

# Repositioning and the Revision of the Horizontal Merger Guidelines

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De novo entry has long been accepted as a possible defense against anticompetitive concerns in any merger context. The potential for using product repositioning by extant competitors as a defense has only received consideration as the unilateral effects analysis of differentiated product mergers has entered the mainstream. In 1991, Robert Willig—at that time the chief economist at the Department of Justice (DOJ) Antitrust Division—noted that if other firms can easily reposition their products to be closer to those of the merging parties, then “there would be little reason for special concern about the effects of a merger between two firms just because their products happened to be close substitutes at the current point in time.”<sup>1</sup>

Carl Shapiro, currently the chief economist at the DOJ Antitrust Division, offered similar observations in a 1995 presentation to the American Bar Association during his previous tenure at the DOJ. He noted that in the event of a post-merger price increase

it may well pay for a rival firm to reposition its brand closer to the merging brands. And this threat could well deter the price increase in the first place . . . . Very often in differentiated-product markets, brands enter and exit with some regularity, and existing products may be repositioned either through design changes or revised marketing strategies.<sup>2</sup>

Indeed, some prominent examples of repositioning include grocery stores and beer—examples we describe in greater detail below.

Against that background, it is not surprising that the DOJ and FTC’s Horizontal Merger Guidelines consider the potential for repositioning (and entry) by existing rivals in response to a merger as potential factors in assessing the likelihood of a post-merger price increase.<sup>3</sup> In particular, repositioning—at least until recently—had become a standard defense for mergers in differentiated product industries. Specifically, Section 2.212 of the Horizontal Merger Guidelines notes that a “merger is not likely to lead to unilateral elevation of prices of differentiated products if, in response to such an effect, rival sellers likely would replace any localized competition lost through the merger by repositioning their product lines.”

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<sup>1</sup> Robert Willig, *Merger Analysis, Industrial Organization Theory, and Merger Guidelines*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 281, 304–05 (Clifford Winston & Martin Neil Baily eds., 1991).

<sup>2</sup> Carl Shapiro, Dep. Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, *Mergers with Differentiated Products*, Address Before the ABA and IBA 17 (Nov. 9, 1995), available at <http://www.justice.gov/atr/public/speeches/227167.pdf>. Shapiro also notes that “the greater are the sunk costs associated with product entry or repositioning, and the longer such supply responses take, the less likely they are to deter or defeat an anticompetitive price increase.” *Id.* at 18. As this caveat suggests, the differences between entry and repositioning are effectively quantitative, not qualitative.

<sup>3</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, *Horizontal Merger Guidelines* §§ 2.2, 3 (1992, rev. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.pdf>.

However, despite the apparent importance of the potential for repositioning to evaluating post-merger competition, the extent to which repositioning arguments have influenced the actual review of potential mergers is not obvious. In the antitrust agencies' 2006 *Commentary on the Horizontal Merger Guidelines*, which was an attempt to provide some clarification and discussion of the actual practice of the agencies in applying the Guidelines, the repositioning defense was effectively written out of the Guidelines:

The Agencies rarely find evidence that repositioning would be sufficient to prevent or reverse what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger. Repositioning of a differentiated product entails altering consumers' perceptions instead of, or in addition to, altering its physical properties. The former can be difficult, especially with well-established brands, and expensive efforts at doing so typically pose a significant risk of failure and thus may not be undertaken.<sup>4</sup>

*[W]e find that the factual assertions in the Commentary that repositioning is difficult appear at odds with the data we have seen in consumer goods industries—those where product differentiation models are most likely to be relevant.*

In this article, we consider what role repositioning should play in the merger review process as the agencies begin the task of revising the Guidelines. Specifically, we look at the economic arguments for why explicit consideration of repositioning (and entry) may be unwarranted in some cases and ask what limitations those arguments have. We find, for example, there are some theoretical reasons why reliance on repositioning (or even entry) to defend a merger is misplaced in circumstances where appropriate elasticities (i.e., ones that account for the threat of repositioning by rivals) can be readily estimated. However, in most instances, estimating appropriate elasticities will be difficult at best, and so the repositioning defense can be key to a complete evaluation of competitive effects.

Perhaps more importantly, we find that the factual assertions in the *Commentary* that repositioning is difficult appear at odds with the data we have seen in consumer goods industries—those where product differentiation models are most likely to be relevant.<sup>5</sup> Thus, we conclude that repositioning should continue to receive explicit consideration in the revised Guidelines. There should be a clear statement of any factors that the agencies believe limit the role of repositioning in practice or any reasons for discounting evidence concerning repositioning based on theoretical grounds.<sup>6</sup>

## Repositioning in Theory

**Coordinated Effects.** In the context of coordinated effects concerns, repositioning may not always be relevant to the assessment of competitive effects. For example, suppose a merger raises coordinated effects concerns because the effect of the merger is likely to increase tacit collusion by perfecting the ability to detect and punish “cheaters” to the agreement. The effect of the merg-

<sup>4</sup> U.S. Dep't of Justice & Fed. Trade Comm'n, *Commentary on the Horizontal Merger Guidelines* 31 (2006), available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf> [hereinafter *Commentary*].

<sup>5</sup> This view of the *Commentary* is all the more troubling to the extent that the revisions considered by the agencies may well be driven by the *Commentary* as the most recent interpretation of current agency practice. See Darren S. Tucker, *Seventeen Years Later: Thoughts on Revising the Horizontal Merger Guidelines*, ANTITRUST SOURCE, Oct. 2009, at 1, <http://www.abanet.org/antitrust/at-source/09/10/Oct09-Tucker10-23f.pdf>.

<sup>6</sup> Economists Gregory Werden and Luke Froeb have noted that in the presence of sunk costs for entrants, anticompetitive mergers in differentiated product industries may not provide an entry opportunity sufficiently large to induce entry. In these general situations, reliance on entry as a “cure” for an otherwise anticompetitive merger may be misplaced. See Gregory J. Werden & Luke M. Froeb, *The Entry-Inducing Effects of Horizontal Mergers: An Exploratory Analysis*, 46 J. INDUS. ECON. 525 (1998). While in principle, these same arguments could apply to repositioning, the prevalence of repositioning opportunities seems empirically important.

er then may be to enhance the internal stability of the coordinating group, but it has no apparent effect on the external constraints on the merged firm. That is, the merger may have no price effect but acts only as a tacit cartel stabilizer. Thus, arguably, entry and repositioning are not affirmative defenses to coordinated effects concerns because there is no price change to respond to.

However, there are several ways in which repositioning can be relevant in a coordinated effects case. First, to the extent that repositioning is a regular feature of an industry, the likelihood that a merger in that industry would improve firms' ability to coordinate may be lessened. Frequent repositioning of products would likely frustrate efforts by any putative coordinating group to monitor price and share and so would disrupt efforts to coordinate pricing tacitly (other things equal). In this sense, explicit consideration of repositioning during the merger review process would be an important part of assessing the likely competitive effects of the merger.

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Repositioning also would be relevant in the context of coordinated effects when a merger eliminates a maverick. If before the merger, the maverick was the constraint on the ability of the coordinating group to raise price, then the elimination of that constraint would result (all things equal) in a higher price.<sup>7</sup> However, that higher price, in turn, may invite repositioning by firms outside of the coordinating group. In effect, the merger may give rise to a new maverick that exerts as great a constraint on the coordinating group as the previous maverick eliminated by the merger. If that were the case, then the merger would have no price-increasing effect and, indeed, the only reason for the merger would then be efficiency based. Ignoring the potential for repositioning in such a case could lead to a substantial overstatement of the adverse competitive effects of the merger.

Thus, as a matter of theory, repositioning should be a key part of the revisions to the Guidelines' discussion of coordinated effects. To proceed otherwise could substantially increase the likelihood of false positives without any corresponding benefit in reducing the likelihood of false negatives.

**Unilateral Effects.** In the context of a merger review, the role of repositioning is most prominent in considering the likelihood of adverse unilateral effects for a merger in a differentiated product industry, i.e., the likelihood of a unilateral post-merger price increase in such an industry. The question we ask is whether the effects of such repositioning on the likelihood of adverse unilateral effects need explicitly to be taken into account. If the effects of repositioning on the likelihood of adverse unilateral effects are already accounted for through their embodiment in own- and cross-price elasticities and diversion ratios—factors that are usually examined in the context of a differentiated product merger—then it may be unnecessary or even inappropriate to consider the potential for product repositioning by rivals.

When two firms in a differentiated product industry merge, the post-merger incentive to increase price depends on the extent to which the products of the merging firms are close substitutes. As long as there is some degree of substitution between the products of the merging firms, prices will increase absent any offsetting efficiencies. If an increase in price of one firm's products leads some consumers to shift to the products of the other merged firm, the merged firm will have an incentive to increase price. That is, as a result of the merger, the firm increasing its price recaptures some of its lost sales when consumer purchases are diverted to the merging partner. That recapture rate provides the merged firm with the incentive to increase prices above the pre-merger level.

<sup>7</sup> If there are multiple equally effective mavericks, then the elimination of one will not change the external constraints on the coordinating group. For a discussion of the maverick role, see Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. Rev. 135 (2002).

In Bertrand-type models of differentiated product competition, key inputs into an assessment of the likelihood of unilateral effects include the own- and cross-price elasticities of the firms in the industry. If those elasticities are estimated correctly in that they account for repositioning, then no additional consideration of repositioning by rival firms is necessary.

For example, suppose that in the pre-merger state a firm raises its price, and that when it does so, one or more rivals reposition their products to appeal to consumers who valued the lower price point. In that case, the measured own- and cross-price elasticities will reflect the fact that the firm lost additional sales to those that repositioned—more sales than would have been lost had repositioning not occurred. Thus, the elasticities—both own and cross—will be larger than if repositioning had not occurred, and, in that sense, those elasticities will already reflect the effects of repositioning on the likelihood of a unilateral post-merger price increase. Concomitantly, the diversions from the firm raising price to those that repositioned will be larger in proportion to the effect of the repositioning.<sup>8</sup> The greater the extent to which rivals can reposition their products when the firm increases price (and the extent to which consumers of the firm that increased price divert their purchases to the newly repositioned firm), the more elastic will be the estimated firm's demand curve and the larger will be the cross elasticities.

Therefore, if one relies on an analysis that is based on estimates of elasticities and diversions from actual data that account for repositioning—an analysis such as the Guidelines market definition test using a small but significant and non-transitory increase in price (SSNIP), the use of an Upward Pricing Pressure index as recently suggested by Farrell and Shapiro,<sup>9</sup> a critical loss analysis, or a full simulation of the post-merger equilibrium—the fact of the potential for repositioning generally could not be used as an affirmative defense of a merger. That would amount to double dipping because the elasticities already reflect any repositioning that may result from merger-induced price increases.<sup>10</sup>

However, estimating a demand system to obtain such own- and cross-price elasticities can be difficult, especially in the context of frequent product repositioning. In the first instance, the presence of repositioning may make it difficult to construct a demand model that allows for product characteristics to change over time. Repositioning may itself also be endogenous (i.e., repositioning may occur in response to shocks in demand that also affect pricing) and thereby render estimates biased or necessitate more sophisticated econometric approaches. Therefore, explicit consideration of repositioning in assessing competitive effects may be warranted if it is not possible to obtain reliable estimates of elasticities that adequately account for repositioning.

Approaches that rely on HHIs, capacities, or win-loss records, rather than estimated elasticities, to infer competitive effects may also not adequately capture the effects of repositioning on the likelihood of post-merger competitive effects.<sup>11</sup> For example, one might use win-loss records

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<sup>8</sup> This assumes that future repositioning patterns will be reflected in historical repositioning patterns. If that is not the case, then even what would otherwise be a reasonable estimate of the own- and cross-price elasticities will not reflect the repositioning that matters for mergers—i.e., repositioning should the merged firm attempt to increase price.

<sup>9</sup> Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition* (Working Paper 2008), available at <http://faculty.haas.berkeley.edu/shapiro/>.

<sup>10</sup> One could make the same argument about entry.

<sup>11</sup> It is possible that the econometric approach used in *FTC v. Staples Inc.*, 970 F. Supp. 1066 (D.D.C. 1997), for example, of regressing price on HHI, while introducing numerous well-documented challenges to the researcher, may succeed in capturing the effects of repositioning. This would be the case if repositioning provides a strong constraint on pricing such that the regression shows little effect on pricing from changes in concentration.

to identify the extent to which products of the merging parties are close substitutes, and the extent to which products of other rivals are close substitutes for those of the merging parties. But diversion estimates based on win-loss records will not account for post-merger repositioning. Thus, there is the possibility that historical win/loss records may present a distorted picture of who the real constraints might be at any given time.

Similarly, relying on proportional diversion—that is, assuming that diversions are proportional to industry shares—may provide a reasonable starting point for a competitive effects analysis, but may not be sufficiently reliable for a full analysis. If a post-merger price increase results in repositioning by the rivals of the firm, that repositioning will dampen the incentives to raise post-merger prices. Based as it is on current shares, proportional diversion cannot account for repositioning.

While in principle there may be ways of estimating own-price and cross-price elasticities that reduce the need for any reliance on external repositioning information, in practice such estimates are difficult to generate. Thus, reliance on external data to gauge the extent of repositioning will be necessary if, as a general matter, repositioning is a reasonable possibility in the event of a post-merger price increase.

*Repositioning has historically played a significant role in the grocery industry.*

### Repositioning in Fact

As noted at the outset, the *Commentary* asserts that as a general rule, repositioning in practice is not likely to be of any competitive significance. We assess the validity of that general rule by considering the evidence on the possible extent of repositioning in some common consumer goods industries. In doing so, rather than generally identifying repositioning in response to a merger-induced price change (although such a data set would have been ideal for this exercise), we illustrate that repositioning in general, whether through the introduction of new brands or through product extension, is common in a number of consumer goods industries.

**Examples from the Retail Grocery Industry.** Repositioning has historically played a significant role in the grocery industry. The potential for repositioning by “conventional” grocery stores in response to the success of the “natural and organic” grocery store concept was a central issue in a recent challenge by the FTC of the merger of grocery chains Whole Foods and Wild Oats.<sup>12</sup> The FTC’s complaint alleged that Whole Foods and Wild Oats competed in a market of “premium, natural and organic supermarkets” (PNOS) and faced no effective competition from conventional grocery stores.<sup>13</sup> The merging parties argued that they faced competition from a broad range of grocery stores, including grocery chains focused on natural and organic foods; so-called conventional grocery stores, such as Safeway and Kroger; as well as some more specialized stores like Trader Joe’s, so that there could be no market defined as narrowly as PNOS.

In its finding that Whole Foods competes in a broad market including all grocery stores and not just the PNOS market alleged by the FTC, the district court cited evidence of actual entry and repositioning by so-called conventional stores in response to stores in the putative PNOS’ market. For example, the court noted that numerous grocery stores had already proven themselves adept at repositioning through the addition and expansion of organic produce sections, perishable meat sections and other products, and through reformatting and redesigning stores. These firms included Delhaize America and, in particular, its high-end banners, Hannaford and Bloom; Safeway; Publix; Kroger; Supervalu; and Wegmans.<sup>14</sup>

<sup>12</sup> *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007), *rev’d*, 548 F.3d 1028 (D.C. Cir. 2008).

<sup>13</sup> *Id.* at 5.

<sup>14</sup> *Id.* at 43–48.

In fact, there appear to be numerous examples of repositioning by grocery chains as a means of competition. Whole Foods launched its “365” brand in 1997 as a low-cost all-natural product line (but without the organic designation) to attract more customers and compete against lower priced private label brands of conventional supermarkets and Trader Joe’s.<sup>15</sup> The 365 line includes many of the same products that Whole Foods sells as natural and organic, such as soft drinks, juices, salad dressings, and pasta sauces.<sup>16</sup> Thus, this launch was an attempt by Whole Foods to reposition itself in the grocery space to compete not only with other natural and organic supermarkets but also with stores in the conventional space. The launch of the 365 brand has been regarded as a success for Whole Foods and other manufacturers, and retail competitors have since responded by introducing or repositioning product lines, or altering pricing on existing product lines, to compete with Whole Foods’ 365 brand.<sup>17</sup>

More generally, as various non-conventional grocery chains have demonstrated that “organic” and “natural” concepts appeal to consumers, “traditional” chains like Safeway have felt pressure to respond and adapt to the changing preferences of customers. In particular, Whole Foods’ challenge to conventional grocery chains is based on a combination of successful marketing designed to exploit a growing preference for healthy, natural, and organic foods and an acquisition strategy in which Whole Foods has converted numerous smaller chains into Whole Foods banners.

In response to this challenge, grocery chains, such as Safeway, Shaws, and Publix, have repositioned themselves by introducing new product lines and reformatting stores, allowing them to compete more directly in the fast growing natural and organic grocery space. For example, in 2003, as the demand for specialized stores grew, Safeway introduced several new brands, such as Ranchers Reserve meats and Signature sandwiches, soups, and salads. A year later, Safeway introduced its healthy-sounding “Ingredients for Life” advertising campaign and started remodeling its stores to create a warmer environment with hardwood floors and softer lighting to compete more effectively in the “healthy foods” product space.<sup>18</sup>

Each of these initiatives was part of a broader campaign by Safeway to rebrand itself under the “Lifestyle” moniker, emphasizing healthy foods, prepared foods, an enhanced shopping experience, and organic foods.<sup>19</sup> By the end of 2006, Safeway had already remodeled 751 of its more than 1,500 stores to the new Lifestyle format. In December 2006, Safeway also introduced its “O Organics” private label line of organic products, including beverages, baked goods, cereals, canned and frozen foods, dairy products, and snack items.<sup>20</sup> The O Organics line was positioned to compete with Whole Foods’ 365 brand of private label non-perishables.

Examples of repositioning are not confined to conventional grocery chains. Perhaps one of the more notable and widely reported efforts to compete in organic and natural foods came from Wal-Mart. By early 2006, Wal-Mart was already introducing multi-product lines of organic foods into its

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<sup>15</sup> Michelle Wilde, *Low-Priced Private Label Is Coming to Whole Foods*, SUPERMARKET NEWS, Mar. 10, 1997, at 49.

