practice against it. He cites, among other examples, the holding that Microsoft unlawfully pressured Intel to drop its project to develop a high-performance Java Virtual Machine that might have threatened Microsoft’s monopoly of PC operating systems.<sup>4</sup>

Hovenkamp recognizes that, in some cases, the same practice that allegedly hinders innovation by the plaintiff may actually enhance innovation by the defendant. He gives the example of joint ventures and standard setting, but he might also have cited *Microsoft* again. He concedes that, particularly in this kind of case, it is difficult to estimate *ex ante* the social gains and losses from the effects of such practices on innovation. He argues, nevertheless, that antitrust courts can, at a minimum, adjust their degree of scrutiny depending upon the extent to which the alleged practice facially appears to promote innovation or to suppress it.

Like Hovenkamp, Jonathan Baker criticizes Evans and Hylton paper for focusing too narrowly on the goal of fostering innovation by *limiting* antitrust enforcement. First, like Ariel Ezrachi and David Gilo, *infra*, Baker notes that the simple exploitation of monopoly power is lawful for a variety of reasons besides the incentives that monopoly profits might provide for innovation. For example, condemning simple monopoly would entail the loss of economies of scale and would force courts to regulate prices. Second, Baker argues that recognizing the role of monopoly in spurring innovation has little significance for antitrust policy, because monopolization enforcement does not necessarily inhibit innovation very much and may actually enhance it. He suggests, for

---

<sup>4</sup> *United States v. Microsoft Corp.*, 253 F.3d 34, 77–78 (D.C. Cir. 2001). Hovenkamp also discusses *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 496–97 (1988), which involved a boycott by steel conduit manufacturers aimed at excluding conduit made from PVC.

example, that “the available evidence” suggests that greater competition increases the incentive to innovate.

Moreover, like Hovenkamp, Baker emphasizes that monopolization enforcement may protect smaller firms’ incentives to innovate by preventing “cheap exclusion,” that is, “exclusionary practices by a dominant firm that are inexpensive for the dominant firm to implement and have no efficiency justification.” These practices may increase the dominant firm’s profit, but are unlikely to increase incentives for the dominant firm to innovate. Moreover, even if monopolization enforcement reduces a dominant firm’s monopoly profits, it may actually increase overall spending on research and development by increasing the incentives of rivals of the dominant firm to innovate. These effects are most likely to be welfare-enhancing in winner-take-all markets, where the dominant firms will have ample incentive to innovate simply to protect their dominant position.

Ezrachi and Gilo’s paper challenges one of the asserted justifications for antitrust law’s leniency toward monopoly pricing, the most basic form of monopolistic exploitation. They observe that U.S. and EC law generally decline to challenge “excessive” pricing on the grounds that doing so would be counterproductive, impractical, and unnecessary: it would be counterproductive because it would inhibit dominant firms’ incentives to innovate (as Evans and Hylton argue); it would be impractical because courts have no good way to establish a reasonable price; and it would be unnecessary, because high prices attract entry and thus are “self-correcting.” The authors seek to refute the last justification and thus refocus attention on the other two.

Ezrachi and Gilo’s argument that excessive prices do not attract entry turns out to be very involved and purely theoretical. The gist of the argument is that pre-entry prices do not attract entry; only expected post-entry prices do. If an incumbent is more efficient than the prospective entrant, it can always reduce prices to marginal cost and deprive the entrant of any reward from entry. Consequently, according to Ezrachi and Gilo, the potential entrant will only enter if it believes the incumbent is less efficient. The authors thus reason that a more efficient incumbent’s strategy in response to entry will be to reduce prices to marginal cost and drive out the entrants. Only when entry is “insignificant,” they suggest, will the incumbent make room for the entrants and to set the short-run profit-maximizing price for a dominant firm:

Once the incumbent detects the first steps of entry, it is expected to react immediately, and the resulting price war is expected to bring prices down to competitive levels very quickly. The entrant, for its part, expects such competitive pricing to prevail almost immediately upon entry, and it contemplates whether to expend the costs of entry into the market given these competitive and modest post-entry profits. Another possibility is that the entrant wishes to remain a fringe competitor, with a very small market share. Such fringe entry would usually not stimulate a price war and would therefore be attracted by excessive prices. But the entr[y] of insignificant fringe firms, which cannot restrain the incumbent’s excessive price in the long run, is not the sort of entry that would alleviate concerns from excessive prices.