<sup>16</sup> R. Michelle Breyer, *Whole Foods to Introduce New Line of Products/Whole Foods Outlines Vigorous Plans to Expand*, AUSTIN AMERICAN-STATESMAN, Mar. 25, 1997, at D1.

<sup>17</sup> “365” Brand Leads Private-Label Charge Among Retailers, Distributors, LOHAS WKLY. NEWSL., Dec. 1, 1997, available at <http://www.lohas.com/articles/65563.html>.

<sup>18</sup> Andrea K. Walker, *Safeway Readies Ad Drive as Grocer Redefines Itself: The Supermarket Chain Redesigns Stores, Redraws Its Logo and Introduces New Brands to Compete with Discounters and Specialty Rivals*, BALT. SUN, Apr. 15, 2005, at 1D.

<sup>19</sup> *Solutions for Living*, PROGRESSIVE GROCER, Oct. 1, 2006, at 31; Pia Sarkar, *Safeway Paying for New “Lifestyle,”* S.F. CHRON., July 27, 2005, at C3.

<sup>20</sup> David Goll, *Organic Food Fight: Safeway Gets Aggressive with New Line*, EAST BAY BUS. TIMES, Mar. 20, 2006.

stores and by late 2007, some industry watchers were declaring it to be the largest retailer of organic foods.<sup>21</sup>

While the district court's finding in favor of Whole Foods in *FTC v. Whole Foods* was overturned on appeal,<sup>22</sup> the district court's opinion nevertheless highlights the important role that evidence of repositioning can play in a merger analysis. And, while those repositioning arguments did not ultimately save the Whole Foods merger, there may be others where this history of repositioning will be a potent affirmative defense against claims of post-merger harms.

#### **Examples from the Retail Pharmaceutical Industry.**

**IN-STORE MEDICAL CLINICS.** In 2005, partly in response to rising health care costs, CVS partnered with MinuteClinic to open in-store health clinics and subsequently acquired MinuteClinic in 2006.<sup>23</sup> These clinics expanded CVS' health care offerings by providing diagnoses and treatments of common illnesses, health screenings, and vaccinations. The CVS partnership with and acquisition of MinuteClinic was quickly mimicked by rival pharmacy retailers. In 2006, Take Care Health Systems opened clinics in Walgreens stores,<sup>24</sup> SmartCare Family Medical Centers opened clinics in Wal-Mart stores, and Lindora and Sutter Health opened clinics in Rite Aid stores.<sup>25</sup> By the end of 2008, the number of retail clinics in the United States reached 1,135, and Walgreens had the highest growth with 293 in-store clinics.<sup>26</sup>

**90-DAY RETAIL PHARMACY PRESCRIPTIONS.** Pharmacy benefit management (PBM) companies have long offered drug benefit plans to insurers that include tiered co-pay incentives to encourage plan members to fill ninety-day prescriptions at PBM-owned mail-order pharmacies, rather than thirty-day prescriptions at retail pharmacies. A ninety-day prescription through mail order can be filled at lower cost than a thirty-day retail prescription, so PBMs are able to pass lower costs on to plan sponsors in the form of lower prices. In response, retail pharmacies, including Walgreens, CVS, and Rite Aid, developed their own PBM offerings and either bought or contracted with mail-order pharmacies to provide mail-order prescription services. This allowed them not only to compete directly with independent PBM-owned mail-order operations, but also to offer their own drug benefit plans featuring ninety-day mail-order prescriptions.<sup>27</sup>

Some retail pharmacies have taken this one step further and have begun offering ninety-day prescriptions at retail as a way of differentiating their PBM offerings from those of the independent PBMs. For example, with its acquisition of Caremark in 2007, CVS positioned itself to develop new offerings for plan sponsors that would exploit the combined entity's strengths as both a retail

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<sup>21</sup> *Wal-Mart Goes Organic: Giant Looks to Lure Affluent Shoppers with Green Move*, ASSOCIATED PRESS, Mar. 26, 2006, available at <http://www.msnbc.msn.com/id/11977666/>; Press Release, Scarborough Research, When It Comes to Organic Food, the West is the Best (Oct. 10, 2007), available at [http://www.scarborough.com/press\\_releases/Grocery%20FINAL%2010.10.07.pdf](http://www.scarborough.com/press_releases/Grocery%20FINAL%2010.10.07.pdf).

<sup>22</sup> *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008).

<sup>23</sup> *First Three MinuteClinics in CVS Stores Set to Open*, CHAIN DRUG REV., May 23, 2005, at 1; Press Release, CVS Corp., CVS Corporation to Acquire MinuteClinic, Largest Provider of Retail-based Health Clinics in the US (July 23, 2006), available at [http://www.minuteclinic.com/Documents/Press-Releases/MC\\_CVS\\_Release.pdf](http://www.minuteclinic.com/Documents/Press-Releases/MC_CVS_Release.pdf).

<sup>24</sup> Bruce Japsen, *Walgreen to Set Up 20 Clinics; Kansas City, St. Louis Facilities Are Planned*, CHI. TRIB., Apr. 26, 2006, at 3.

<sup>25</sup> *In-store Clinics on Rise*, CHAIN DRUG REV., Oct. 23, 2006, at 3.

<sup>26</sup> Bruce Japsen, *Walgreens Leads Field in Retail Medicine: Drugstore Chain to Operate 400 Clinics in U.S. by August*, CHI. TRIB., Dec. 4, 2008, at 38.

<sup>27</sup> James Mulder, *Chains Adopt By-Mail Tactics; Drugstore Giants to Fill 90-Day Prescriptions*, NEW ORLEANS TIMES PICAYUNE, July 31, 2005, at 1.

pharmacy chain and a major PBM.<sup>28</sup> One example of this is its introduction of its “Maintenance Choice” program, which allows patients with chronic conditions to purchase ninety-day prescriptions at retail for the same price as by mail.<sup>29</sup> Rival retail pharmacy chains have introduced similar programs. Rite Aid, for example, offers a “Rite Fill 90” program for maintenance drugs through its PBM, Rite Aid Health Solutions.<sup>30</sup> Most recently, Walgreens, which offered a 90-day retail PBM offering called “Advantage90” as early as 2003 through its PBM, Walgreens Health Initiative, announced a new 90-day retail initiative in September of this year. The new initiative is a national ninety-day retail program aimed not only at its own PBM customers but also those of other PBMs.<sup>31</sup>

#### **Examples from the Beer Industry.**

*The beverage industry offers numerous examples of dynamic repositioning by rivals.*

**THE RISE OF LIGHT BEERS.** The beverage industry offers numerous examples of dynamic repositioning by rivals. One such example is competition in light beers. In January 1975, Miller Brewing Company introduced the first nationally distributed light beer, Miller Lite.<sup>32</sup> Miller accompanied the introduction with an aggressive advertising campaign, and Miller’s overall beer sales increased 43 percent in the following year, in large part due to the success of Miller Lite.<sup>33</sup> Miller’s success with light beer set off a wave of product line extensions and new brand introductions by both small and well-established brewers. The Joseph Schlitz Brewing Company was the first to follow, introducing its light beer in December 1975;<sup>34</sup> Anheuser-Busch (AB) followed in 1977;<sup>35</sup> and Coors Brewing Company followed in 1978.<sup>36</sup> By mid-1977, there were over twenty light beers being marketed, and by 1980, there were nearly forty light-beer brands in the United States.<sup>37</sup> In 1982, AB introduced Budweiser Light, which became the top selling light beer by 1994.<sup>38</sup>

**THE RISE OF MICROBREWS AND CRAFT BREWS.** Another well-known example of new brand entry and dynamic repositioning is found in the rise of microbrews.<sup>39</sup> Throughout the 1980s, numerous small, local brewers began encountering success in marketing their products and increasing

<sup>28</sup> Antoinette Alexander, *PBM Powerhouse CVS Caremark Redefines Retail Model*, DRUG STORE NEWS, Apr. 21, 2008, at 115.

<sup>29</sup> *Id.*

<sup>30</sup> Rite Aid Health Solutions, Enhanced Network Services, Maintenance Drug Programs, [http://www.riteaidhealthsolutions.com/network\\_services.html](http://www.riteaidhealthsolutions.com/network_services.html).

<sup>31</sup> Press Release, Walgreens Co., Walgreens Launches National Initiative for 90-Day Prescriptions at Community Pharmacies (Sept. 29, 2009); Russell Redman, *Push for 90-day at Retail Prescriptions Begins at Walgreens*, CHAIN DRUG REV., Sept. 29, 2009, <http://www.chaindrugreview.com/front-page/newsbreaks/push-for-90day-at-retail-prescriptions-begins-at-walgreens>; Matthew Coffina, *Walgreen Pushes 90-Day Scripts*, Morningstar Stock Analyst Notes, Sept. 29, 2009, available at <http://quicktake.morningstar.com/StockNet/san.aspx?id=310155>; Mari Edlin, *Retail Pharmacies Fill 90-Day Prescriptions to Compete with Mail*, MANAGED HEALTHCARE EXECUTIVE, Apr. 1, 2006, at 46.

<sup>32</sup> MAUREEN OGLE, *AMBITIOUS BREW: THE STORY OF AMERICAN BEER* 283 (2006).

<sup>33</sup> *Id.*

<sup>34</sup> Judith VandeWater, *Letting Go; New Brands Are Crucial to Success In Brewing*, ST. LOUIS POST-DISPATCH, Feb. 4, 1990, at 1E.

<sup>35</sup> *Corporation Affairs: Anheuser-Busch Sets Industry Record*, N.Y. TIMES, Jan. 18, 1978, at D10.

<sup>36</sup> Philip H. Dougherty, *Advertising; Coors Adds an Ale to Its Product Line*, N.Y. TIMES, Apr. 1, 1981, at D16.

<sup>37</sup> *Many Brewers Set New Entries in Surging Light-Beer Market*, WALL ST. J., Sept. 3, 1980, at 29.

<sup>38</sup> Ryan Nakashima, *Miller’s Time: Oldest Major U.S. Brewer Turns 150*, AP WORLDSTREAM, Aug. 1, 2005. Bud Light was AB’s third light beer, following Natural Light and Michelob Light. See *Anheuser-Busch Introduces Light Beer—Its Third*, WALL ST. J., Mar. 1, 1982.

<sup>39</sup> A microbrewery is usually defined as a small brewery, often attached to a pub, that produces less than 15,000 barrels per year. See Brewers Association, *Craft Brewer Definition*, [http://www.beertown.org/education/craft\\_defined.html](http://www.beertown.org/education/craft_defined.html); see also Brewers Association, *Market Segments*, <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/market-segments>.

sales.<sup>40</sup> The most prominent and successful examples of this phenomenon were the Sierra Nevada Brewery, which was the first of the microbreweries to cross the 25,000 barrel/year mark in 1990; Jim Koch's Boston Beer Company, which brews Sam Adams; and the Redhook Ale brewery.<sup>41</sup>

By the early 1990s, these microbreweries—often called craft breweries once they have grown past the threshold for being classified as a microbrewery—were stealing substantial market share from the big breweries. In 1992, for example, while the overall U.S. beer market remained flat, sales of craft beers rose by 44 percent.<sup>42</sup>

Concerned with the rise of craft brewers and waning sales on college campuses, the major brewers entered the craft space themselves by purchasing and repositioning smaller brands or by extending existing product lines. In 1988, Miller Brewing Company bought Jacob Leinenkugel Brewing Company, a regional Wisconsin brewery, and in 1992, it introduced the Miller Reserve line of all-barley draft beers.<sup>43</sup> In 1993, Miller added Amber Ale and Velvet Stout to the Reserve family,<sup>44</sup> and Stroh Brewing Company launched its Augsburg line, including Oktoberfest and Doppelbock.<sup>45</sup> In 1994, Coors Brewing Company started seasonal boutique brews, such as its Wheat Beer, Bock Beer, and Marzen Oktoberfest labels,<sup>46</sup> and AB introduced Elk Mountain Amber Ale.<sup>47</sup> In 1995, Coors Brewing Company launched the Blue Moon Brand with the first craft beer of the line, Blue Moon Belgian White.<sup>48</sup> Despite these efforts by the major brewers in the craft space, many of the original microbrewers grew significantly and continue to hold large shares today, such as Boston Beer (Sam Adams), Redhook Ale, Genesee, and Sierra Nevada.

**THE RISE OF MEXICAN BEERS.** Yet another example of new brand entry and repositioning in the beer industry occurred in response to the rising popularity of Mexican beers. The initial growth of Mexican beers was spurred by the growth of the Hispanic demographic among beer drinkers. However, as the popularity of Mexican beers spilled over to a wider demographic, Mexican brewers such as Grupo Modelo (Corona) and FEMSA (Dos Equis and Tecate) have been able to achieve much broader success. This success (likely among other reasons) led AB to purchase a 17.7 percent share of Grupo Modelo in 1993, and it later expanded its ownership share to 50 percent. Partly as a result of its access to AB's distribution network, as well as aggressive and successful marketing campaigns, Grupo Modelo was able to increase Corona's share of the U.S. market rapidly, and by 1997 Corona had surpassed Heineken as the number one imported beer in the United States.<sup>49</sup>

In response to AB and Grupo Modelo's success with Corona, AB's domestic rivals have engaged in product line extensions. While Grupo Model and AB successfully introduced into the United States the trend of drinking Corona with a wedge of lime, AB's rivals have responded by

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<sup>40</sup> These included Old New York, Sierra Nevada, Redhook Ale, William S. Newman, Boulder, Yakima, Manhattan, Hale's Ales, Montana Beverage, Columbia River, Chesapeake Bay, and Widmer brewing companies.

<sup>41</sup> Beer Advocate, History of American Beer, [http://beeradvocate.com/beer/101/history\\_american\\_beer](http://beeradvocate.com/beer/101/history_american_beer).

<sup>42</sup> *Micro Breweries*, INDUSTRIES IN TRANSITION BUSINESS COMMUNICATIONS, INC., Mar. 1, 1993.

<sup>43</sup> *Miller Brewing Company Introduces Miller Reserve Amber Ale*, PR NEWSWIRE, Mar. 10, 1993.

<sup>44</sup> *Miller Reserve Velvet Stout Set for February Introduction*, PR NEWSWIRE, Dec. 14, 1993.

<sup>45</sup> Tim Moran, *Something's Brewing: Microbreweries and Brew-pubs Are Becoming Popular Players in the Suds Wars, But Restrictive Laws Keep the Numbers Small*, DETROITER, Feb. 1994, at 14.

<sup>46</sup> *Coors Winterfest Beer; Bock Beer; Wheat Beer; Marzen Oktoberfest Beer*, PRODUCT ALERT MARKET INTELLIGENCE SERV., Nov. 29, 1993.

<sup>47</sup> Mitchell Landsberg, *Unblinded by the Lite: The Brewing Industry's Renaissance*, ASSOCIATED PRESS, Jan. 29, 1995.

<sup>48</sup> MillerCoors LLC, MillerCoors Timeline, <http://www.millercoors.com/who-we-are/miller-coors-history/timeline/PanelId/6.aspx>.

<sup>49</sup> Rick Wills, *Corona Brews Way to Top of Imported Beers in U.S.*, DAILY NEWS L.A., May 30, 1999, at B1.

launching lime flavored beers. In 2007, Miller introduced a new product called Miller Chill, which is a version of Miller's light beer that is infused with salt and lime.<sup>50</sup> Miller's introduction was quickly followed by AB, which introduced Bud Light Lime in 2008, and by Coors' Blue Moon Brewing Company, which launched Rising Moon, a lime version of its Blue Moon ale.<sup>51</sup>

**Examples from the Shampoo Industry.** A hallmark of the hair care industry is the extensive proliferation of brands and brand extensions. In the case of shampoo, there appear to be hundreds of profitable ways for competing firms to locate their products to satisfy seemingly narrow consumer demands for a shampoo type. A recent visit to a local CVS drug store revealed a total of 153 brands or brand extensions at that one store alone. These included shampoos for damaged hair (e.g., Aussie brand's "Protect and Soften" and Pantene Pro-V's "Nature Infusion"); for dandruff protection (e.g., Head and Shoulders' "Intensive Treatment" and Gillette's "Antidandruff"); and for moisturizing shampoos (Aveeno's "Nourish and Moisturize").

*In the case of shampoo,  
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Table 1 in the Appendix sets out the wide variety of types and combinations of shampoos observed at the CVS. Not surprisingly, with so many product varieties, many of these have small shares, yet they appear to have a lasting presence and succeed despite their small shares. More generally, our experience working on matters in the shampoo industry suggests that the minimum viable scale for repositioned brands and brand extensions seems quite small.

Our example from the CVS store visit is just a snapshot. We also reviewed a number of national magazines over the past three years to identify the shampoos advertised and the extent to which new shampoos were advertised. This broader review provides some indication of how frequently brands (particularly national brands) "reinvent" themselves, i.e., are repositioned. As indicated in Table 2 in the Appendix, between 2007 and 2009, 227 shampoo advertisements appeared in the magazines we reviewed.<sup>52</sup> Of those, nearly one third were advertising new products. Thus, at least among nationally advertised brands, repositioning and brand extensions are very frequent occurrences.

For example, in the third quarter of 2007, John Frieda introduced "Daily" (and "Moisturizing") versions of its "Brilliant Brunette Shine Release" shampoos. At about the same time, John Frieda also introduced "Daily" versions of the "Sheer Blonde" and "Radiant Red" shampoos.<sup>53</sup>

Around the third quarter of 2008 Pantene Pro-V "reinvented" the products in its "Expressions" line, which consists of shampoos designed for specific hair colors ("Brunette Expressions Shampoo," "Blonde Expressions Shampoo," and "Red Expressions Shampoo"). In particular, Pantene introduced a new formula for these shampoo lines (a "Liquid Crystals" technology)<sup>54</sup> and began emphasizing the ability to use the color-enhancing products on a daily basis.<sup>55</sup> These changes allowed Pantene Pro-V products to compete more directly with the more narrowly tailored daily-use John Frieda color care products mentioned above.