The record in some antitrust cases is consistent with the prediction that a dominant incumbent would respond aggressively to significant entry.<sup>5</sup> In other cases, however, incumbents have found it unprofitable to do so and have chosen to maintain the short-run profit-maximizing umbrella

---

<sup>5</sup> See, e.g., *United States v. AMR Corp.*, 335 F.3d 1109, 1112 (10th Cir. 2003) (reporting that American Airlines responded to entry on profitable routes at its Dallas hub by reducing prices, adding capacity, and offering more seats at lower prices; after driving out the entrants, American raised prices to prior levels).

price.<sup>6</sup> So it is unclear how generally Ezrachi and Gilo's account of the relevant incentives reflects reality.

In any event, if a potential entrant should rationally expect an efficient incumbent to respond aggressively to entry, it follows that excessive pre-entry prices will not necessarily attract entry. Excessive prices, Ezrachi and Gilo argue, are not very good signals of whether the incumbent is more or less efficient than the prospective entrant. So only in narrow circumstances would potential entrants glean enough information about the relative efficiency of the incumbent simply from the fact that it is charging high prices. Even if there is some signaling value of excessive prices, that value is not necessarily greater than the signaling value of regulated non-excessive prices. An inefficient incumbent that is required to charge a lower price may find it difficult to set prices that mislead prospective entrants into believing that it is efficient.

Ezrachi and Gilo observe that, if they are correct that excessive prices do not attract entry, the question of whether to prohibit excessive prices hinges on the remaining two justifications for forbearance: the impracticality of determining a reasonable price and the fear of deterring innovation. The authors do not consider these justifications in any detail, but suggest tentatively that they may not hold in all circumstances. For example, the authors suggest that limiting excessive prices may not deter innovation "when the level of investment required in the particular industry in question is relatively low, when the dominant firm has presumably recouped its investments in the past . . . or when the competition authority has found a way to take account of the investment consideration when assessing what an excessive price is."

—WHP

**Joseph Farrell and Carl Shapiro, Antitrust Evaluation of Horizontal Mergers:  
An Economic Alternative to Market Definition (Nov. 28, 2008)**

<http://faculty.haas.berkeley.edu/shapiro/>

For some time, economists (and lawyers) have struggled with the seeming inconsistency of defining markets and focusing on market share when evaluating mergers in differentiated product industries. In this paper, two highly respected economists, Joseph Farrell and Carl Shapiro (both former chief economists for the Antitrust Division), put this issue front and center on the antitrust stage.<sup>7</sup> Their paper proposes a "simple and transparent" formula to replace the market share-based presumption of consumer harm in mergers of producers of differentiated products.

---

<sup>6</sup> See, e.g., *United States v. American Can Co.*, 230 F. 859, 879–80 (D. Md. 1916), which reports that, after the formation of the American Can trust through a series of acquisitions:

prices were put up to a point which made it apparently profitable for outsiders to start making cans with any antiquated or crude machinery they could find in old lumber rooms or which they could have made for them in a hurry, or even to resume can making by hand. . . . At first, the defendant seems to have thought it would try to buy them out, and it bought a few of them . . . ; but . . . such policy was impossible. In the first place, its money was gone. . . . There were too many new shops to buy them all, and, as it has turned out, it was easy enough to start some more. The real remedy would have been to reduce the price of cans. If defendant had not been under the necessity of realizing large and quick profits, doubtless it would have done so. Its mere cost of operation, excluding any allowance for capital investment, must have been below that of many of its poorly equipped competitors, who then rushed into the field. But, if prices had been reduced, the idea that there was a speedy fortune to be made by defendant's stockholders would have been too speedily dispelled. Other devices were resorted to. The attempt to keep up the price of cans was persisted in. In an effort to do so, the defendant itself sent brokers into the market and bought some millions of cans from its rivals. Some of these were very badly made, as was to be expected from new shops, equipped with wretched machinery and hastily rushed into business. These cans were stored for a while, and ultimately such of them as were salable at all were sold for what they would bring. Possibly these purchases did keep up the price longer than would otherwise have been the case.

<sup>7</sup> Both authors have relationships with my employer, CRA International.

If the products in a particular industry segment are differentiated, then they are not perfect or even equally close substitutes for each other. If the products of the merging firms are much closer substitutes than others, then standard unilateral competitive effects analysis—for example, some version of the simulations based on Bertrand models of competition—could suggest a substantial risk of a post-merger price increase. Absent offsetting efficiencies, repositioning, entry, dynamic considerations, etc., economists would be inclined to view this as the end of the analysis.

If that merger is to be challenged in court, then the antitrust agency's economists and lawyers (or maybe just the agency's lawyers) are likely (or likely feel compelled) to cast this in more familiar litigation terms—that the merger will lead to a large combined share or high HHI plus a large delta in a defined antitrust market. That is, the agency will rely on what Farrell and Shapiro call the “structural presumption” that higher market shares lead to higher prices.<sup>8</sup> This recasting of the competitive effects story is not surprising. As Farrell and Shapiro note (p. 5), questions of market definition “are typically central in court while economists wonder how the outcome of a merger can turn on an inevitably somewhat artificial and arbitrary line drawing exercise.”

Suppose that the agency staff concluded that the differentiated products of the merging parties were in fact the closest substitutes for each other and so would predict a unilateral price increase if the merger were cleared. In order to fit the square peg of product differentiation into the round hole of market definition, one could define the market as consisting of primarily the products of the merging parties on the grounds that they are the closest substitutes (or virtually so) for each other. And that market definition may well be consistent with the Guidelines' “hypothetical monopolist” paradigm. In that market, the combined firm would have a 100 percent share (or virtually so), leading to the conclusion that the merger would likely lead to higher prices.

As Farrell and Shapiro observe, even if that conclusion were correct, it may well be that the agency would lose a court challenge to the merger. Suppose that there were numerous other products that were more or less close substitutes for those of the merging parties (even if not nearly as close as the products of the merging parties were to each other). The merger's defenders could argue the agency has ignored the pricing constraints imposed by these alternatives. Once one considers the array of “reasonably interchangeable” alternatives, the merging parties would argue that the market would have to be broadened to include those alternatives. And in that more broadly defined market, the combined share of the merged firm may be relatively small, thus rebutting any “structural presumption.”

As a matter of economics, both approaches to evaluating a differentiated products merger are wanting. The merger's defenders are correct that the narrow market approach does in fact ignore the price competition provided by excluded products. But the broad market approach effectively and incorrectly treats all products in the defined market as equally substitutable.

Notwithstanding those flaws, Farrell and Shapiro observe that the rebuttable structural presumption is one that continues to dominate antitrust litigation. Aside from legal precedent, the attractiveness of the structural presumption lies in its simplicity and transparency. It requires “only” a market definition, a simple share calculation, and the assumption of a simple and intuitive causal relationship between market share and price.

---

<sup>8</sup> Of course, you would expect the agency to also argue that there are no offsetting factors that would rebut that presumption since market share is no longer the overriding consideration in antitrust it once was.

Against that background, Farrell and Shapiro set out to develop an alternative rebuttable presumption that is also simple and transparent but more accurately reflects the underlying economics in differentiated-products mergers.<sup>9</sup> That presumption can be used by the agencies when they challenge a merger and can also guide them in their HSR review of whether such mergers raise unilateral effects concerns.<sup>10</sup> The Farrell-Shapiro alternative to the structural presumption would not rely on market definition but rather on the underlying profit-maximizing principles that can drive post-merger prices upward (or not) in a differentiated product industry.

Farrell and Shapiro develop a measure of the post-merger upward pricing pressure (UPP) that is similar to one developed by O'Brien and Salop.<sup>11</sup> Farrell and Shapiro then compare the UPP to an assumed level of merger-specific cost savings that one might generally expect to be associated with mergers, what they (and others) call a "standard deduction" for efficiencies.

That comparison depends only on the first principles of profit maximization and not in any way on the particular shape of the demand curve and so bears an acknowledged similarity to a paper by Werden.<sup>12</sup> In the context of a differentiated products industry, Werden demonstrates how to determine the level of merger-specific efficiencies that will just offset any post-merger price increase—the "critical" level of cost-savings. Werden's analysis depends only on the first principles of profit maximization and is independent of any particular shape of the demand curve.