<sup>50</sup> Emily Fredrix, *Miller to Launch Mexican-Style Beer to Court Hispanics*, AP WORLDSTREAM, Feb. 5, 2007.

<sup>51</sup> David Kesmodel, *Anheuser to Offer Lime in Bud Light*, WALL ST. J., Feb. 13, 2008, at B3.

<sup>52</sup> The magazines reviewed were *Cosmopolitan*, *Seventeen*, *Marie Claire*, and *Redbook*. Not all issues were available for each year reviewed.

<sup>53</sup> Over the same time period, John Frieda offered three new color-focused varieties of its Sheer Blonde product: one characterized as "high-light activating," another called "Go Blonder Lightening" option, and another called "Color Renew Tone Restoring" for color-treated hair. These were advertised as new in the third quarter of 2007, the second quarter of 2009, and the fourth quarter of 2009, respectively.

<sup>54</sup> Hannah Morrill, *Crystal Lights*, ALLURE, July 2008, at 44.

<sup>55</sup> These were "Brunette Expressions Daily Color Enhancing Shampoo, with Liquid Crystals," "Blonde Expressions Daily Color Enhancing Shampoo, with Liquid Crystals," and "Red Expressions Daily Color Enhancing Shampoo, with Liquid Crystals."

That a shampoo brand can reposition and extend itself in such a flexible manner is also evident from the Herbal Essences experience. Over the 2007–2009 time period, Herbal Essences offered ten distinct shampoo products, five of which were identified as “new.” For example, Herbal Essences expanded its line in the fourth quarter of 2007 to include a shampoo product that claimed to increase hair volume. It also offered three new hydrating products called “Hydralicious Featherweight,” “Hydralicious Reconditioning,” and “Hydralicious Self Targeting Shampoos,” each of which focuses on a particular hair type. In the fourth quarter of 2009, Herbal Essences advertised as new a “Toussle Me Softly” Shampoo product, which is for individuals who want wavy, but not necessarily curly hair. (Herbal Essences offered a “Curls and Wave” product already.)

In short, there appears to be no shortage of repositioning in the shampoo industry.

**Examples from the Radio Industry.** Another industry that has been known for rapid repositioning is the radio industry, where format changes appear to be an ongoing part of the competitive dynamic. This is illustrated in a 2005 paper by Charles Romeo and Andrew Dick assessing in part the effect of ownership changes on format changes.<sup>56</sup> In looking at five two-year periods between 1988 and 1998 across ten large Metropolitan Statistical Areas, the paper counted 153 “major” format changes over the five two-year periods, for example, a change from a category like “Talk” to “Rock.” In addition, the paper found 104 “minor” format changes during those time periods, e.g., a change from “Album-Oriented Rock” to “Classic Rock.”<sup>57</sup> Thus, over these five two-year periods, there were over 250 format changes in total, an average of five format changes per MSA for each two-year period. The paper further reports that nearly 17 percent of all stations experienced a major format change during the period; another 11 percent made minor format changes; and almost half of all format changes were associated with ownership changes.<sup>58</sup>

The frequency of format changes should not be surprising. As Romeo and Dick note, “Superficially, format changes would appear to be relatively straightforward to undertake. The requisite tangible investment appears to be quite nominal: purchasing a new library of CDs, hiring new disc jockeys, and undertaking an advertising campaign.”<sup>59</sup> Put somewhat differently, the minimum viable scale of a new format seems small. And the evidence cited above is consistent with that view.

While the data used by Romeo and Dick are a little over a decade old, there is no reason to believe that repositioning in the radio industry has become any more difficult. Table 3 in the Appendix highlights twenty-five recent format changes. For example, in Jacksonville, “Point” WMXQ changed its format from “‘80s music” to “Contemporary Hit Radio” in February 2009. In Chicago, 105.9 WCKG switched its format from “Talk” to “Adult Contemporary.”

There were three relatively rapid changes in formats for a single station in New York. In early 2006, 92.3 K-Rock changed its format from a “Rock”-orientation to “all Talk.” In May 2007, it switched back to a “Rock” format. Then in March 2009, it modified its format to “Contemporary Hit” radio from “Rock.” (See Table 3 in the Appendix.)

In most cases reported in Table 3, these format changes were associated with name changes. In the language of the *Commentary*, most of these changes involved not product extensions but

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<sup>56</sup> Charles J. Romeo & Andrew R. Dick, *The Effect of Format Changes and Ownership Consolidation on Radio Station Outcomes*, 27 REV. INDUS. ORG. 351 (2005).

<sup>57</sup> *Id.* at 354–55.

<sup>58</sup> *Id.* at 356–57.

<sup>59</sup> *Id.* at 353.

brand name changes. For example, 92.3 K-Rock changed its name to Free FM, back to K-Rock, and then to 92.3 Now. While the frequency of both the format change and the “brand name” change for this example is probably atypical, Table 3 highlights the apparent ease of repositioning even when a “brand name” change is involved.

Finally, note that nearly half of the examples of repositioning discussed by Romeo and Dick are examples of changes made by the merged firm, not by rivals to the merged firm. By contrast, the repositioning “defense” is usually focused on whether rivals have the incentive and ability to reposition their products closer to those of the merged firms in response to a price change by the merged firm. There is no discussion of a merger’s effect on the merged firm’s incentives to alter the positioning of the newly merged firm’s products. Indeed, in a related paper, Berry and Waldfogel note that (using a Hotelling-like spatial model of product differentiation where the locations along a line represent different locations in product space and consumers must pay a “travel” cost to move from one location to another) mergers of radio stations in the same market that broadcast similar programming may result in the merged firm moving the radio stations farther apart in product space to avoid the cannibalization of the audience of one station by another.<sup>60</sup> Their empirical results are consistent with the variety-increasing effect of the consolidation relative to the number of stations in the market.

*The antitrust importance of repositioning by the merging firm is not one that has been widely assessed.*

The antitrust importance of repositioning by the merging firm is not one that has been widely assessed. One paper, by Gandhi et al., considers the post-merger price effect when the merged firm is allowed to make price and product location changes simultaneously, instead of just price changes.<sup>61</sup> Using a Hotelling-like model, the paper shows that if pre-merger the products of the merging parties were close substitutes, then post-merger an increase in the sales of one product will (to some extent) come at the expense of the other product (other things equal). If the merged firm’s only choice variable is price, then the merger will result in a substantial price increase (other things equal). If instead, the merged firm can choose both price and product locations, those pricing effects are greatly attenuated. To reduce cannibalization, the merged firm will move both products farther apart in product space (thus reducing post-merger incentives to raise prices) while rivals will respond to the repositioning of the merged firm by moving their products in between those of the merging firm.

In sum, the radio station example reveals a history of continual product repositioning. Importantly, repositioning by the merged firm may be as important, if not more important, than repositioning by rivals.

## Conclusion

Our experience in conducting antitrust analyses in the various industries reviewed above—the retail grocery, retail pharmacy, shampoo, radio and beer industries—suggests that new brands or product extensions introduced by one firm are frequently and quickly matched by rivals. As a result, the fact patterns from these industries appear to support the view that at least some significant repositioning could occur as a result of a merger-induced price increase, i.e., that repositioning will be timely and likely. While we cannot demonstrate sufficiency, in our experience new brands or product extensions in shampoo and beer in particular have survived for substantial peri-

<sup>60</sup> Steven T. Berry & Joel Waldfogel, *Do Mergers Increase Product Variety? Evidence From Radio Broadcasting*, 116 Q.J. ECON. 1009, 1011 (2001).

<sup>61</sup> Amit Gandhi, Luke Froeb, Steven Tschantz & Gregory Werden, *Post-Merger Product Repositioning*, 56 J. INDUS. ECON. 49 (2008).

ods of time with quite small shares. That is, our experience suggests that for many consumer goods industries, the minimum viable scale for repositioning will be small. Further, the evidence (particularly from the radio industry) highlights the importance of accounting for repositioning by the merged firm itself.

Finally, the evidence offered during the course of the *Whole Foods* litigation and the opinion of the district court in that matter highlight the importance the courts have placed on evidence of entry and repositioning.

This article was written shortly after the antitrust agencies announced their intention to consider revising the Merger Guidelines.<sup>62</sup> In a series of questions posed about possible revisions, the agencies included “the role of product repositioning in evaluating unilateral effects.”<sup>63</sup> Based on our review of both the theory and evidence of repositioning, we believe that repositioning should not be written out of the Merger Guidelines, as might be suggested by the *Commentary*. Instead, the potential for repositioning by rivals should be given full consideration as a potential affirmative defense in the face of agency concerns in a merger matter, and the Merger Guidelines should continue to reference if not emphasize repositioning as a possible factor reducing the potential for harmful post-merger competitive effects. ●

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<sup>62</sup> See Press Release, Fed. Trade Comm’n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), available at <http://www.ftc.gov/opa/2009/09/mgr.shtm>.

<sup>63</sup> See Fed. Trade Comm’n & U.S. Dep’t of Justice, Horizontal Merger Guidelines: Questions for Public Comment 1–2 (Sept. 22, 2009), available at <http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf>.

# Appendix

**Table 1: Shampoos Available at the Surveyed CVS**

PRODUCT CATEGORY	PRODUCT NAME
<b>Color Care</b>	BedHead TIGI – Dumb Blonde: Colored Hair
	Dove – Advanced Color: Lightened or Highlighted Hair
	Fruitopia – Color Control
	Garnier Fructis – Fortifying: Color Shield
	Herbal Essences – Color Me Happy: Color Treated
	John Frieda – Brilliant Brunette: Daily
	John Frieda – Radiant Red: Daily Color Captivating
	John Frieda – Sheer Blonde: Color Renew
	John Frieda – Sheer Blonde: Enhancing
	John Frieda – Sheer Blonde: Go Blonder Lightening
	Matrix – Biolage: Color Care Therapie
	Nexus – Color Assure: Replenishing Color Care
	Pantene Pro-V – Color Revival (2 in 1)
	Pantene Pro-V – Daily Color Enhancing: Blonde Expressions
	Pantene Pro-V – Daily Color Enhancing: Brunette Expressions
	Pantene Pro-V – Daily Color Enhancing: Silver Expressions
	TRESemme – Color Thrive: Blonde
	TRESemme – Color Thrive: Brunette and Red
<b>Color Care and Damaged Hair</b>	Loreal – Ever Pure: Color Care System (Smooth)
	John Frieda – Sheer Blonde: Strengthening
	Nexus – Dualiste Dual Benefit: Color Pro and Anti-Breakage
<b>Color Care and Moisturizing</b>	John Frieda – Brilliant Brunette: Moisturizing
	Loreal – Ever Pure: Color Care System (Moisture)
	Nexus – Dualiste Dual Benefit: Color Pro and Intense Hydration
<b>Color Care and Natural Ingredients</b>	Naked Naturals – Awapuhi and Lavender Color Treated Hair
<b>Curly/Frizzy Hair</b>	BedHead TIGI – Control Freak: Frizzy Hair
	Garnier Fructis – Fortifying: Wondor Waves
	Herbal Essences – Anti-Frizzy: None of Your Frizzyiness
	Herbal Essences – Curly Hair: Totally Twisted
	Herbal Essences – Straightening: Dangerously Straight
	John Frieda – Frizzy Ease: Curl Ahead
	John Frieda – Frizzy Ease: Straightening
	Marc Anthony – Strictly Curls: Curl Defining
	Marc Anthony – Strictly Curls: Frizz Sealing
	Matrix – Sleek.look: Smoothing
	Pantene Pro-V – Curls
	Pantene Pro-V – Smooth
	Rusk – Sensories: Calm
	Sexy Hair (Ecology International) – Curly Sexy Hair
	TRESemme – Flawless Curls: Curl Moisturizing

**Table 1: Shampoos Available at the Surveyed CVS** *continued*

PRODUCT CATEGORY	PRODUCT NAME
<b>Damaged Hair</b>	Aussie – Protect and Soften
	Pantene Pro-V – Nature Fusion: Smooth Vitality
	Aussie – Cleanse and Mend
	Aussie – Opposites Attract
	Biosilk – Silk Therapy
	Dove – Intense Therapy
	Herbal Essences – Strengthening: Break's Over
	John Frieda – Root Awakening: Nourishing Moisture (For Dry Hair)
	John Frieda – Root Awakening: Strength Restoring (For Breakage-Prone Hair)
	Matrix – Biolage: SmoothTherapie
	Nexus – Keraphix: Restorative Strengthening
	Optimum Care – Stay Strong: Antibreakage Shampoo and Conditioner
	Optimum Oil Therapy – Ultimate Recovery: Shampoo and Conditioner
	Rusk – Sensories: Smoother
	Sexy Hair (Ecology International) – Silky Sexy Hair
	Suave – Professionals: Humectant (Dry Hair, Moisturize)
	TRESemme – Anti-breakage: Reducing Split Ends
	TRESemme – Moisture Rich
	TRESemme – Smooth: Smooth and Silky for Dry/Damaged Hair
	Viologie – Smooth and Silky
<b>Damaged Hair and Dandruff</b>	Head & Shoulders – Smooth and Silky
	Head & Shoulders – Smooth and Silky (2 in 1)
<b>Dandruff</b>	Gillette – Anti-Dandruff
	Head & Shoulders – Intensive Treatment
	Head & Shoulders – Classic Clean
	Head & Shoulders – Dry Scalp Care
	Herbal Essences – Anti-Dandruff: No Flakin' Way
<b>Dandruff and Natural Ingredients</b>	Head & Shoulders – Citrus Breeze
	Head & Shoulders – Refresh
	Head & Shoulders – Sensitive Care
	Head & Shoulders – Ocean Lift
	Head & Shoulders – Ocean Lift (2 in 1)
<b>Dandruff and Shine</b>	Head & Shoulders – Restoring Shine
	Head & Shoulders – Restoring Shine (2 in 1)
<b>Deep Clean</b>	Gillette – Clean and Conditioning
	Gillette – Deep Clean
	Neutrogena – Anti-Residue Formula
	Herbal Essences – Refresh/Renew: Drama Clean
	Loreal – VivePro: “For Men” Absolute Clear
	TRESemme – Deep Cleansing
<b>Long Hair</b>	Garnier Fructis – Fortifying: Length and Strength
	Pantene Pro-V – Beautiful Lengths
	Viologie – Great Lengths

**Table 1: Shampoos Available at the Surveyed CVS** *continued*

PRODUCT CATEGORY	PRODUCT NAME
<b>Moisturizing</b>	Pert Plus – Deep Conditioning Formula: For Dry Hair (2 in 1)
	American Crew Classic – Daily Moisturizing Shampoo
	Ellen Lavar – Textures: OptiMoist
	Neutrogena – Triple Moisture: Cream Lather
	Aveeno – Nourish and Moisturize
	Biosilk – Hydrating
	Dove – Daily Moisture Therapy
	Dove – Go Fresh Therapy: Cool Moisture
	Fruitopia – Healthy Hydration
	Garnier Fructis – Fortifying: Moisture Works, Vitamin B3 and B6
	Herbal Essences – Moisturizing: Hello Hydration
	Herbal Essences – Moisturizing: Hydralicious
	Matrix – Biolage: HydraTherapie
	Neutrogena – Clean Replenishing: Moisture
	Nexxus – Humectress: Ultimate Moisture
	Nexxus – Therappe: Luxurious Moisture
	Pantene Pro-V – Nature Fusion: Moisture Balance
	Rusk – Sensories: Moist
	Pantene Pro-V – Moisture Renewal
Pantene Pro-V – Moisture Renewal (2 in 1)	
<b>Moisturizing and Natural Ingredients</b>	Fruitopia – Moisturizing Acai Berry
	Organix – Hydrating Teatree Mint
<b>Moisturizing and Shine</b>	Loreal – Vivepro: Hydra Gloss Moisturizing, Royal Jelly Omega Complex
<b>Natural Ingredients</b>	BedHead TIGI – Mega Nutrient
	Organix – Healing Mandarin Olive Oil
	TRESemme – Natural Aveeno – Nourish and Soothe
	Garnier Fructis – Fortifying: Triple Nutrition (Avocado, Shea)
	Nexxus – Botanphuse: Nourishing Botanical
	Naked Naturals – Shea Butter and Avocado Smoothing
	Organix – Nourishing Coconut Milk
	Organix – Revitalizing Pomegranite
	Suave – Naturals: Aloe and Water Lilly (Aloe Vera and Vitamin E)
	Suave – Naturals: Ocean Breeze (Sea Algae and Vitamin E)
	V05 – Moisturizing: Kiss me Fresia
	V05 – Moisturizing: Strawberries and Cream
	V05 – Tea Therapy: Clarifying Vanilla Mint Tea
	V05 – Volumizing: Collagen, Maximizes body and bounce; Shine Enhancing
<b>Other</b>	Garnier Fructis – Fortifying: Daily Care (2 in 1)
	Pert Plus – Medium Conditioning Formula: For Normal Hair
	American Crew Classic – Daily Shampoo
	Gillette – Daily Balance
	Aveeno – Nourish and Revitalize
	John Frieda – Root Awakening: Health Infusing (For Normal Hair)
	Pantene Pro-V – Classic Clean
	Pantene Pro-V – Classic Clean (2 in 1)
Suave – Professionals: 2 in 1 Plus	