As will be apparent from the discussion below, one can use the Farrell-Shapiro metric to calculate that level of efficiencies that just offsets the upward pricing pressure, an approach very similar to Werden's. But perhaps the Werden approach would not provide the courts with a simple and transparent rebuttable presumption that the merger would harm consumers. It only provides a critical efficiency level that the expected efficiencies associated with the particular merger must equal or exceed. That level of expected efficiencies may be difficult to quantify and may be anything but transparent.<sup>13</sup> (But obviously, a rebuttal to the rebuttable Farrell-Shapiro presumption is that the expected efficiencies are greater than the standard deduction.)

The underlying principles of the paper's proposal are easy to illustrate. Farrell and Shapiro posit two firms, A and B, with A producing good 1 and B producing good 2. When A is considering the

---

<sup>9</sup> Just to be clear, what follows applies only to unilateral effects in differentiated product industries where (as noted below) the Bertrand model applies. Thus, it does not apply to coordinated effects or to unilateral effects driven by models other than Bertrand (e.g., Cournot). In short, this paper does not write the HHI out of the Guidelines or legal precedent, nor does it purport to do so.

<sup>10</sup> I am somewhat confused about how this alternative "presumption" would be used. Sometimes the paper can be read as suggesting that the agencies can use the Farrell-Shapiro approach as a first screen (like the 1000 HHI safe harbor in the Guidelines) in the internal review of mergers. For example, the paper notes (at pp. 11–12) that its proposed metric would "yield a tractable screen, much as the concentration-based approach sets aside for later consideration many possible reasons why concentration may not accurately gauge competitive effects." In that case, the approach wouldn't be used in and of itself to challenge mergers any more than any HHI above 1000 is used by the agencies as a presumption of competitive harm. But regardless of how the authors intend the staff to use the Farrell-Shapiro metric, the bulk of the paper clearly sees this approach as something much more than a screen—that it would replace the structural presumption in agency-challenged mergers.

<sup>11</sup> Daniel O'Brien & Steven Salop, *Competitive Effects of Partial Ownership: Financial Interest and Control*, 67 ANTITRUST L.J. 559 (2000).

<sup>12</sup> Gregory Werden, *A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products*, 44 J. INDUS. ECON. 409 (1996).

<sup>13</sup> However, as the paper itself notes (at n.32), one could compare Werden's critical cost savings associated with any particular merger to Farrell and Shapiro's "standard deduction" for efficiencies. If the critical cost savings were greater than the standard deduction, the presumption would be that prices would increase post-merger. That presumption could be rebutted by the merging parties by showing that the actual expected efficiencies were larger than the critical cost savings or that other factors (e.g., entry, repositioning) would result in a lower critical cost savings. Farrell and Shapiro don't indicate why this would or would not be a reasonable alternative to their approach.

profit-maximizing degree of price aggressiveness for good 1, it will not account for the losses experienced by B when B loses sales to A. After all, A and B are independent firms.

If  $P_2$  is the price of good 2 and  $C_2$  is its marginal cost,  $P_2 - C_2$  is the absolute gross margin earned by B on every sale of good 2. Suppose that for every additional unit of good 1 sold by A when A lowers the price of good 1, B loses “d” units of good 2 sales. Farrell and Shapiro call “d” the diversion ratio from good 1 to good 2.<sup>14</sup> Then for each additional unit of good 1 sold at the lower prices, B’s lost profit is d times the absolute margin earned on the sale of good 2, or  $d*(P_2 - C_2)$ .

Of course, if A and B are independent firms, A doesn’t consider this loss in its pricing of product 1. Suppose that A and B merge. Now when A prices good 1 aggressively, some of A’s additional sales come from the “cannibalization” of B’s sales of good 2 by the increased sales of good 1. The new owner of both A and B will want the manager of A to account for this cannibalization effect in its profit calculus.

The sale of an additional unit of good 1 now generates an opportunity cost to the owner of the merged firm equal to the reduction in B’s profits, i.e.,  $d*(P_2 - C_2)$ . For A’s managers to internalize the cannibalization effect (i.e., to create incentives for A’s managers to account for this opportunity cost when setting the profit-maximizing price of good 1), the owner of the merged firm can levy on A’s managers a per-unit “tax,”  $t_1$ , on the production of good 1 equal to  $d*(P_2 - C_2)$ . This tax increases the marginal cost of producing good 1 by the amount of the lost profits on good 2 from the sale of an additional unit of good 1. As a result of the higher marginal cost, the corresponding profit-maximizing price charged by A’s manager will also be higher.<sup>15</sup> An analogous tax,  $t_2$ , would be levied on the production of good 2 to enable the managers of Firm B to internalize the cannibalization of good 1 sales when another unit of good 2 is sold.

Thus, in the case of good 1, the measure of upward pricing pressure is

$$UPP_1 = t_1 = d*(P_2 - C_2).$$

Using pre-merger data, one can interpret UPP as an indicator of whether price will rise post-merger. The paper (p.9) refers to these indicators as a quantitative expression of how “the loss of competition between Firms A and B will cause upward pricing pressure.”

UPP does not measure by how much post-merger prices might rise and so differs from the post-merger price predictions that are generated by simulation models. As with any other marginal cost increase, the predicted price increase would depend on the extent to which marginal cost increases (i.e., the cannibalization costs) are passed through to consumers via higher prices. And that, in turn, depends on assumptions about the shape of firm demand curves, among other things. Like Werden’s measure of the critical efficiency gain, the UPP is not dependent on the shape of the demand curve.

As long as goods 1 and 2 are substitutes and have positive margins, any merger between two firms producing differentiated products will result in positive measures of UPP because the diver-

<sup>14</sup> This counter-intuitive description of d—which in this example would appear to be diversion from good 2 to good 1—is partly a result of the way we normally think about diversion. That is, if A raises the price of good 1 by some small amount, we usually think of diversion as the fraction of good 1’s losses from its price increase that will be “captured” by good 2. If A now lowers its price to its previous level, then the fraction of the gains to A coming from B will be the same as the fraction of its losses to B when A increased price.

<sup>15</sup> The paper notes that this need not always be the case, but it also notes that in “a very broad class of oligopoly models, including all reasonable Bertrand models, an increase in some firms’ marginal costs, with no shift in those of other firms, raises equilibrium prices.” (p.9) (note omitted).

sion ratios will always be positive. That's not very helpful as a presumption of merger harm because all differentiated-product mergers with positive margins and some degree of substitutability will lead to a positive UPP. Any merger policy premised on a positive UPP would result in a virtual per se ban on such mergers.

That is why Farrell and Shapiro introduce the "standard deduction" for efficiencies, which I mentioned earlier. The "standard deduction" represents a presumed minimum efficiency gain from any merger. Suppose that the merger-specific standard-deduction efficiencies are expected to reduce the costs of producing good 1 by  $E$  percent. Then the enforcement question is whether the net UPP (i.e., the UPP net of efficiencies) is positive.

More specifically, the test is whether (for good 1)

$$(1) d^*(P_2 - C_2) > E * C_1$$

where  $C_1$  is the marginal/variable cost of producing good 1.<sup>16</sup> If this inequality holds for both goods 1 and 2, price will tend to increase at least in the standard Bertrand price-setting models typically used for differentiated product analysis. The merger-induced opportunity cost increase (which will tend to raise prices) on the left-hand side of (1) will be larger than the cost-reducing effect generated by the efficiency standard deduction on the right-hand side of (1).<sup>17</sup> If the inequality is satisfied for both goods, the rebuttable presumption would be that prices would rise substantially.<sup>18</sup> Farrell and Shapiro note that "our test has power because it captures the much more general idea that the loss of competition between the merging firms is significant enough to outweigh the efficiencies presumed to result from the merger." (p.12.)

Farrell and Shapiro note that the opportunity cost or cannibalization tax,  $d^*(P_2 - C_2)$ , itself depends on the post-merger prices that are set, not on the pre-merger prices—that is, higher post-merger prices for good 2 will mean that the tax on good 1 should be higher than that suggested by a tax based on the pre-merger good 2 price. The merger raises the margin on good 2 and so raises the opportunity cost of selling another unit of good 1.

To account for these feedback effects, the paper follows Werden to show that the price of good 1 will rise if the following somewhat more complicated expression holds:

$$(2) d_{12}(P_2 - C_2) + d_{12}d_{21}(P_1 - C_1) > E C_1(1 - d_{12}d_{21})$$

where  $d_{12}$  is the diversion from good 1 to good 2 and  $d_{21}$  is the diversion from good 2 to good 1. There is an analogous condition for the price of good 2 to rise. The paper seems to recommend the use of (2) within the agencies during the merger review process, but the use of (1) in court because it is more transparent. And inequality (1) remains the focus of the paper.