**Table 1: Shampoos Available at the Surveyed CVS** *continued*

PRODUCT CATEGORY	PRODUCT NAME
<b>Shine</b>	Viologie – Crystal Shine
	Dove – Shine
	Fruitopia – Silk and Shine
	Garnier Fructis – Fortifying: Sleek and Shine
	Loreal – VivePro: High Gloss
	Rusk – Sensories: Brilliance
<b>Shine and Volumizing</b>	Loreal – VivePro: Glossy Volume
<b>Volumizing</b>	Loreal – VivePro: "For Men" Daily Thickening (2 in 1)
	Neutrogena – Triple Renewal: Volume Boosting
	Aussie – Aussume Volume
	Aveeno – Nourish and Volumize
	Dove – Volume Therapy
	Fruitopia – Total Volume
	Garnier Fructis – Fortifying: Body Boost
	Herbal Essences – Body Envy: Volumizing
	John Frieda – Luxurious Volume: Full Splendor
	Marc Anthony – Instantly Thick: Hair Thickening
	Matrix – Amplify: Volumizing
	Matrix – Biolage: VolumaTherapie
	Neutrogena – Clean Volume: Body
	Rusk – Sensories: Full
	Sexy Hair (Ecology International) – Big Sexy Hair
	TRESemme – 24 Hour Body: Healthy Volume
	Viologie – Incredibly Full
	Pantene Pro-V – Full and Thick
Pantene Pro-V – Full and Thick (2 in 1)	
<b>Volumizing and Color Care</b>	Loreal – Ever Pure: Color Care System (Volume) Nexus – Dualiste Dual Benefit: Color Pro and Volume
<b>Volumizing and Dandruff</b>	Head & Shoulders – Extra Volume

**Table 2: Nationally Advertised Shampoos Table**

QUARTER	ALL SHAMPOO PRODUCTS	NEW SHAMPOO PRODUCTS	NEW PRODUCTS AS % OF ALL
Q1 2007	34	11	32.4%
Q2 2007	12	3	25.0%
Q3 2007	11	6	54.5%
Q4 2007	39	5	12.8%
Q2 2008	19	6	31.6%
Q3 2008	30	10	33.3%
Q4 2008	14	5	35.7%
Q1 2009	20	8	40.0%
Q2 2009	14	8	57.1%
Q3 2009	19	6	31.6%
Q4 2009	15	4	26.7%
<b>Total</b>	<b>227</b>	<b>72</b>	<b>31.7%</b>

**Table 3: Recent Radio Format Changes**

MARKET	ORIGINAL STATION	ORIGINAL FORMAT	NEW FORMAT	STATION NAME CHANGE (IF ANY)	DATE OF FORMAT CHANGE
New York, NY	92.3 K-Rock	Classic Rock/Alternative/ Active Rock	Talk	Free-FM	early 2006
New York, NY	Free-FM	Talk	Rock	K-Rock	5/2007
New York, NY	K-Rock	Rock	CHR	92.3 Now	3/11/2009
Jacksonville, FL	“Point” WMXQ	80s	Modern Rock	X102.9	2/25/2009
Los Angeles, CA	97.1 KLSX	Talk	CHR	97.1 “Amp Radio”	2/20/2009
Baltimore, MD	104.3 Smooth Jazz WSMJ	Jazz	Modern Rock	Channel 104.3	5/23/2008
Chattanooga, TN	96.5 WDOD-FM “The Mountain”	AAA/Modern Rock	CHR	No Change	3/3/2008
Chicago, IL	105.9 WCKG	Talk	Adult Contemporary	Fresh 105.9	11/5/2007
San Francisco, CA	95.7 Max FM	Variety Hits	Country	95.7 The Wolf	2/28/2007
Austin, TX	98.9 La Ley	Spanish music	News/Talk	“Big Talker” 98.9 KXBT	11/2/2009
Austin, TX	Digital 104.9 FM	Spanish pop	Sports/Talk	ESPN's 104.9 “The Horn”	11/2/2009
Dallas, TX	KDBN Quality Rock 93.3	AAA	CHR	I 93.3	11/4/2009
Pittsburgh, PA	98.3 WOGL “Froggy Country”	Country	Contemporary Christian	K-Love	9/1/2009
Lexington Park, MD	97.7 “The Rocket”	Adult Contemporary	CHR	Magic 97.7	5/2009
Sacramento, CA	106.5 KWOD	Modern Rock	90s	106.5 The Buzz	5/22/2009
Las Vegas, NV	Fresh 102.7	Adult Contemporary	CHR	102.7 Now	4/1/2009
Eatontown, NJ	Rock Radio 106.3	Rock Alternative	CHR	Hit 106	1/2009
Los Angeles, CA	Indie 103.1	Modern Rock	Regional Mexican	103.1 El Gato	1/15/2009
Miami, FL	Love 94	Smooth Jazz	Rhythmic AC	93.9 MIA	12/25/2008
Memphis, TN	Snap 94.1	Rhythmic AC	Rock and Roll	Classic Hits 94-1 KQK	10/17/2008
Palm Springs, CA	M99.5	Modern Rock	Classic Rock	99.5 The Heat	3/2008
Myrtle Beach, SC	107.1 The Sound	Variety Hits	Urban AC	Q107.1	2/18/2008
Salt Lake City, UT	Movin' 100.7	Rhythmic AC	CHR	No Change	6/15/2009
Northwest Georgia	WXKT 103.7	Classic Rock	News/Talk/Sports	No Change	8/2009
Trempeleau, WI	WFBZ 105.5	Classic Rock	Sports	No Change	6/2009
Dallas, TX	KJSA 110	Classic Country	Spanish Language Music	No Change	4/2009
Albuquerque, NM	KABQ-FM 104.7	Smooth Jazz	Classic Country	“The New 104.7”	5/2009

**Notes:**

[1] CHR stands for Contemporary Hit Radio.

[2] AAA stands for Adult Album Alternative.

**Sources:**[1] RadioInsight, <http://radioinsight.com/>[2] FormatChange.com, <http://www.formatchange.com/>[3] Radio-Info.com, <http://www.radio-info.com/>

# Conflict and Ethics Issues Arising from Joint Defense/Common Interest Relationships

**Kathryn M. Fenton**

Antitrust lawyers involved in merger reviews or multi-party litigation frequently enter into joint defense agreements (JDAs).<sup>1</sup> While such agreements are important in preserving legal privileges and facilitating coordination among parties with similar interests, they can create potentially significant conflict of interest issues.

It is common for companies under investigation for possible cartel activities to enter into a JDA to facilitate fact gathering and development of a coordinated strategy. Similar interests might motivate formation of common interest groups in merger reviews or civil antitrust lawsuits. In all of these settings, there may be reasons for one or more parties subsequently to withdraw from a JDA (e.g., an individual litigation settlement, or a leniency application or plea agreement in the criminal context) and, in so doing, become potentially adverse to the remaining members of the group.

A recently issued D.C. Bar ethics opinion (Opinion 349) offers a useful analysis of the ethical and fiduciary issues presented by JDAs and provides a strong reminder to lawyers of the need to consider these issues before they enter into such relationships.<sup>2</sup> After briefly reviewing the basic elements of JDAs and the guidance provided by Opinion 349, this article discusses the potential conflicts and ethics issues posed by JDAs and offers some practical suggestions on how to minimize these risks in antitrust representations.

## Basic Elements of Joint Defense Agreements

A JDA is a means for a client and its lawyer to share privileged information with third parties sharing a “common interest” without waiving otherwise applicable legal privileges by this disclosure. It is based on the joint defense privilege, which

permits a client to disclose information to her attorney in the presence of joint parties and their counsel without waiving the attorney-client privilege and is intended to preclude joint parties and their attorneys from disclosing confidential information learned as a consequence of the joint defense without permission.<sup>3</sup>

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<sup>1</sup> While the term “joint defense agreement” is commonly used, the existence of formal litigation is not required to protect the sharing of privileged information. As a result, other terms have been applied to this relationship, such as the “allied lawyer doctrine,” “common interest doctrine,” or “pooled information doctrine.” See *Lugosch v. Congel*, 219 F.R.D. 220, 236 (N.D.N.Y. 2003). For convenience, this article primarily will use the term JDA.

<sup>2</sup> D.C. Bar Legal Ethics Comm., Op. 349, Conflicts of Interest for Lawyers Associated with Screened Lawyers Who Participated in a Joint Defense Group (Sept. 2009) (Opinion 349), available at [http://www.dcbar.org/for\\_lawyers/ethics/legal\\_ethics/opinions/opinion349.cfm](http://www.dcbar.org/for_lawyers/ethics/legal_ethics/opinions/opinion349.cfm).

<sup>3</sup> *United States v. Hsia*, 81 F. Supp. 2d 7, 16 (D.D.C. 2000) (citations omitted).

Although the joint defense privilege is accepted by most courts, there are differences in the type and degree of common interest required before the privilege is applied.<sup>4</sup> At a minimum, a party seeking to establish the privilege generally must show by a preponderance of the evidence that the shared communications were: (1) intended to be kept confidential,<sup>5</sup> (2) made at a time the parties shared a common legal interest,<sup>6</sup> and (3) exchanged in pursuit of that joint legal interest.<sup>7</sup>

The specific obligations on participants depend largely on the precise terms of the JDA, which can range from very simple oral undertakings to detailed written agreements.<sup>8</sup> Most JDAs operate smoothly to accomplish their intended objectives and do not raise conflicts or ethics issues. However, it is not uncommon to find instances when a party will withdraw from a JDA—for example, an antitrust defendant agrees to a settlement and/or enters into a cooperation agreement with plaintiffs. In such cases, the lawyer for the former joint defense group participant subsequently may find himself adverse to other members of the joint defense group on behalf of his original or a new client.<sup>9</sup>

**[A]ny use of confidential information of other parties obtained through the joint defense relationship may be challenged or asserted as a basis for lawyer disqualification.**

Take, for example, a cartel investigation that subsequently proceeds to class action damages litigation. Defendants formed a joint defense group that ultimately dissolved because of multiple leniency applications and individual settlements. In such circumstances, one party's subsequent use of information obtained through the joint defense relationship against former joint defense group members may be problematic.

The defendants' lawyers may face similar issues. As recognized by the D.C. Bar ethics committee in Opinion 349, post-withdrawal, a lawyer may be limited in his ability to:

- Cross-examine at trial a co-defendant who later decided to cooperate with the government and testify on its behalf;
- Put on a defense that conflicted with the defenses of the other defendants participating in a JDA; or
- Attempt to shift blame to other defendants or introduce any evidence which undercuts their defenses.

In all of these cases, any use of confidential information of other parties obtained through the joint defense relationship may be challenged or asserted as a basis for lawyer disqualification.

Moreover, it is not simply the individual attorney personally involved in the joint defense representation who confronts these issues. Applying the concept of imputed disqualification,<sup>10</sup> the

<sup>4</sup> While the Restatement finds that a common interest “may be either legal, factual, or strategic in character,” RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 76 cmt (2000), most courts limit its application to common legal interests. See THOMAS E. SPAHN, THE ANTITRUST-CLIENT PRIVILEGE: A PRACTITIONERS GUIDE 252 (2007).

<sup>5</sup> See, e.g., *United States v. Bay State Ambulance & Hosp. Rental Serv., Inc.*, 874 F.2d 20, 28 (1st Cir. 1989) (“To qualify for the privilege, the communication must have been made in confidence.”).

<sup>6</sup> See, e.g., *United States v. United Techs. Corp.*, 979 F. Supp. 108, 111 (D. Conn. 1997) (parties asserting the joint defense privilege must share “a common legal interest about a legal matter” but “it is . . . unnecessary that there be actual litigation in progress”) (citing *United States v. Schwimmer*, 892 F.2d 237, 243–44 (2d Cir. 1989)).

<sup>7</sup> See, e.g., *SCM Corp. v. Xerox Corp.*, 70 F.R.D. 508, 513 (D. Conn. 1976) (communications must be “directed at advancing the joint interest vis-à-vis the rest of the world”).

<sup>8</sup> There is no requirement that joint defense agreement be in writing. See, e.g., *Continental Oil v. United States*, 330 F.2d 347, 350 (9th Cir. 1964).

<sup>9</sup> See, e.g., Amy Foot, *Joint Defense Agreements in Criminal Prosecution: Tactical and Ethical Implications*, 12 GEO. J. LEGAL ETHICS 377 (1999).

<sup>10</sup> MODEL RULES OF PROF'L CONDUCT R. 1.10 (Imputation of Conflicts of Interest: General Rule), available at [http://www.abanet.org/cpr/mrpc/rule\\_1\\_10.html](http://www.abanet.org/cpr/mrpc/rule_1_10.html).

conflicts and other ethical restrictions of a single attorney can be imputed to the other attorneys “associated in a firm.” Indeed, given the increasing lateral movement of lawyers among firms, issues arising from joint defense representations may confront an entirely new law firm that had no involvement in the original joint defense. In the worst possible outcome, a prior joint defense relationship may lead to disqualification of the lateral attorney’s new law firm. Understanding the reasons for, and preventing, such outcomes requires a deeper consideration of the ethical issues presented by participating in JDAs.

### **Does the Sharing of Confidential Information in Joint Defense Agreements Create an Attorney-Client Relationship?**

Because a primary goal of a JDA is to facilitate the sharing of otherwise privileged information without loss of the privilege, lawyers who participate in JDAs necessarily are exposed to confidences of the other, non-client members of the joint defense group. Does the receipt of such confidences create an implied or actual attorney-client relationship or otherwise trigger ethical obligations to protect or to not misuse the information, such as the confidentiality obligations of ABA Model Rule 1.6.<sup>11</sup> If such obligations are found, do they apply just to the time period in which a lawyer participates in a joint defense group? Or, like former client confidences,<sup>12</sup> do they continue to bind the attorney even after the joint defense relationship is terminated? The answers to these questions are important because access to confidential information can form the basis of attorney disqualification motions. Various courts that have found confidentiality obligations in joint defense relationships have utilized general conflict of interest principles to disqualify lawyers from representations adverse to participants in a joint defense group following their withdrawal.<sup>13</sup>

One basis for disqualification is that the JDA established an implied attorney-client relationship between the lawyers and the individual clients participating in the JDA.<sup>14</sup> Once an attorney-client relationship is found, some courts have found it easy to disqualify a participating lawyer who subsequently became adverse to one or more members of the joint defense group:

[A]n attorney should also not be allowed to proceed against a co-defendant of a former client [if] the subject matter of the present controversy is substantially related to the matters in which the attorney was previously involved, and [if] confidential exchanges of information took place between the various co-defendants in preparation of a joint defense.<sup>15</sup>

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<sup>11</sup> ABA Model Rule 1.6 provides in part that “[a] lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).” MODEL RULES OF PROF’L CONDUCT R. 1.6 (Confidentiality of Information), available at [http://www.abanet.org/cpr/mrpc/rule\\_1\\_6.html](http://www.abanet.org/cpr/mrpc/rule_1_6.html).

<sup>12</sup> MODEL RULES OF PROF’L CONDUCT R. 1.9(c) (“A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter: (1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.”), available at [http://www.abanet.org/cpr/mrpc/rule\\_1\\_6.html](http://www.abanet.org/cpr/mrpc/rule_1_6.html).

<sup>13</sup> See, e.g., *All Am. Semiconductor, Inc. v. Hynix Semiconductor, Inc.*, 2009-1 Trade Cas. (CCH) ¶ 76,465 (N.D. Cal. 2008), order clarified by 2009-1 Trade Cas. (CCH) ¶ 76,501 (N.D. Cal. 2009).

<sup>14</sup> See, e.g., *United States v. Henke*, 222 F.3d 633, 637 (9th Cir. 2000) (“A joint defense agreement establishes an implied attorney-client relationship with the co-defendant”).

<sup>15</sup> *Wilson P. Abraham Constr. Corp. v. Armco Steel Corp.*, 559 F.2d 250, 253 (5th Cir. 1977).

On the other hand, other courts<sup>16</sup> and the American Bar Association<sup>17</sup> have not found that joint defense participation creates a client relationship. The ABA in its analysis in Opinion 95-395, a formal ethics opinion on joint defense relationships, noted that information received through the joint defense relationship rather would be “information relating to representation of a client,” which the lawyer would have an obligation to maintain in confidence under Rule 1.6(a), even though the information came not from the lawyer’s client “but from another member of the consortium that was not represented by [t]he lawyer.”<sup>18</sup> As a result, the consent of the original client to use the information may be required.<sup>19</sup> The ABA concluded that any obligations that the lawyer may have to other members of the joint defense group derive from fiduciary, not ethical, obligations.<sup>20</sup>

The D.C. Bar through its ethics committee in Opinion 349 also expressly rejected the argument that the sharing of confidences under a joint defense agreement gives rise to attorney-client relationship. Noting that a non-client member of a joint defense group often could not become a client under the applicable conflict rules,<sup>21</sup> the committee concluded that a non-client member of a joint defense group is not a client and thus the former client conflicts rule does not apply.

The potential implications of a contrary finding are enormous—almost certain disqualification due to former client conflicts. Lawyers frequently make it a practice to include specific language in their JDAs specifically disclaiming any attorney-client relationship with the clients of other JDA participants. While this helps in withdrawal situations in avoiding the former client issues under ABA Model Rule 1.9, it does not completely resolve the possible conflict issues that might be found based on other obligations (i.e., as fiduciary obligations). Nor does it address the extent to which an attorney’s individual disqualification is imputed to other lawyers in his firm. These are the issues that the D.C. Bar tackles in Opinion 349, the most recent (and certainly the most comprehensive) treatment of the conflict and disqualification issues arising out of JDAs.

*The ABA concluded that any obligations that the lawyer may have to other members of the joint defense group derive from fiduciary, not ethical, obligations.*

### Disqualification Issues: Screened Lawyer Changed Law Firms

In Opinion 349, the D.C. Bar ethics committee addressed two scenarios relating to joint defense groups that present familiar issues for antitrust lawyers. The first assumes that lawyer A represented an individual employee in a criminal investigation focused on that individual’s employer (e.g., international cartel investigation). Attorney A executed a JDA with the other subjects of the investigation, including his client’s employer, who all had a common interest in defeating the government charges. Under the JDA, Lawyer A received confidential information from the employer and participated in meetings with employer’s counsel to discuss joint strategy and other work

<sup>16</sup> See *United States v. Almeida*, 341 F.3d 1318, 1326 (11th Cir. 2003) (“when each party to a joint defense agreement is represented by his own attorney, and when communications by one co-defendant are made to the attorneys of other co-defendants, such communications do not get the benefit of the attorney-client privilege in the event that the co-defendant decides to testify on behalf of the government”).

<sup>17</sup> ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 95-395, *Obligations of a Lawyer Who Formerly Represented a Client in Connection with a Joint Defense Consortium* (1995).

<sup>18</sup> *Id.* at 3 (emphasis added).