As noted above, the net UPP does not measure price increases, only post-merger cost changes. Translating the net UPP into a predicted price increase (or decrease) requires information on the extent to which cost increases are passed-through to consumers via higher prices. But

---

<sup>16</sup> For reasons that are completely unclear to me, the paper transforms expressions such as that in (1) into a ratio form that lacks the straightforward intuitive appeal of inequality (1).

<sup>17</sup> It may be worth noting that the expression could be modified to account for the standard deduction for the post-merger efficiencies in the production of good 2. If so, the expression would be  $d^*(P_2 - (1 - E)C_2) > E * C_1$ , assuming the same standard efficiency deduction is ascribed to both good 1 and good 2. (My thanks to my colleague Serge Moresi for pointing this out.)

<sup>18</sup> It is possible that the net UPP for good 1 might be positive (i.e., that the cannibalization tax is not offset by the cost savings for good 1) while that for good 2 might be negative. While the paper indicates that the mixed test results should be "enough to establish the rebuttable presumption," it also considers other alternatives. (pp. 23–24.)

that in turn requires an assumption of a specific functional form for (or curvature of) demand (e.g., linear, logit, AIDS, constant elasticity) and an assumption about how firms interact when costs and prices change. “Because the magnitude of the price effects varies so much with these somewhat arcane assumptions, for reasons that are opaque to non-economists, the [price-prediction] methodology is hard to make robust and transparent.” (p. 19.)

As a result, the authors prefer their simpler and more straightforward approach. “[It] is generally much easier and more robust to predict the *sign* of the price effects of a merger, as our test aims to do, than to predict their *magnitude*.” (p. 17.) That is, determining whether, after accounting for the standard efficiency deduction, the post-merger price will rise by a substantial amount or a trivial amount requires more structure (assumptions) about the shape of the demand curve in particular than is required by the Farrell-Shapiro approach. If the cannibalization tax is not offset by the standard deduction for efficiencies, the Farrell-Shapiro approach will indicate that post-merger prices will likely increase. And in the view of the authors, that should be sufficient to establish the necessary presumption that the merger will harm consumers.

Nonetheless, Farrell and Shapiro then go on to modify the test to account for the possibility that the agencies and courts might prefer a price increase threshold above which mergers are presumed to be harmful to consumers. If  $G$  is the pre-specified price-increase threshold and  $R$  is the rate of the pass-through of cost increases of good 1 to prices, the test in expression (1) can be modified to answer the question of whether the opportunity cost-driven cost increase net of efficiencies for good 1, when translated into higher prices, is greater than some pre-determined price increase for good 1.

$$(3) R [d^*(P_2 - C_2) - E^*C_1] > G^*P_1$$

where  $R$  is the fraction of any cost increase for good 1 (net of efficiencies) that is passed on to consumers via higher prices and  $G$  is the “tolerance” level for price increase (e.g., 5 percent). If this is the test that were to be implemented, Farrell and Shapiro suggest setting  $R = 0.5$ , the pass-through rate assuming linear demand. (The paper does not seem to suggest a level for  $G$ , although it offers an example using 5 percent.)

For any given  $E$ , inequality (3) is less demanding than (1). If the bracketed expression on the left-hand side of (3), i.e.,  $[d^*(P_2 - C_2) - E^*C_1]$ , is positive, Farrell and Shapiro would conclude that that alone means the agencies have satisfied the rebuttable presumption burden—the UPP is greater than the standard-deduction efficiencies (i.e., inequality (1) holds). But the deal could still fail to satisfy the rebuttable presumption in (3) if the resulting price increase is less than  $G$ . Thus, (3) would be more permissive towards mergers.<sup>19</sup>

Expressions (1) through (3) are the core of the paper’s proposed new rebuttable presumption: if the inequalities in those expressions hold, there is a rebuttable presumption that the merger will harm consumers. But the paper clearly prefers the demand-free expressions in (1) and (2).

Farrell and Shapiro then address measurement issues and caveats. The paper notes the general availability of prices and the more limited availability of marginal cost measures. But the paper

---

<sup>19</sup> Farrell and Shapiro offer this modification to account for a view that the incidence of false positives might be more significant or costly than false negatives. Alternatively, mergers may have benefits beyond the merger itself (such as a “lively” corporate control market). (pp. 20–21.) But another reason for being more permissive is that the presumption doesn’t account for either easy entry or rapid repositioning that could offset relatively modest price increases. Easy entry or rapid repositioning in response to a post-merger price increase would reduce diversion between goods 1 and 2 and so reduce the size of the cannibalization tax. Even within expressions (1) and (2) which avoid price predictions, these possibilities could be accounted for by reducing “ $d$ ” by some “standard deduction”-like percentage.

notes that margins in differentiated product good industries tend to be high and so the test may not be “especially sensitive to the measurement of marginal costs.”<sup>20</sup>

Diversion ratios can be estimated using “econometric methods,” inferred from customer switching studies or from consumer surveys. The paper doesn’t specify how the surveys should be designed or what “econometric methods” might be used. With respect to the latter, diversion ratios are frequently inferred from own-price and cross-price elasticities generated by an econometrically-estimated demand model. And that demand estimation relies on specifying the shape of the demand curve, making expressions (1) and (2) indirectly dependent on that shape.

Another approach suggested by the paper is to infer diversion ratios by calculating the shares of the collection of products that “are about equally close substitutes” for the products of the merging parties and then using proportional diversion for the estimate of  $d$  in the net UPP test. The paper is quick to note that identifying this collection of close substitutes does not have to satisfy any market definition test. However, the paper offers no guidance in how to identify the collection of “about equally close substitutes.”

But even if the paper had an algorithm to identify the set of “about equally close substitutes,” the risk is that once again, the analysis is pushed into the same kind of line-drawing exercise as is true with current market definition. Indeed, if there are  $n$  products considered to be “about equally close substitutes,” then it’s not hard to infer from the discussion in the paper that one way of choosing those  $n$  products is to choose those whose shares are about equal in some product segment under consideration. Then the share of each in the limited collection of “about equally close substitutes” would be very close to  $1/n$ . So inevitably and in a seemingly arbitrary way, some goods (or services) that are almost “about equally close substitutes” will be left out of this direct analysis. This approach seems unnecessarily restrictive, could itself lead to false positives, and so is subject to the same line-drawing criticism that the authors (and many if not most economists) have leveled at the use of market definition when products are differentiated.

There is also the critical choice of what the standard deduction for efficiencies ( $E$ ) should be. The paper uses an illustrative 10 percent, although it suggests as a start  $E$  could be set “based on evidence of the efficiencies that commonly result from horizontal mergers.” (p.10). Michael Salinger, former Director of the FTC’s Bureau of Economics, has suggested that the standard deduction should be 1–3 percent based on post-merger productivity studies.<sup>21</sup> That level of the standard-deduction efficiencies can result in (1) or (2) being satisfied for almost any deal involving two merely somewhat substitutable goods.<sup>22</sup>

In addition, the paper regards this approach as embodied in inequalities (1) and (2) as superior to the use of simulations to predict post-merger price increases because it does not require any assumptions about demand shapes. As discussed, the shape of the firm’s assumed demand

---

<sup>20</sup> The authors also believe that “firms keep track of their cost functions . . . to know how far they can profitably cut prices.” (p. 16.) That would be incredibly helpful if true, but it’s certainly news to me.

<sup>21</sup> Michael Salinger, Four Questions About Horizontal Merger Enforcement, Presentation to ABA Section of Antitrust Law Economics Committee 3 (Sept. 14, 2005), available at <http://www.ftc.gov/speeches/salinger/050914ababrownbag.pdf>.

<sup>22</sup> For example, using (1), suppose that the diversion from A’s good 1 to B’s good 2 is a modest 10%, the good 1 price is 4, and the marginal cost is 3. The last two imply a relatively low pre-merger margin of 25%. If  $E = 10\%$ , then inequality in (1) does not hold and so there is no presumption that this deal would adversely affect consumers (the left-hand cannibalization-tax side of the inequality is 0.1 and the right-hand efficiency side is 0.3.) If  $E = 3\%$ , then inequality (1) is satisfied and under this approach, there is a presumption that the deal will harm consumers (the right-hand side of the inequality now falls to 0.09).

curve is a key to determining the pass-through rate and so the predicted price effects of the merger. And across the usual functional forms for demand, predicted price changes can vary widely.<sup>23</sup>

It's not clear whether the authors are arguing that given the limitations of simulations, that all simulations should be off the table or whether they should be explored only if the agencies have established that inequalities (1) and/or (2) hold. While focusing on the sign rather than the magnitude of (1) and (2) means the analysis is robust to the shape of demand, it certainly isn't true that nothing is lost in translation. Predicted price changes can provide agency staff and the courts with at least some preliminary notion of how solid the evidence of efficiencies, entry, repositioning, and so on, must be if the merger is to be cleared. A large predicted price increase might suggest that such evidence must be quite strong and persuasive.<sup>24</sup>