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

<sup>20</sup> *Id.* at 5. The ABA found that this fiduciary obligation might arise from the law of agency (the lawyer having been a sub-agent of the client who in turn was the agent of the co-defendant with whom confidential information is shared), rather than from the law governing lawyers. *Id.* at 5 n.3 (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 213 comment g(ii) (Preliminary Draft No. 11, 1995)).

<sup>21</sup> An antitrust example is when a cartel investigation joint defense group includes a corporate employer and individual employees who are represented by separate counsel because of the potential direct adversity with their employer. See Kathryn M. Fenton & Ryan C. Thomas, “*The Rule of Professional Conduct Are Not Aspirational*”: *Joint Representation of Corporations and Their Employees*, ANTITRUST SOURCE, June 2009, <http://www.abanet.org/antitrust/at-source/09/06/Jun09-Fenton6-29f.pdf>.

product. Lawyer A ultimately was successful in resolving his individual client's liability with the government, and so terminated the representation of the individual employee.

At this point, Lawyer A left his original law firm and joined a new law firm, which subsequently was approached by Client X, who wished to sue the employer of Lawyer A's client for treble damages arising out of the criminal price-fixing cartel. Lawyer A's new firm agreed to do so, and proposed to screen Lawyer A, the only lawyer at the firm who participated in the JDA and was exposed to confidential information of the other joint defense group participants. Even with the screen, would this representation violate Rules 1.6, 1.9, and 1.10, protecting confidential information and former client confidences and imputing an individual lawyer's conflict to all other lawyers in his firm?

The D.C. Bar ethics committee started its analysis by noting that the D.C. Rules of Professional Responsibility do not specifically address the subject of JDAs. It determined that the closest relevant provision—D.C. Rule 1.9 dealing with former client conflicts—was not directly applicable because a non-client member of a joint defense group is not a “client.” Thus, neither the participating lawyer nor his new law firm is limited by former client conflict principles.<sup>22</sup>

The D.C. Bar ethics committee also rejected the confidentiality obligations of D.C. Rule 1.6, because it found that this rule applies to “a confidence or secret of the lawyer's client.” Again, because the JDA did not make the parties to the joint defense agreement “clients” of the participating lawyers, Rule 1.6 did not apply. However, the committee noted that non-client members of a joint defense group can claim the protections due third parties to whom a lawyer may owe legal or fiduciary obligations. Such obligations, including the contractual commitments contained in JDAs, may trigger the conflict of interest provisions of D.C. Rule 1.7 (b)(4), which recognizes the potential for conflict when:

The lawyer's professional judgment on behalf of the client will be or reasonably may be adversely affected by the lawyer's responsibilities to or interests in a third party or the lawyer's own financial, business, property, or personal interests.

Thus, if a lawyer has undertaken fiduciary obligations by entering into the JDA, that lawyer may be personally disqualified from a subsequent representation adverse to a joint defense group member in a substantially related matter unless the lawyer is released from his obligation.

In the moving lawyer situation, the natural next question is whether this Rule 1.7(b)(4) conflict is imputed to the other lawyers in the new law firm. Under D.C.'s version of the imputation rules, Rule 1.7(b)(4) conflicts are not automatically imputed to other lawyers in the firm. Such imputation would arise only where the individual lawyer's personal interest “present[s] a significant risk of adversely affecting the representation of the client by the remaining lawyers in the firm.”<sup>23</sup> The D.C. Bar ethics committee therefore concluded that a joint defense obligation to a non-client generally will be treated solely as an individual lawyer's obligation and not imputed to other lawyers in the new firm. In addition, according to the opinion, “[i]n most circumstances, deployment of a timely and effective screen will eliminate the risk that an individual lawyer's obligations under a joint defense agreement will adversely affect the client's representation by other lawyers in the firm.”<sup>24</sup>

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<sup>22</sup> As the D.C. Bar committee recognized, “In the absence of a prohibited ‘former client’ conflict under Rule 1.9, there is nothing to impute to other lawyers at the same firm under Rule 1.10(a).” D.C. Bar Ethics Comm., Opinion 349, *supra* note 2.

<sup>23</sup> D.C. Rule 1.10(a)(1).

<sup>24</sup> D.C. Bar Ethics Comm., Opinion 349, *supra* note 2.

## Disqualification Issues: Screened Lawyer Has Stayed at Same Law Firm

The D.C. Bar ethics committee used the same background facts to consider the ethical implications when Lawyer A did not change law firms. In this case, because the joint defense agreement required Lawyer A to keep confidential all information as well as work product received through the joint defense group, the firm proposed to screen Lawyer A and all the lawyers who represented the individual employee from any involvement in the lawsuit to be filed on behalf of Client X. Assuming an effective screen could be established, does this permit the original law firm to represent Client X against the employer of its former client without violating Rules 1.6, 1.9, and 1.10?

*The individual lawyer may have obligations under Rule 1.7(b)(4) and these obligations may be imputed to other lawyers in the firm only if the JDA obligations present a "significant risk" of adversely affecting the representation of the firm's client.*

The Rule 1.9 analysis remains the same as discussed above: because the employer never was Lawyer A's client, there was no former client issue under Rule 1.9, and hence no conflict to impute to the other lawyers in the firm under Rule 1.10. The individual lawyer may have obligations under Rule 1.7(b)(4) and these obligations may be imputed to other lawyers in the firm only if the JDA obligations present a "significant risk" of adversely affecting the representation of the firm's client.

In this "original firm" scenario, however, there are two additional issues that may affect the conflicts analysis: (1) the possibility that the firm itself is bound by the JDA (especially if the contractual undertaking was signed in the name of the firm); and (2) the practical difficulty of establishing retroactively a screen when multiple lawyers in the firm may have been exposed to confidences of the joint defense group during the period before the adverse representation commenced.

These considerations may make it more difficult for the original firm to avoid the imputed disqualification issues, and more likely to lead to a "significant risk" that joint defense obligations will impair the firm's ongoing representation of its proposed new client. As a result, the D.C. Bar ethics committee concluded:

[I]n this scenario, the law firm likely would be precluded from undertaking the representation unless the law firm could conclude: (i) it and its other lawyers are not bound by the joint defense agreement; and (ii) none of the other lawyers had been exposed to any confidential information relating to the joint defense agreement.

The committee in Opinion 349 suggested two measures to minimize these potential conflicts issues. First, as soon as the joint defense agreement was executed, screens should be established within the firm to ensure that only Lawyer A and any other firm lawyers actually participating in the representation of the individual employee had access to confidential joint defense information. Second, assuming such screens would be created, the joint defense agreement should include language specifically acknowledging that nothing precluded the other lawyers in the firm "from undertaking litigation and other matters adverse to non-client members of the joint defense group, including matters that might be deemed to be substantially related to the matter that is the subject of the joint defense agreement."<sup>25</sup>

## Practical Advice

Like a number of other ethics committees,<sup>26</sup> the D.C. Bar ethics committee encourages lawyers to anticipate and address in advance potential conflict issues that might arise upon withdrawal from the joint defense group. Practical measures that might minimize the risks of conflicts of interest and subsequent disqualification as a result of participation in JDAs include:

<sup>25</sup> The opinion notes the practical difficulty that may be encountered in getting participants in the joint defense group to sign off on such undertakings. *Id.*

<sup>26</sup> See, e.g., ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 95-390, Conflicts of Interest in the Corporate Family Context (Jan. 25, 1995) (urging use of initial engagement letter to identify clients and non-clients in corporate representation).

1. Always include language in the JDA that disclaims the creation of an attorney-client relationship and waives any right to file motions to disqualify in an action involving a withdrawn attorney and non-client member of the group. While not controlling in all circumstances, such disclaimers provide useful evidence of the contemporaneous intent of the parties and can be used to refute claims of an implied attorney-client relationship with a non-client member.
2. Include in a JDA specific waiver language. Among specific waivers that might be considered are those that address: (a) cross-examination and possible impeachment of a defecting joint defense group member; (b) lateral lawyers/new law firms and reject any imputed disqualification of a new law firm; and (c) expressly permit other lawyers in the participating attorney's law firm to represent clients in matters adverse to other joint defense members (even including matters substantially related to the joint defense matter).
3. Have individual attorneys sign the JDA rather than signing it on behalf of, or in the name of, the law firm. As Opinion 349 recognized, a JDA signed on behalf of the firm may give rise to the argument that the firm has undertaken fiduciary obligations to the other members of the joint defense group. This may present conflict or disqualification issues for the firm subsequently seeking to represent a new client against a non-client member of the group, even in circumstances in which all of the attorneys who participated in the joint defense activities have left the firm.
4. Consider limiting the number of attorneys who are exposed to confidential information from other members of the joint defense group; possibly undertake formal screening procedures like those suggested in Opinion 349 to limit access to the information received from other joint defense members. Both these steps may make it easier to demonstrate that any confidential information derived from the joint defense group was not widely disseminated throughout the firm and thus may assist in defending disqualification motions based on a later representation adverse to a former non-client member.

### **Conclusion**

Joint defense agreements will continue to be used in a variety of antitrust representations. To ensure that they remain an effective tool on behalf of clients, it is important for attorneys to understand the possible risks associated with their use and to take prudent steps to avoid conflict of interest and disqualification issues. ●

# Antitrust Federalism in Action— State Challenges to Vertical Price Fixing In the Post-*Leegin* World

Alan M. Barr

*Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>1</sup> replaced per se condemnation of vertical price fixing or resale price maintenance (RPM) agreements under federal antitrust law with rule of reason analysis. *Leegin* poses significant challenges to state attorneys general, who have aggressively prosecuted RPM, more so than their federal counterparts.<sup>2</sup> For more than twenty years, state attorneys general have combined resources through the Multistate Antitrust Task Force of the National Association of Attorneys General<sup>3</sup> to attack vertical price-fixing agreements. Their collective efforts have returned in excess of \$115 million in cash and \$75 million in products to consumers<sup>4</sup> through federal *parens patriae* cases<sup>5</sup> alleging RPM.

Despite the demands of *Leegin*, attorneys general will not end their pursuit of RPM cases because of a central truth—RPM means higher prices to consumers.<sup>6</sup> While the job has become more difficult, they will pursue RPM along several paths: (1) bringing federal antitrust *parens patriae* cases under the *Leegin* regime; (2) advocating legislative repeal of *Leegin* in the United States Congress; and (3) suing under state antitrust law to challenge RPM in state courts.

These state law challenges to RPM arise from our system of federalism, under which state and federal antitrust laws have co-existed for many years. Some state antitrust laws continue to regard RPM as per se unreasonable conduct. Other states, as Maryland has, may enact laws that make

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<sup>1</sup> 551 U.S. 877 (2007).

<sup>2</sup> Pamela Jones Harbour, Commissioner, Fed. Trade Comm'n, Vertical Restraints: Federal and State Enforcement of Vertical Issues, SJ075 ALI-ABA 185 (2004), <http://www.ftc.gov/speeches/harbour/0403vertical.pdf>.

<sup>3</sup> The Task Force is composed of assistant attorneys general from many states who coordinate and conduct multistate investigations and litigation. See 1 ABA SECTION OF ANTITRUST LAW, STATE ANTITRUST PRACTICE AND STATUTES 1-8 to 1-10 (2d ed. 1999) [hereinafter STATE ANTITRUST PRACTICE AND STATUTES].

<sup>4</sup> Brief for States of New York, Alaska, Arkansas, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Utah, Vermont, Washington, West Virginia, and Wyoming as Amici Curiae Supporting Respondent, *Leegin Creative Leather Prods. v. PSKS*, 551 U.S. 877 (2007).

<sup>5</sup> These cases, brought pursuant to 15 U.S.C. §§ 15C, include, e.g., *New York v. Salton, Inc.*, 265 F. Supp. 2d 310 (S.D.N.Y. 2003); *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. 197 (D. Me. 2003); *In re Nine West Shoes Antitrust Litig.*, 80 F. Supp. 2d 181 (S.D.N.Y. 2000); *New York v. Reebok Int'l, Ltd.*, 903 F. Supp. 532 (S.D.N.Y. 1995), *aff'd*, 96 F.3d 44 (2d Cir. 1996); *Maryland v. Mitsubishi Elecs. Am., Inc.*, 1992-1 Trade Cas. (CCH) ¶ 69,743 (D. Md. 1992); *New York v. Nintendo of Am., Inc.*, 775 F. Supp. 676 (S.D.N.Y. 1991); and *In re Minolta Camera Prods. Antitrust Litig.*, 668 F. Supp. 456 (D. Md. 1987).

<sup>6</sup> Robert F. Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1488 (1983) ("The one point that emerges clearly in any debate concerning the per se rule is that minimum vertical price agreements lead to higher, and usually uniform, resale prices."). See *Leegin*, 551 U.S. at 910–13 (Breyer, J., dissenting); 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶1604b, 40 (2d ed. 2004); *Bye Bye Bargain? Retail Price Fixing; The Leegin Decision, and its Impact on Consumer Prices before the Subcomm. on Courts, and Competition Policy*, 111th Cong. 13–14 (2009) (statement of Richard M. Brunell), available at [http://www.antitrustinstitute.org/archives/files/Brunell%20House%20Testimony\\_042820090740.pdf](http://www.antitrustinstitute.org/archives/files/Brunell%20House%20Testimony_042820090740.pdf).

RPM agreements per se unlawful. These state antitrust laws are well within the bounds of the Constitution and will be enforced against RPM to lower prices to consumers and to protect the autonomy of small retailers.

### Post-*Leegin* Federal Antitrust Litigation

The per se rule was a “conversation stopper”<sup>7</sup> that resulted in significant settlements in all of the pre-*Leegin* parens patriae RPM cases brought by the Task Force. Federal antitrust litigation under the rule of reason is a far more onerous matter for a plaintiff. In the absence of the per se rule, proof becomes more complex and already expensive litigation becomes even more expensive.<sup>8</sup>

The *Leegin* Court expressed the expectation that “over time,” as federal courts acquire experience dealing with vertical price-fixing cases, they will “devise rules” or even recognize presumptions to promote a “fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones.”<sup>9</sup> As these “fair and efficient” rules develop over the years, plaintiffs will have to spend large sums to litigate rule of reason cases.

Nonetheless, attorneys general will likely continue to bring select federal RPM cases, and the significant benefits to states that litigate together under the auspices of the Task Force will continue to provide a strong incentive to remain in a federal forum. Indeed, the States of New York, Illinois and Michigan filed, and settled, a federal minimum RPM case in March of 2008 against furniture maker, Herman Miller, Inc. The states alleged that this furniture manufacturer violated federal and state antitrust laws by preventing retailers from advertising discount prices that were below minimum prices set by the manufacturer.<sup>10</sup>

### Federal Legislation “Repealing” *Leegin*

On October 27, 2009, thirty-eight state attorneys general, joined by attorneys general from three territories, submitted to Congress letters strongly supporting the passage of S. 148 and H.R. 3190, the Discount Pricing Consumer Act (DPCA), which would repeal *Leegin*. In the letters, the attorneys general assert that passage of the DPCA will benefit consumers “from both cost efficiencies within the distribution chain as well as product qualities promoted by sellers and manufacturers of branded goods.”<sup>11</sup> Further, they state that “sufficient experience with ‘state fair trade laws’ during the middle of the last century evidenced that consumers paid significantly more for goods when manufacturers could maintain prices at the retail level.”<sup>12</sup> These letters reflect even greater support for Congressional repeal of *Leegin* than the letter submitted to the 110th Congress in support of S. 2261.<sup>13</sup>

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<sup>7</sup> United States v. Realty Multi-List, Inc., 629 F.2d 1351, 1363 (5th Cir. 1980).

<sup>8</sup> See Robert F. Pitofsky, *Are Retailers Who Offer Discounts Really “Knaves”?: The Coming Challenge to the Dr. Miles Rule*, ANTITRUST, Spring 2007, at 61, 64.

<sup>9</sup> *Leegin*, 551 U.S. at 898–99.

<sup>10</sup> Complaint, New York v. Herman Miller, Inc., No. 08-CV-2977 (S.D.N.Y. filed Mar. 21, 2008).

<sup>11</sup> Letter from Thirty-Eight State Attorneys General to Sen. Herb Kohl and Sen. Orrin G. Hatch (Oct. 27, 2009), available at [http://naag.org/assets/files/pdf/signons/20091027.S\\_148.pdf](http://naag.org/assets/files/pdf/signons/20091027.S_148.pdf); Letter from Thirty-Eight State Attorneys General to Rep. John Conyers and Rep. Lamar Smith (Oct. 27, 2009), available at [http://naag.org/assets/files/pdf/signons/20091027.HR\\_3190.pdf](http://naag.org/assets/files/pdf/signons/20091027.HR_3190.pdf). The two letters are identical.

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

<sup>13</sup> Letter from Thirty-Five State Attorneys General to Sen. Patrick Leahy et al. (May 14, 2008), available at [http://www.naag.org/assets/files/pdf/signons/antitrust.AG\\_Letter\\_Supporting\\_S2261.pdf](http://www.naag.org/assets/files/pdf/signons/antitrust.AG_Letter_Supporting_S2261.pdf).

## Vertical Price-Fixing Enforcement Under Existing State Antitrust Laws

A number of attorneys general will prosecute RPM in their respective state courts under their existing antitrust laws despite the fact that litigation in state forums will create challenges to achieving the collective action that served the states so well before *Leegin*. The ability of individual attorneys general to sue under state law depends on whether their respective legislatures have expressly condemned RPM, whether their antitrust laws are intended to act independently of federal antitrust law or whether their antitrust laws are intended to defer to federal antitrust law.<sup>14</sup> In a recent compilation, Richard A. Duncan and Alison K. Guernsey identify thirteen states that appear to have state laws prohibiting RPM that are independent of federal antitrust law.<sup>15</sup>

*Our two most populous states, California and New York, are well positioned to sue vertical price fixers in their state courts.*

Our two most populous states, California and New York, are well positioned to sue vertical price fixers in their state courts. California's courts have consistently held that the Cartwright Act<sup>16</sup> prohibits resale price maintenance as per se unlawful conduct,<sup>17</sup> for a vertical price fixing scheme "destroys horizontal competition as effectively as would a horizontal agreement among distributors or retailers."<sup>18</sup> California's antitrust law was enacted in 1907 "in reaction to perceived ineffectiveness" of the Sherman Act<sup>19</sup> even though its prohibitions resemble federal antitrust law. Thus, California's Supreme Court has held that "judicial interpretation of the Sherman Act, while often helpful, is not directly probative of the Cartwright drafters' intent."<sup>20</sup> It is unlikely that California's courts will permit RPM to "destroy" competition when they decide whether to retain the per se rule for vertical price fixing.

New York's Donnelly Act contains provisions that clearly resemble section 1 of the Sherman Act and New York's courts have followed federal antitrust precedent "unless there are differences in state and federal policy, statutory policy, statutory language, or legislative history."<sup>21</sup> New York policy parted company from federal law in 1974 with the legislative repeal of New York's Fair Trade Law.<sup>22</sup> In response to Governor Hugh Carey's plea "to insure that consumers are not victimized by

<sup>14</sup> Richard A. Duncan & Alison K. Guernsey, *Waiting for the Other Shoe to Drop: Will State Courts Follow Leegin?* 27 FRANCHISE L.J. 173 (2008). The authors provide a taxonomy of state antitrust laws' adherence to federal antitrust law.

<sup>15</sup> These states are California, Connecticut, Kansas, Mississippi, Montana, Nevada, New Hampshire, New Jersey, New York, Ohio, South Carolina, Tennessee, and West Virginia. *Id.* at 174; see also Michael A. Lindsay, *Resale Price Maintenance and the World After Leegin*, ANTITRUST, Fall 2007, at 32 (2007) [hereinafter *Resale Price Maintenance* (2007)]. Mr. Lindsay recently published an update to his 2007 article and chart. See Michael A. Lindsay, *State Resale Price Maintenance Laws After Leegin*, ANTITRUST SOURCE, Oct. 2009, <http://www.abanet.org/antitrust/at-source/09/10/Oct09-Lindsay10-23f.pdf>.

Additionally, Hawaii has a strong argument that its antitrust law condemns vertical price fixing despite *Leegin*. The Hawaiian statute provides, "[N]o person, exclusive of members of a single business entity consisting of a sole proprietorship, partnership, trust, or corporation, shall agree, combine, or conspire with any other person or persons, or enter into, become a member of, or participate in, any understanding, arrangement, pool, or trust, to do, directly or indirectly, any of the following acts, in the State or any section of the State: (1) Fix, control, or maintain, the price of any commodity." HAW. REV. STAT. § 480-4(b)(1) (Repl. 2008). This provision is in addition to the general prohibition against contracts, combinations and conspiracies that restrain trade unreasonably found in section 480-4(a) of Hawaiian law. HAW. REV. STAT. § 480-4(a) (Repl. 2008).

<sup>16</sup> Cartwright Act, CAL. BUS. & PROF. CODE §§ 16700–70 (West 2006).

<sup>17</sup> See *Miland v. Burckle*, 572 P.2d 1142, 1147 (Cal. 1978); *Kunert v. Mission Fin. Servs. Corp.*, 1 Cal. Rptr. 3d 589, 605 (Cal. Ct. App. 2003).

<sup>18</sup> *Chavez v. Whirlpool Corp.*, 113 Cal. Rptr. 2d 175, 180 (Cal. Ct. App. 2001).

<sup>19</sup> STATE ANTITRUST PRACTICE AND STATUTES, *supra* note 3, at 6–1 (California).

<sup>20</sup> *California ex. rel. Van de Kamp v. Texaco, Inc.*, 762 P.2d 385, 395 (Cal. 1988), *superseded by statute on other grounds*, 1992 Cal. Stats., ch. 430, §§ 2 and 3, p. 1707; see also Duncan & Guernsey, *supra* note 14, at 177.

<sup>21</sup> Robert L. Hubbard, *Protecting Consumers Post-Leegin*, ANTITRUST, Fall 2007, at 41, 43, n.38 (2007) (citing cases).

<sup>22</sup> N.Y. GEN. BUS. LAW § 369-a (McKinney 2004).

price-fixing schemes,”<sup>23</sup> the New York legislature enacted a law providing that vertical price-fixing under federal trade laws “shall not be enforceable or actionable at law.”<sup>24</sup> The Governor’s Program Bill noted that RPM keeps prices “artificially higher” than those in a free market.<sup>25</sup> New York’s law was enacted a year prior to the Consumer Pricing Goods Act of 1975 that repealed the Federal Fair Trade laws, and has its own independent history. This history provides New York with strong arguments that *Leegin* should not be applied to the Donnelly Act.<sup>26</sup> Indeed, two pre-*Monsanto*<sup>27</sup> federal court decisions and one relatively recent New York state appellate decision appear to support per se treatment of vertical price fixing under the Donnelly Act.<sup>28</sup>

### Maryland’s *Leegin* Repealer

When the federal courts close their doors to antitrust plaintiffs, state law sometimes provides succor to excluded parties. The most dramatic example of this is many states’ response to *Illinois Brick Co. v. Illinois*,<sup>29</sup> where the Supreme Court construed section 4 of the Clayton Act<sup>30</sup> to preclude plaintiffs from recovering damages when they did not purchase directly from the antitrust wrongdoer. To date, at least thirty-six states<sup>31</sup> have acted, through legislation or court decisions, to permit these “indirect purchasers” to recover damages under state antitrust laws. The power of the states to enact this legislation, which contradicts the Court’s construction of federal antitrust law, was upheld in *California v. ARC America Corp.*<sup>32</sup> In April of 2009, Maryland’s General Assembly passed the first statute<sup>33</sup> in the country expressly rejecting the application of *Leegin*’s reasoning to the Maryland Antitrust Act (MATA).<sup>34</sup>

MATA prohibits combinations, conspiracies and agreements that restrain trade “unreasonably” and is very similar to section 1 of the Sherman Act.<sup>35</sup> Section 11-202(a)(2) of MATA bids Maryland’s

<sup>23</sup> Jay L. Himes, *New York’s Prohibition of Vertical Price-Fixing*, N.Y.L.J., Jan. 29, 2008, available at [http://lawprofessors.typepad.com/antitrustprof\\_blog/files/nylj\\_rpm\\_paper.pdf](http://lawprofessors.typepad.com/antitrustprof_blog/files/nylj_rpm_paper.pdf) (citing PUBLIC PAPERS OF HUGH L. CAREY, FIFTY-FIRST GOVERNOR OF THE STATE OF NEW YORK 77 (1992)).

<sup>24</sup> *Id.*

<sup>25</sup> Hubbard, *supra* note 21, at 43 (quoting N.Y. GEN. BUS. LAW § 369-a).

<sup>26</sup> *Id.* at 43. New Jersey also repealed fair trade laws before the Consumer Goods Pricing Act of 1975. See N.J. STAT. ANN. § 56:4-1.1 (West 2007). Duncan and Guernsey note, “The New Jersey courts have only referred to this statute once in a published decision, and then only in passing. However, the reference came in a case decided after *Leegin*, and the statute is cited as having continuing vitality. See *Exit A Plus Realty v. Zuniga*, 930 A.2d 491, 497 (N.J. Super. Ct. App. Div. 2007).” Duncan & Guernsey, *supra* note 14, at 175 n.53.

<sup>27</sup> *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) (setting evidentiary rules for establishing an agreement under 15 U.S.C. § 1 as opposed to unilateral action that is not subject to this provision).

<sup>28</sup> *Carl Wagner & Sons v. Appendagez, Inc.*, 485 F. Supp. 762, 773 (S.D.N.Y. 1980); *Uniroyal, Inc. v. Jetco Auto Serv., Inc.*, 461 F. Supp. 350, 357 (S.D.N.Y. 1978); *George C. Miller Brick Co., Inc. v. Stark Ceramics, Inc.*, 770 N.Y.S.2d 235, 236 (N.Y. App. Div. 2003).

<sup>29</sup> 431 U.S. 720 (1977).

<sup>30</sup> 15 U.S.C. § 15.

<sup>31</sup> *Roundtable Discussion, The Report of the Antitrust Modernization Commission*, ANTITRUST, Summer 2007, at 9, 16 (Comment of Roxane Busey).

<sup>32</sup> 490 U.S. 93 (1989).

<sup>33</sup> 2009 Md. Laws 169–171.

<sup>34</sup> MD. CODE ANN., COM. LAW §§ 11-201–213 (LexisNexis 2005).

<sup>35</sup> 15 U.S.C. § 1. Unlike section 1 of the federal law, Section 11-204(a)(1) of the Maryland law expressly limits its prohibition on combinations that restrain trade “unreasonably.” MD. CODE ANN., COM. LAW § 11-204(a)(1) (LexisNexis 2005). The addition of this term reflects early federal jurisprudence that limited that reach of section 1 of the Sherman Act to unreasonable restraints. See *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 58 (1911).

courts to be “guided by the interpretation given by the federal courts to the various federal statutes dealing with the same or similar matters . . . .”<sup>36</sup> In its first decision under MATA, Maryland’s Court of Appeals construed this section to say that it was to be “guided (but not bound) by the opinions of the federal courts under the federal antitrust laws . . . .”<sup>37</sup> Despite reserving the possibility of reaching results inconsistent with federal antitrust law, Maryland’s courts have consistently cited “almost exclusively to federal case law” and have reached “results consistent with federal precedent.”<sup>38</sup>

The Court of Appeals last heard a case involving allegations of vertical price fixing in *Natural Design, Inc. v. Rouse Co.*<sup>39</sup> The court reversed a grant of summary judgment to a shopping center that allegedly conspired with one of its tenants to terminate the lease of a discounting tenant and held that RPM is per se illegal under MATA. The Court of Appeals declined an invitation to analyze the alleged vertical price-fixing under the rule of reason concluding, “the per se rule...still retains its vitality.”<sup>40</sup>

**Significantly, the**

**Leegin Repealer was**

**supported by both**

**Maryland consumer**

**and retailer groups.**

Concerned that the Court of Appeals might apply *Leegin* to cases arising under MATA, Maryland’s General Assembly enacted two identical bills intended to preserve the authority of *Natural Design*.<sup>41</sup> The General Assembly amended section 11-204(a)(1) of MATA by adding the following provision (the “*Leegin* Repealer”): “For purposes of subsection (a)(1) of this section, a contract, combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service is an unreasonable restraint of trade or commerce.”<sup>42</sup> Legislative history makes it clear that the bills preserve the per se rule.<sup>43</sup>

Significantly, the *Leegin* Repealer was supported by both Maryland consumer and retailer groups. The Maryland Consumer Rights Coalition urged the General Assembly to enact the *Leegin* Repealer, permitting the free market to work to “keep prices as low as possible.”<sup>44</sup> In oral testimony before Maryland’s House Economic Matters Committee, a representative of the Maryland Association of Retailers explained that, just as retailers seek to be as free as possible from governmental constraints, they also seek to be free of constraints imposed by manufacturers.<sup>45</sup>

**Issues in the Application of Maryland’s Leegin Repealer.** With the enactment of its *Leegin* Repealer, Maryland has parted company with federal antitrust law on RPM. This raises doubt whether, as to RPM, Maryland’s courts will be “guided by the interpretation given by the federal courts to the various federal statutes dealing with the same or similar matters . . . .”<sup>46</sup> The *Leegin*

<sup>36</sup> MD. CODE ANN., COM. LAW § 11-202(a)(2) (LexisNexis 2005).

<sup>37</sup> *Quality Discount Tires, Inc. v. Firestone Tire & Rubber Co.*, 382 A.2d 867, 870 (Md. 1978).

<sup>38</sup> Ellen S. Cooper & Alan M. Barr, *Attacking the Odious: One Hundred Years of Antitrust Law in Maryland*, Md. B.J., Jan. 2000, at 44, 48.

<sup>39</sup> 485 A.2d 663 (Md. 1984).

<sup>40</sup> *Natural Design*, 485 A.2d at 669.

<sup>41</sup> S.B. 239, 426th Gen. Assem., Reg. Sess. (Md. 2009); H.B. 657, 426th Gen. Assem., Reg. Sess. (Md. 2009).

<sup>42</sup> *Id.* § 11-204(b).

<sup>43</sup> Fiscal and Policy Note, S.B. 239, 426th Gen. Assem., Reg. Sess. at 2 (Md. 2009) (S.B. 239 became Maryland’s *Leegin* Repealer. The Note states that Maryland’s law is similar to S. 2261, which is “intended to overturn the Supreme Court’s decision in *Leegin* . . .”), available at [http://mlis.state.md.us/2009rs/fnotes/bil\\_0009/sb0239.pdf](http://mlis.state.md.us/2009rs/fnotes/bil_0009/sb0239.pdf).

<sup>44</sup> Letter from Charles Shafer, President, Maryland Consumer Rights Coalition, to Senator Brian E. Frosh, Chairman, Senate Judicial Proceedings Committee (Feb. 4, 2009) (on file with the Maryland Senate Judicial Proceedings Committee).

<sup>45</sup> Telephone interview with Jeff Zellmer, Legislative Dir., Md. Ass’n of Retailers (Oct. 6, 2009) (on file at the Antitrust Div., Office of the Attorney General of Md.).

<sup>46</sup> MD. CODE ANN., COM. LAW § 11-202(a)(2) (LexisNexis 2005).

Repealer could be exempt from this provision of MATA, since the General Assembly took a deliberate step away from federal law on RPM when it enacted the *Leegin* Repealer. However, Maryland courts will likely look to *Natural Design*, the last occasion the Court of Appeals had to consider RPM under MATA.

In *Natural Design*, the Court of Appeals found that plaintiff had alleged sufficient evidence of vertical price-fixing to meet the standard set out in the Supreme Court's then-recent decision in *Monsanto Co. v. Spray-Rite Service Corp.*, in that plaintiff's evidence tended "to exclude the possibility that [defendants] were acting independently."<sup>47</sup> The Court stated that *Monsanto* would take precedence over prior Maryland decisions that may have applied a different rule.<sup>48</sup> The rules set forth in *Monsanto* will likely continue to guide Maryland's courts.

Maryland's *Leegin* Repealer retains the same requirement of an agreement that governs section 11-201(a)(1) of the Maryland Antitrust Act.<sup>49</sup> Known as the "Colgate Doctrine," this requirement permits action by a manufacturer unilaterally to suggest prices or unilaterally to announce that it will not deal with retailers who sell below its suggested price.<sup>50</sup> *Natural Design* also recognized the *Colgate* Doctrine.<sup>51</sup> However, it is unclear to what extent, if any, the law will be read to expand the *Colgate* doctrine, as some courts have done,<sup>52</sup> to permit the manufacturer to exhort, cajole, argue or pressure a retailer into compliance with its pricing scheme. In *Natural Design*, the Court of Appeals stated, "When the manufacturer's actions . . . go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices . . . he has put together a combination in violation of the Sherman Act."<sup>53</sup>

Maryland's *Leegin* Repealer makes unlawful agreements that that establish "a minimum price below which a retailer . . . may not sell a commodity or service."<sup>54</sup> The statute would not seem to apply to agreements among advertisers and retailers as to the minimum price at which a product may be advertised, as long as the retailer is free to set its own selling price. As a result, minimum advertised price (MAP) programs, where the manufacturer pays a portion of the retailer's advertising costs if the retailer advertises the product at or above an advertising price set by the manufacturer<sup>55</sup> will likely be held lawful. However, MAP programs that are enforced by the manufacturer in a manner that goes beyond supporting advertising and effectively set the minimum selling price<sup>56</sup> will violate Maryland's *Leegin* Repealer.

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<sup>47</sup> *Natural Design*, 485 A. 2d at 670 (quoting *Monsanto*, 465 U.S. at 764).

<sup>48</sup> *Id.* at 670 n.9.

<sup>49</sup> 2009 Md. Laws 169–171.

<sup>50</sup> See *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

<sup>51</sup> *Natural Design*, 485 A.2d at 670.

<sup>52</sup> See, e.g., *Acquaire v. Canada Dry Bottling Co. of N.Y., Inc.*, 24 F.3d 401, 410 (2d Cir. 1994); see also ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 130–40 (6th ed. 2007) [hereinafter DEVELOPMENTS].

<sup>53</sup> *Natural Design*, 485 A.2d at 670 (quoting *United States v. Parke, Davis & Co.*, 362 U.S. 29, 44 (1960)).

<sup>54</sup> 2009 Md. Laws 169–171.

<sup>55</sup> MAP programs are also referred to as "cooperative advertising programs." See, e.g., DEVELOPMENTS, *supra* note 52, at 144–45.

<sup>56</sup> See *Complaint, New York v. Herman Miller, Inc.*, No. 08-CV-2977 (S.D.N.Y. filed Mar. 21, 2008).

## State Antitrust Laws that Condemn Resale Price Fixing Under a Per Se Analysis Do Not Offend the United States Constitution

Following *Leegin*, at least one commentator has suggested that defendants may challenge state laws adjudging RPM under the per se rule by claiming that they are preempted by federal antitrust law under the Supremacy Clause of the Constitution<sup>57</sup> or that they violate the Dormant Commerce Clause of the Constitution.<sup>58</sup> Another has asserted that state laws that employ the per se rule in RPM cases actually do offend the Constitution.<sup>59</sup> However, as argued below, these state antitrust laws, exercising traditional state police power, do not offend the Constitution and will survive challenge.

**State Antitrust Laws Holding RPM Per Se Unlawful Are Not Preempted by Federal Antitrust Law.** The Supremacy Clause of the United States Constitution provides that laws made by Congress are the supreme law of the land and are binding upon the States.<sup>60</sup> If there is an “irreconcilable conflict between the federal and state regulatory schemes,” the state law is preempted.<sup>61</sup> This conflict may be “direct” where Congress expressly states its intent to preempt a field or where Congress sets out such a comprehensive scheme of regulation that one may reasonably conclude that it has left no room for state legislation.<sup>62</sup> Preemption may also be “implied” where “it is impossible to comply with both state and federal law or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress.”<sup>63</sup> No irreconcilable conflict exists, however, between federal and state antitrust laws.