In addition, simulation models can be flexible enough to better tailor the model to the facts of the industry, such as accounting for capacity constraints or non-price methods of competition. Moreover, in terms of a remedy, simulation models can provide insight into the full competitive effect of (for example) divesting a plant by the merging parties to another firm in the industry. Because the approach in (1) and (2) focuses just on the merging parties, that approach cannot evaluate the competitive effect of the divestiture to an industry incumbent.

In any event, as suggested by the title of the paper and the discussion in the paper, the authors argue that for assessing unilateral effects in product-differentiated industries, the rebuttable presumption of harm embodied in inequalities (1) and (2) is a superior "alternative to the entrenched method based on market definition and concentration." (p.3). But the authors are clearly struggling with the ongoing reliance by the courts on market definition and market share. So the authors suggest that the Farrell-Shapiro approach "could be implemented without requiring that the courts abandon the use of market definition and without requiring that the courts embrace the narrower relevant markets implied by the Guidelines." (p. 25). In challenging a merger, the government can define the market broadly and then within that market, satisfy the rebuttable presumptions in inequalities (1) or (2).

If the post-merger market shares are high in the defined market, then the original structural presumption would likely be satisfied. Given the history of the courts' reliance on the structural presumption, why would the courts even bother to say in addition, inequalities (1) and (2) hold?

And as Farrell and Shapiro recognize, if the market shares of the merging firms are relatively small in this broadly defined market, then agencies will have to explain to the court why the low shares are irrelevant by invoking inequalities (1) and (2) and the accompanying intuition. Which is where all this started.

For evaluating a merger's potential for unilateral effects, it would seem far more natural (and even more honest) to begin with inequalities (1) and (2) along with the underlying intuition.

---

<sup>23</sup> But the paper also suggests that simulations require a calibration of the model to current market conditions and then suggests using that calibration to predict post-merger price changes and so "risks mis-specification by omitting the less immediate and concrete aspects of the firms' objectives and conduct." (p. 25.) I don't think this says anything more than that one wants the simulation to be consistent with data on prices (and maybe costs) and shares in the pre-merger world, *assuming* a specific functional form for demand. And this seems more generally to focus back on the advantage of (1) and (2) as being independent of the shape of demand. But the notion that simulations fail to account for "the less immediate and concrete aspects of the firms' objectives and conduct" seems odd—the motivation for the simulation has always been the intuition behind inequality (1), that post-merger, the acquiring firm accounts for effects of its actions on the profits of the acquired firm (and vice-versa) in a way that did not happen pre-merger.

<sup>24</sup> Of course, a modified version of the left-hand side of expression (3) could be used as a preliminary indicator of the size of the price increase. That is, one could use  $R [d^*(P_2 - C_2)]$  as a measure of the possible post-merger price increase, which translates the post-merger cannibalization tax into a price increase using the pass-through rate  $R$ .

Consistent with that view, the penultimate sentence in this paper notes that “the market definition exercise is a distracting appendage to the ‘real’ analysis of mergers with unilateral effects.” (p. 29.)

This is a paper worth reading because these two eminently qualified economists have resurrected the question of the need for and relevance of relevant market definition in differentiated product industries. I am concerned about the shorter shrift given to implementation issues (estimating diversion, determining which products to directly include in the analysis). But given the broad sweep of this paper, it probably is unfair to expect every implementation detail to be discussed in much depth. It goes without saying that those details will be critical. And the paper is at its best when it doesn’t fall back into something like a market definition trap.

Farrell and Shapiro have proposed an interesting and potentially powerful way of supplanting the structural presumption in differentiated product industries. Hopefully, the debate regarding the use of market definition in such industries may now take (or re-take) one of the center stages of antitrust enforcement. If so, this in and of itself will be an important contribution of the paper. The structural presumption is clearly not one that is a good fit in differentiated product industries. This same debate will no doubt also generate discussion on the optimal use of simulations in antitrust.

Moreover, the importance of the market definition debate may be heightened, as we are now on the verge of changing antitrust enforcement regimes. As a consequence, this is a debate that the courts may well take note of. ●

—JRW