*California v. ARC America*<sup>64</sup> controls the analysis of whether state antitrust laws are preempted by federal antitrust law. In *ARC America* the Supreme Court held that state antitrust laws permitting indirect purchasers to recover damages were not preempted by its earlier decision in *Illinois Brick Co. v. Illinois*,<sup>65</sup> which construed section 4 of the Clayton Act, with few exceptions, to restrict money damages to direct purchasers. Some argue that *ARC America* should be limited to analysis of state remedies that differ from federal law and does not reach substantive differences.<sup>66</sup> However, the analysis in *ARC America* provides a primer to analyze all aspects of our federal system of antitrust enforcement. *ARC America* retains its authority even twenty years after having been issued.<sup>67</sup>

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<sup>57</sup> Lindsay, *Resale Price Maintenance* (2007), *supra* note 15, at 33.

<sup>58</sup> *Id.*

<sup>59</sup> Robert M. Langer, Submission to the Federal Trade Commission Resale Price Maintenance Workshop (Dec. 12, 2008), available at <http://www.ftc.gov/os/comments/resalepricemaintenance/00001.pdf>. Langer attempts to extend the analysis used in *Flood v. Kuhn*, 407 U.S. 285 (1972), to affirm antitrust law’s baseball exemption to reach state antitrust law. However, in *Major League Baseball v. Crist*, 331 F.3d 1177, 1188 (11th Cir. 2003), upon which Langer relies, the court states, “The exemption was founded upon a dubious premise, and it has been upheld in subsequent cases because of an equally dubious premise.” Even the Court in *Flood* called the baseball exemption an “aberration.” *Flood*, 407 U.S. at 282. Thus, courts reconcile the baseball exemption with preemption analysis saying, “[a]ntitrust law, for example, with an isolation [sic] exception, *Flood v. Kuhn* . . . is a field in which Congress has not sought to replace state with federal law.” *Crist*, 331 F.3d at 1185 n.19 (quoting *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 611 (7th Cir. 1997) (emphasis in *Crist*)).

<sup>60</sup> U.S. CONST. art. VI.

<sup>61</sup> *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

<sup>62</sup> See *Silkwood v. Kerr-McGee Corp.* 464 U.S. 238, 248 (1984).

<sup>63</sup> *Id.* (citations omitted).

<sup>64</sup> 490 U.S. 93 (1989).

<sup>65</sup> 431 U.S. 720 (1977).

<sup>66</sup> See Langer, *supra* note 59, at 10; see also Lindsay, *Resale Price Maintenance* (2007), *supra* note 15, at 33.

<sup>67</sup> See *Wyeth v. Levine*, 129 S. Ct. 1189, 1195 n.3 (2009).

*ARC America* follows the “path” set out in the Supreme Court’s prior preemption cases.<sup>68</sup> This analysis begins by asking whether Congress expressly preempted the field of antitrust law. As the parties conceded, Congress has never done this.<sup>69</sup> In the absence of express preemption, two other questions are considered. First, did Congress intend to preempt the field of antitrust law?<sup>70</sup> Second, does state antitrust law “actually conflict[] with federal law?”<sup>71</sup>

CONGRESS DID NOT INTEND TO PREEMPT STATE ANTITRUST LAW. Preemption questions focus on the intent of Congress, not on the Court’s construction of the antitrust laws Congress enacted.<sup>72</sup> Moreover, the questions must be considered in light of a presumption against finding preemption of state law in areas traditionally regulated by the States, including antitrust.<sup>73</sup> The party asserting preemption must demonstrate the “clear and manifest” purpose of Congress to supersede “the historic police powers of the States.”<sup>74</sup> Congress has never expressed a “clear and manifest” purpose preempt state antitrust law. In fact, “Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies.”<sup>75</sup> Prior to *ARC America*, the Court “recognized that the federal antitrust laws do not pre-empt state law.”<sup>76</sup> Congress has taken no action since *ARC America* that suggests that its intent has changed.

STATE ANTITRUST LAW DOES NOT CONFLICT WITH FEDERAL LAW. “Actual conflict” exists when it is impossible to comply with federal law or when “state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>77</sup> “Conflict” is construed very narrowly in preemption analysis to mean that compliance with state antitrust law prevents compliance with federal law and compels a violation of federal law.<sup>78</sup> For example, in *Exxon Corp. v. Governor of Maryland*,<sup>79</sup> the Supreme Court rejected a preemption challenge to Maryland’s statute forbidding petroleum producers and refiners from selectively offering discounts, even to meet competition as permitted by section 2(b) of the Robinson-Patman Act.<sup>80</sup>

State laws applying the per se rule to RPM do not conflict with federal law. *Leegin* does not grant a right to commit RPM; it merely prohibits RPM in certain circumstances. Thus, a person could comply with both state and federal law by abstaining from RPM. A person enjoined from committing RPM under state law is not required to commit conduct in violation of federal law.

Of course, it is not certain that state and federal law will reach different results in particular RPM cases. *Leegin* did not hold RPM per se lawful; it decided that legality would be decided under the

*Leegin* did not hold

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the rule of reason.

<sup>68</sup> *ARC America*, 490 U.S. at 100; see *Rice*, 458 U.S. at 659 (“In determining whether the Sherman Act pre-empts a state statute, we apply principles similar to those which we employ in considering whether any state statute is pre-empted by a federal statute pursuant to the Supremacy Clause.”).

<sup>69</sup> *ARC America*, 490 U.S. at 101–02.

<sup>70</sup> *Id.* at 100 (citations omitted).

<sup>71</sup> *Id.* (citations omitted).

<sup>72</sup> See *Id.* at 103 (“It is one thing to consider the congressional policies identified in [the Court’s cases] . . . it is something altogether different, and in our view inappropriate, to consider them as defining what federal law allows States to do under their own antitrust law.”).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at 101; see *Wyeth*, 129 S. Ct. at 1194–95.

<sup>75</sup> *ARC America*, 490 U.S. at 101 (citation omitted).

<sup>76</sup> See *id.*

<sup>77</sup> *Id.* at 100–01 (citations omitted).

<sup>78</sup> See *Silkwood v. Kerr-McGee Corp.* 464 U.S. 238, 248 (1984).

<sup>79</sup> 437 U.S. 117 (1978).

<sup>80</sup> *Id.* at 129–34.

rule of reason.<sup>81</sup> In *Rice v. Norman Williams Co.*,<sup>82</sup> the Supreme Court held that California's "designation" statute<sup>83</sup> did not violate the Dormant Commerce Clause even though the appellant claimed that compliance with the law would compel violation of federal antitrust law. The Court determined that the alleged violation of federal law would be adjudged under the rule of reason<sup>84</sup> so that the challenged state statute might require a violation of the antitrust laws under some circumstances but would not require a violation in many cases. Writing for the Court, the late Chief Justice Rehnquist stated that the Court's decisions teach that a statute may be condemned only if it "mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases."<sup>85</sup> If the conduct required by the state statute is governed by the rule of reason, it "cannot be condemned in the abstract."<sup>86</sup>

STATE ANTITRUST LAW DOES NOT STAND AS AN OBSTACLE TO THE ACCOMPLISHMENT OF THE FULL PURPOSES AND OBJECTIVES OF CONGRESS IN ENACTING FEDERAL ANTITRUST LAWS. State antitrust laws that regard RPM as per se unlawful are faithful to purposes of Congress' federal antitrust laws "detering anticompetitive conduct and ensuring the compensation of victims of that conduct."<sup>87</sup> The deterrence of anticompetitive conduct is achieved by prosecuting RPM under a per se rule. Federal antitrust law employed this view for nearly a century<sup>88</sup> and the Supreme Court modified its rule only two years ago by its 5–4 vote in *Leegin*. The new majority in *Leegin* evidenced the Court's current economic<sup>89</sup> orientation and not a new expression of policy or law from Congress. States' decisions to retain the longstanding repudiation of RPM continue in concert with Congressional policy.

***State Antitrust Laws Treating RPM Under the Per Se Rule Are Not Preempted Under the Dormant Commerce Clause of the United States Constitution.*** The Dormant Commerce Clause supercedes state laws that discriminate against interstate commerce or impose a burden on interstate commerce "clearly excessive in relation to the putative local benefits."<sup>90</sup> State laws "frequently survive this . . . scrutiny,"<sup>91</sup> however, and "the States traditionally have had great latitude under their police powers to legislate as to the protection of the lives, limbs, health, comfort, and quiet of all persons."<sup>92</sup>

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<sup>81</sup> *Leegin*, 551 U.S. at 907–08.

<sup>82</sup> *Rice*, 458 U.S. at 662.

<sup>83</sup> *Id.* at 657. Under California law, alcoholic beverages may only be brought into California for sale in the state by a licensed importer. The challenged law limited the ability of licensed importers to import particular brands to those importers designated as an authorized importer of that brand. *Id.* at 656–57.

<sup>84</sup> *Id.* at 661–62.

<sup>85</sup> *Id.* at 661.

<sup>86</sup> *Id.*; see also *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 130 (1978). ("The 'teaching of this Court's decisions . . . enjoin[s] seeking out conflicts between state and federal law where none clearly exists.'")

<sup>87</sup> *California v. ARC America*, 490 U.S. 93, 102 (1989).

<sup>88</sup> See *Dr. Miles Med. Co. v. John D. Park & Sons, Co.*, 220 U.S. 373 (1911).

<sup>89</sup> See, e.g., Alan Devlin, *The Ramifications of Leegin Creative Leather Products, Inc. v. PSKS, Inc.: Are Tie-Ins Next?*, 56 CLEV. ST. L. REV. 387, 390 (2008) (asserting that *Leegin* furthers the Chicago School's "hegemony" in the Court's antitrust analysis).

<sup>90</sup> *Dep't of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1808 (2008) (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)); see also *Brown v. Hovatter*, 561 F.3d 357 (4th Cir. 2009).

<sup>91</sup> *Davis*, 128 S. Ct. at 1808–09 (citations omitted).

<sup>92</sup> *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 342–43 (2007) (quoting *Metro. Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 756 (1985)).

Obviously, a significant quantity of the goods that are affected by state laws holding RPM per se unlawful are sold across state lines in transactions that involve interstate commerce<sup>93</sup> and potentially subject to challenge under the Dormant Commerce Clause. State antitrust laws, however, do not offend the rule against discrimination that prohibits “economic protectionism” of local businesses under state and local laws.<sup>94</sup> Further, the states’ antitrust laws apply evenhandedly, with equal force to local and out-of-state businesses and goods.<sup>95</sup>

**State antitrust laws  
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State antitrust laws condemning RPM under the per se rule are designed to prevent the inevitable price increases that result from RPM<sup>96</sup> and to preserve the autonomy of small businesses to serve their customers as they think best.<sup>97</sup> The state is entitled to protect its citizens from “economic damage.”<sup>98</sup> State antitrust laws, used for many years to achieve these ends, are unlikely to be held “clearly excessive”<sup>99</sup> to the benefits they seek to achieve.

But what of the internet, which subjects sellers who may never have set foot in a state to that state’s antitrust laws when they sell goods to people in that state? These sellers may argue that application of state antitrust law to RPM in this environment places intolerable burdens on them. Indeed, conduct that has no contact with a particular state is probably beyond the reach of the state’s antitrust law.<sup>100</sup> However, “although the internet is a mighty powerful tool, it is not so potent as to demolish every state’s regulatory schemes as they apply to the sale of goods and services.”<sup>101</sup> In this vein, courts throughout the country have held that internet commerce is not immune from state laws intended to protect consumers from such evils as deceptive mass emails (“spam”).<sup>102</sup>

The essence of RPM enforcement under state law involves goods sold to the internet vendor for resale that are subject to an agreement regarding resale price. As a result, goods subject to RPM are sold to consumers in that state, who likely placed their order in the state and received

<sup>93</sup> See, e.g., *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 141 (1970).

<sup>94</sup> *Davis*, 128 S. Ct. at 1808.

<sup>95</sup> See *Washington v. Heckel*, 24 P.3d 404, 409 (Wash. 2001); *MaryCLE, LLC v. First Choice Internet, Inc.*, 890 A.2d 818, 841 (Md. Ct. Spec. App. 2006).

<sup>96</sup> See *Pitofsky*, *supra* note 6, at 1488; *Hovenkamp*, *supra* note 6, at 40.

<sup>97</sup> Telephone interview with Jeff Zellmer, *supra* note 45.

<sup>98</sup> *MaryCLE*, 890 A.2d at 838–39; *Ferguson v. Friendfinders, Inc.*, 94 Cal. App. 4th 1255, 1268 (Cal. Ct. App. 2002) (quoting *Heckel*, 24 P.3d at 409–11) (asserting that laws making unlawful deceptive email spam messages are supported by substantial state interest).

<sup>99</sup> *Pike*, 397 U.S. at 142.

<sup>100</sup> See *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989); *Edgar v. MITE Corp.*, 457 U.S. 624, 642–43 (1982) (plurality opinion).

<sup>101</sup> *Ford Motor Co. v. Tex. Dep’t of Transp.*, 106 F. Supp. 2d 905, 909 (W.D. Tex. 2000) (upholding Texas law forbidding Internet sales of vehicles from manufacturer rather than local dealers from Dormant Commerce Clause challenge).

<sup>102</sup> See *Heckel*, 24 P.3d at 409–11; *MaryCLE, LLC*, 890 A.2d at 838–39; *Ferguson*, 94 Cal. App. 4th at 1268. However, while state statutes prohibiting spam may not offend the Supremacy or Commerce Clauses of the Constitution, the state must be able to assert jurisdiction over a particular Internet company under its long-arm statute, consistent with the Due Process Clause of the Fourteenth Amendment to the United States Constitution. Long-arm statutes define the sorts of conduct and contacts with the state needed to invoke personal jurisdiction over an out-of-state company. See, e.g., MD. ANN. CODE, CTS & JUD. PRO. § 6-103 (2002 Repl. & Supp. 2005). Moreover, would-be defendants’ contacts with the state must ensure that “individuals have ‘fair warning that a particular activity may subject [them] to the jurisdiction of a foreign sovereign.’” *Mackey v. Compass Marketing, Inc.*, 892 A.2d 479, 488 (Md. 2005) (quoting *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 471–72 (1985); see also *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980) (Defendant’s contacts with the state must be “such that he should reasonably anticipate being haled into courts there.”). Maryland’s long-arm statute is intended to “expand the boundaries of permissible in personam jurisdiction to the limits permitted by the Federal Constitution.” *Mackey*, 892 A.2d at 492 (citations omitted).

the ordered goods in that state—providing substantial connection to that state.<sup>103</sup> Thus, to the extent that the state's antitrust law does not purport to regulate the internet vendor's sales to other states, the Dormant Commerce Clause does not prevent enforcement of the state's antitrust law.<sup>104</sup>

### Conclusion

*Leegin* poses significant challenges to state attorneys general. However, state antitrust laws may turn this case into a speed bump instead of a barrier. State antitrust enforcers will continue to prosecute vertical price fixing. Although fewer prosecutions will be brought under federal antitrust law, prosecutions will likely increase under state antitrust laws. Where possible, attorneys general will look to their existing state laws to find authority to prosecute this conduct and to protect consumers from the inevitable price increases that result from vertical price fixing policies. While, to date, only Maryland has provided statutory redress, it is likely that state legislatures will act to protect their consumers and retailers from the *Leegin* rule. There is a strong likelihood that these state laws mandating per se treatment for vertical price fixing will pass constitutional muster. Manufacturers considering implementing vertical price fixing policies will be well advised to consider state antitrust laws and likely state legislative responses before they act. ●

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<sup>103</sup> See *Ferguson*, 94 Cal. App. 4th at 1264.

<sup>104</sup> See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 93 (1987).

# Health Insurance and Federal Antitrust Law: An Analysis of Recent Congressional Action

**Michael G. Cowie**

Congress is currently considering several proposals to alter antitrust policy in the health insurance sector, including the Health Insurance Industry Antitrust Enforcement Act of 2009.<sup>1</sup> This legislation would have the effect of altering the McCarran-Ferguson Act's antitrust exemption so that it no longer applies to the business of health insurance. The McCarran-Ferguson Act would remain in effect for other types of insurance (e.g., car insurance or property insurance), thus maintaining a narrowly tailored federal antitrust exemption for certain practices relating to the provision of those types of services.

As the debate over health care reform proposals continues, however, one element of the controversy enjoys broad consensus—that competition in the health insurance and other health care marketplaces is an important element of controlling costs, expanding coverage, and improving quality and services. Yet, the proposed Health Insurance Industry Antitrust Enforcement Act of 2009, if enacted, is unlikely to increase competition or enhance consumer or patient welfare because it is based on a misdiagnosis of the problem—that there is an absence of antitrust and regulatory review of health insurance services. Moreover, the proposal would likely add uncertainty to competition policy in this area, potentially deterring procompetitive insurance practices.

## The McCarran-Ferguson Act: History and Key Terms

Historically, the business of insurance was viewed as not falling within interstate commerce and thus was subject to state, not federal, regulation.<sup>2</sup> In 1944, however, the Supreme Court held in *South-Eastern Underwriters Association* that insurance does fall within interstate commerce and was subject to federal regulation, including the federal antitrust laws.<sup>3</sup> In response, in 1945 Congress passed the McCarran-Ferguson Act<sup>4</sup> establishing the states as the primary regulators of insurance and exempting certain insurance practices from federal antitrust laws, including the Sherman Act, Clayton Act, and Federal Trade Commission Act.

Under McCarran-Ferguson, the antitrust exemption is limited to activities that (1) constitute the “business of insurance,” (2) are “regulated by State law,” and (3) do not constitute an agreement or act “to boycott, coerce, or intimidate.”<sup>5</sup> Thus, the activities of companies that provide insurance are not categorically exempt from federal antitrust laws; rather their conduct may be exempt only when meeting each of the three conditions set forth in the Act.

■  
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<sup>1</sup> H.R. 3596, 111th Cong. (2009); S. 1681, 111th Cong. (2009).

<sup>2</sup> *Hooper v. California*, 155 U.S. 648, 658–59 (1895); *Paul v. Virginia*, 75 U.S. (1 Wall.) 168 (1868).

<sup>3</sup> *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).

<sup>4</sup> 15 U.S.C. §§ 1011–1015.

<sup>5</sup> *Id.* § 1012(b).

**The Business of Insurance.** The business of insurance does not encompass all activities of insurers. In determining whether conduct constitutes the business of insurance under McCarran-Ferguson, courts consider (1) whether the activity has the effect of transferring a policyholder's risk, (2) whether the activity is an integral part of the policy relationship between insurer and policyholder, and (3) whether the activity is limited to entities within the insurance industry.<sup>6</sup>

A wide range of practices of health insurers do not constitute the business of insurance under this test. For example, health insurance mergers are reviewed by federal antitrust agencies and have been subjected to conditions when the reviewing agency has determined that the merger raised competitive concerns. One of the stranger assertions made with respect to the McCarran-Ferguson Act is that it has played a role with respect to purported consolidation in health insurance markets,<sup>7</sup> which is impossible considering that the exemption has not been applied to insurance mergers.

*Even if conduct constitutes the business of insurance and is regulated by state law, the McCarran-Ferguson exemption does not apply to boycotts, coercion, and intimidation.*

Bid rigging also has been held not to constitute the business of insurance and thus not within the exemption.<sup>8</sup> Similarly, territorial allocation of Blue Cross Blue Shield-licensees for the marketing and sale of branded health insurance was viewed as not necessarily the business of insurance because it did not directly involve underwriting or risk-spreading activities.<sup>9</sup> Likewise, courts have viewed health insurer reimbursement practices as only indirectly related to risk-spreading. For example, a health insurer's denial of reimbursement for services performed on physician-owned, as opposed to hospital-owned, scanners was held not to constitute the business of insurance.<sup>10</sup>

**Regulated by State Law.** For the McCarran-Ferguson exemption to apply, there must be regulation by the state in which the challenged conduct is practiced and has impact.<sup>11</sup> The state regulation need not expressly address the challenged conduct. It must, however, reach the conduct. A state law prohibiting unfair competition by insurers and enforceable by the state insurance commission may qualify as state regulation for a range of conduct.

**Carve-out for Boycotts, Coercion, and Intimidation.** Even if conduct constitutes the business of insurance and is regulated by state law, the McCarran-Ferguson exemption does not apply to boycotts, coercion, and intimidation. For example, the Supreme Court treated the refusal to provide insurance for one type of coverage in order to influence the terms of another type of coverage as a boycott and, thus, conduct not subject to the exemption.<sup>12</sup>

## The Proposed Legislation

**The Terms of the Pending Bills.** H.R. 3596, The Health Insurance Industry Antitrust Enforcement Act of 2009, was introduced in the House and the Senate this past September.<sup>13</sup> According to the sponsors, health insurers "currently enjoy broad antitrust immunity under the McCarran-Ferguson Act" and "this immunity can serve as a shield" for activities that may be detrimental to consumers

<sup>6</sup> Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 129 (1982).

<sup>7</sup> Health Care For America Now, <http://blog.healthcareforamericanow.org/2009/10/15/what-repealing-the-insurer-anti-trust-exemption-would-do/> ("These kinds of market concentrations were caused by years of mergers, mergers that would never have been allowed under normal anti-trust rules.")

<sup>8</sup> *In re* Ins. Brokerage Antitrust Litig., 2006 WL 2850607, MDL No. 1663 (D.N.J. Oct. 3, 2006).

<sup>9</sup> State of Maryland v. Blue Cross and Blue Shield Ass'n, 620 F. Supp. 907, 917 (D. Md. 1985) (denying motion for summary judgment).

<sup>10</sup> Trident Neuro-Imaging Lab. v. Blue Cross & Blue Shield, 568 F. Supp. 1474 (D.S.C. 1983).

<sup>11</sup> FTC v. Travelers Health Ass'n, 362 U.S. 293, 299 (1960).

<sup>12</sup> Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993).

<sup>13</sup> H.R. 3596, 111th Cong. (2009); S. 1681, 111th Cong. (2009).

and result in higher prices.<sup>14</sup> One of the sponsors' stated objectives in introducing the bill is "to reduce insurance prices for consumers."<sup>15</sup>

H.R. 3596 as proposed, provides that the McCarran-Ferguson Act shall not be construed to permit health insurers or medical malpractice insurers to engage "in any form of price fixing, bid rigging or market allocations in connection with the conduct of the business of providing health insurance coverage . . . or coverage for medical malpractice claims or actions."<sup>16</sup> It contains a carve-out for information gathering and for rate-setting activities of state regulatory agencies.<sup>17</sup> As reported out of the House Judiciary Committee, the bill also included language, from an amendment offered by Representative Lungren "to add safe harbors for collecting and distributing historical loss data, developing a loss development factor, and performing actuarial services that do not involve a restraint of trade."<sup>18</sup>

Another bill, H.R. 3962, the House of Representative's health care reform bill (the Affordable Health Care for America Act), also contains a section entitled "Restoring Application of Antitrust Laws to Health Sector Insurers." This section, which was passed by the House on November 7, would amend McCarran-Ferguson to remove "the business of health insurance or the business of medical malpractice insurance."<sup>19</sup> H.R. 3962 contains carve-outs for insurer collection and distribution of historical loss data, determination of loss development factors, and performance of actuarial services.<sup>20</sup> Thus, those insurance activities would still be evaluated and potentially exempt from federal antitrust law under the McCarran-Ferguson Act, if this bill became law.

**Congressional Testimony and Agency Comments.** Government agencies and the American Bar Association have provided Congressional testimony on the justifications for and likely impact of any modification to the McCarran-Ferguson exemption for health insurance in response to H.R. 3596. The ABA described the McCarran-Ferguson Act as "a *limited* exemption from the federal antitrust laws."<sup>21</sup> The ABA has taken the position that any repeal should reach all types of insurance, rather than targeting health insurance or malpractice insurance.<sup>22</sup> As stated, the ABA would support the legislation "only if it is amended to provide safe harbors that are procompetitive."<sup>23</sup>

Along with the absence of safe harbors, the ABA also expressed the concern that some of the proposed language prohibiting "price fixing" and "market allocations" could potentially be read

<sup>14</sup> 155 Cong. Rec. E2,318 (Sept. 17, 2009) (statement of Representative John Conyers, Jr.), available at <http://www.gpoaccess.gov/crecord>; see also 155 Cong. Rec. S9,556 (Sept. 17, 2009) (statement of Senator Patrick Leahy) ("As the insurance industry prospers behind its exemption, patients and small businesses suffer."), available at <http://www.gpoaccess.gov/crecord>.

<sup>15</sup> 155 Cong. Rec. E2,318 (Sept. 17, 2009) (statement of Representative John Conyers, Jr.) ("Both the House and Senate today have introduced identical language to reduce insurance prices for consumers."), available at <http://www.gpoaccess.gov/crecord>; see also 155 Cong. Rec. S9,556 (Sept. 17, 2009) (statement of Senator Patrick Leahy) ("This bill will prohibit the most egregious anticompetitive conduct . . .—conduct that harms consumers and drives up health care costs."), available at <http://www.gpoaccess.gov/crecord>.

<sup>16</sup> H.R. 3596, 111th Cong. (2009); S. 1681, 111th Cong. (2009).

<sup>17</sup> *Id.*

<sup>18</sup> See Health Insurance Industry Antitrust Enforcement Act of 2009, H.R. Rep. No. 111-322 (2009), available at [http://thomas.loc.gov/cgi-bin/cpquery/?&dbname=cp111&sid=cp111KyE9r&refer=&r\\_n=hr322.111&item=&sel=TOC\\_24011&](http://thomas.loc.gov/cgi-bin/cpquery/?&dbname=cp111&sid=cp111KyE9r&refer=&r_n=hr322.111&item=&sel=TOC_24011&).

<sup>19</sup> H.R. 3962, § 262.

<sup>20</sup> *Id.*

<sup>21</sup> Ilene Knable Gotts, Chair, ABA Section of Antitrust Law, Statement on Behalf of the American Bar Association, Before the Judiciary Committee of the U.S. House of Representatives, Concerning HR 3596, The Health Insurance Industry Antitrust Enforcement Act of 2009 at 3 (Oct. 8, 2009) (emphasis added), available at [http://www.abanet.org/poladv/letters/antitrust/2009oct8\\_gottstestimonyh\\_t.pdf](http://www.abanet.org/poladv/letters/antitrust/2009oct8_gottstestimonyh_t.pdf).

<sup>22</sup> *Id.* at 2.

<sup>23</sup> *Id.* at 6.

to condemn activity that would be permissible under federal antitrust law that applies to all other sectors.<sup>24</sup> This language differs from the Sherman Act, and could be read to cover vertical relationships that are often procompetitive. The ABA noted that health insurers “should not be subject to a more rigorous antitrust standard than the rest of American industry.”<sup>25</sup>

The Congressional Budget Office (CBO) recently “scored,” or provided a cost estimate of, implementation of the Health Insurance Industry Antitrust Enforcement Act of 2009. The CBO’s findings are consistent with the ABA’s legal analysis that McCarran-Ferguson’s antitrust exemption is “limited.”<sup>26</sup> Any increase in costs associated with greater federal antitrust enforcement or court proceedings “would not be significant” because “of the small number of cases likely to be affected.”<sup>27</sup> Because “state laws already bar the activities that would be prohibited under federal law,” any change in premiums charged by health insurers “is likely to be quite small.”<sup>28</sup>

The DOJ’s Antitrust Division recently shifted its position on the McCarran-Ferguson exemption. Ten years ago, during the Clinton Administration, the DOJ told Congress that “the McCarran-Ferguson Act does not give insurers leverage.”<sup>29</sup> It described the exemption as a “limited” one and explained to Congress that “[w]hen the Division learns about exclusionary or collusive activities among health plans, it carefully reviews them, and if necessary, takes appropriate action.”<sup>30</sup> In those situations when a health insurer’s dealings with providers are in violation of the antitrust laws, the DOJ stated that, “McCarran provides no obstacle to prosecution of such claims either by the affected providers or by state or federal enforcement agencies.”<sup>31</sup> In its statement, the DOJ cited examples of enforcement actions against health insurers to support its conclusion that McCarran-Ferguson is a “limited” exemption.<sup>32</sup>

In contrast to its earlier views, the DOJ recently characterized the exemption as “broad” and “very expansive.”<sup>33</sup> The DOJ did not, however, refer to any case law supporting the position that the exemption is broad. Nor did it describe any anticompetitive conduct or practices in the industry that have been authorized or allowed as a result of the exemption. How consumers of health insurance might have been harmed in terms of pricing or quality of services is left unsaid.

To support its view that the exemption is “very broad,” the DOJ stated that “premium pricing and market allocation” may “fall within ‘the business of insurance.’”<sup>34</sup> It is unclear what “premium pricing” refers to or how it would violate federal antitrust law or otherwise harm consumers. As

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<sup>24</sup> *Id.*

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

<sup>26</sup> *Id.* at 3.

<sup>27</sup> CBO Cost Estimate, HR 3596, Health Insurance Industry Antitrust Enforcement Act of 2009 at 1, Oct. 23, 2009.

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

<sup>29</sup> Joel I. Klein, Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Statement Before House Judiciary Comm. on the Quality Health-Care Coalition Act of 1999 at 4 (June 22, 1999), available at <http://www.justice.gov/atr/public/testimony/2502.htm>.

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

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

<sup>32</sup> *Id.* at 3–4.

<sup>33</sup> Christine A. Varney, Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Statement Before Senate Judiciary Comm. Hearing on Prohibiting Price Fixing and Other Anticompetitive Conduct in the Health Insurance Industry at 2–3 (Oct. 14, 2009) (“It also created a broad antitrust exemption based on state regulation. . . . Repeal or reform of the broad antitrust exemption currently enjoyed by the business of insurance has been a perennial subject of interest. . . . It is fair to say that the McCarran-Ferguson Act antitrust exemption is very expansive with regard to anything that can be said to fall within ‘the business of insurance,’ including premium pricing and market allocation.”), available at <http://www.justice.gov/atr/public/testimony/250917.htm>.

<sup>34</sup> *Id.* at 3.

noted before, we think it is unlikely that “market allocation” (or “bid rigging” for that matter) would constitute “the business of insurance” subject to the McCarran-Ferguson exemption. Such market allocation would also be illegal under state antitrust law.<sup>35</sup>

The DOJ stated that “the most egregiously anticompetitive claims, such as naked agreements fixing price or reducing coverage, are virtually always found immune.”<sup>36</sup> The statement contained no references to cases, instead citing a treatise that itself refers to a single case involving car insurance.<sup>37</sup> However, the challenged conduct in the car insurance case cited in the Areeda-Hovenkamp treatise qualifies as “egregiously anticompetitive” or “naked agreement[s] fixing price.”<sup>38</sup> In that case, insurers formed a standard-setting body establishing guidelines or standards for car insurers when authorizing replacement parts.<sup>39</sup> A private plaintiff filed an antitrust suit challenging the industry standard allowing for use of non-OEM car parts—parts manufactured by a company other than the original equipment manufacturer.<sup>40</sup> The Eleventh Circuit found that these allegations concerned performance of car insurers’ duties to policyholders, thus implicating the business of insurance.<sup>41</sup> The court also found that state agencies already regulated the use of non-OEM parts by car insurers and in some situations even required their use.<sup>42</sup>

Thus, the referenced treatise and case do not support a conclusion that McCarran-Ferguson has authorized anticompetitive conduct in the health care industry. Critics of McCarran-Ferguson have pointed to no court decisions allowing anticompetitive conduct. Nor have they cited actual anticompetitive marketplace behavior by health insurers that has been enabled by McCarran-Ferguson.<sup>43</sup>

### Lack of Justification for Legislation

The proposed legislation serves only to remedy a phantom problem—that health insurance practices have been escaping competition law scrutiny. Federal antitrust law, enforced by the federal antitrust authorities and by private plaintiffs, covers a wide array of health insurer practices. Likewise, health insurers have faced close scrutiny under state law.<sup>44</sup> There are no big holes to fill.

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<sup>35</sup> See, e.g., The Donnelly Act, N.Y. Gen. Bus. Law § 340 et seq.

<sup>36</sup> Varney, *supra* note 33, at 3. (quoting PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 219d (3d ed. 2009).

<sup>37</sup> AREEDA & HOVENKAMP, *supra* note 36, ¶ 219d.

<sup>38</sup> *Id.*

<sup>39</sup> *Gilchrist v. State Farm Mutual Auto. Ins. Co.*, 390 F.3d 1327, 1330 (11th Cir. 2004).

<sup>40</sup> *Id.* at 1332.

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

<sup>42</sup> *Id.* at 1334–35.

<sup>43</sup> Indeed, Iowa Insurance Commissioner Susan Voss wrote that “[t]he notion that McCarran-Ferguson is the cause of high health insurance premiums is not based on fact.” *Democrats Push to Strip Insurers of Antitrust Protections*, DES MOINES REGISTER, Oct. 24, 2009, available at <http://m.desmoinesregister.com/BETTER/news.jsp?key=543981&rc=bn&p=1>. Similarly, Colorado Insurance Commissioner Marcy Morrison, recently said she is “comfortable” that the industry is regulated appropriately and that it’s unlikely price-fixing or bid-rigging has taken place.” Jennifer Brown, *Health Insurers’ Antitrust Exemption Becoming a Focus of Reform Debate*, DENVER POST, Nov. 12, 2009, available at [http://www.denverpost.com/headlines/ci\\_13767249](http://www.denverpost.com/headlines/ci_13767249).

<sup>44</sup> Thus, in a letter to Congress, the National Association of Insurance Commissioners noted that it was “concerned about statements made at the hearings that seemed to imply that collusion among health insurance or among medical malpractice companies is permitted under state law and that the McCarran-Ferguson Act somehow protects these practices. This is not true. The McCarran-Ferguson antitrust exemption for insurance does not allow or encourage conspiratorial behavior, as some have characterized it. The exemption simply leaves oversight of insurance, including health insurance and medical malpractice insurance, to the states and, as stated earlier, state laws do not allow collusion.” Letter of Roger Sevigny, N.H. Ins. Comm’r and President, Nat’l Ass’n of Ins. Comm’rs, to Senator Patrick Leahy and Representative John Conyers, Jr. (Oct. 21, 2009), available at [http://rsc.tomprice.house.gov/UploadedFiles/McCarran\\_Final\\_Letter\\_Oct\\_21\\_2009.pdf](http://rsc.tomprice.house.gov/UploadedFiles/McCarran_Final_Letter_Oct_21_2009.pdf) [hereinafter NAIC Letter].

**Enforcement of Federal Antitrust Law.** Proponents of the Health Insurance Industry Antitrust Enforcement Act of 2009 have portrayed McCarran-Ferguson as a broad shield from federal antitrust law, but have not shown that there has been less federal antitrust law enforcement in this industry sector compared to others. It is very difficult to compare federal antitrust law enforcement data by industry sector and draw conclusions about the relative magnitude of enforcement by sector. However, the available information on both federal government enforcement and private enforcement of federal antitrust law suggests extremely active federal antitrust oversight. On top of this, there is relatively intensive state regulatory oversight of health insurers.

Over the years, the DOJ has conducted many antitrust investigations focusing on health insurers. According to a former Assistant Attorney General, the Antitrust Division “carefully scrutinizes mergers and other activities among health plans that may harm consumers.”<sup>45</sup> It has challenged health insurer mergers on the grounds that the merger would lead to higher insurance rates.<sup>46</sup> This has included mergers raising concerns of an increase in rates for traditional commercial health plans and for Medicare Advantage plans.<sup>47</sup> It has also challenged health insurer mergers on the grounds that the merger may result in a reduction of prices paid to physicians.<sup>48</sup>

Federal antitrust enforcement in the health insurance industry has also focused on non-merger conduct, such as health insurer contracting. For example, the DOJ has “aggressively challenged contractual provisions imposed by payers on Rhode Island dentists . . . and Cleveland area hospitals.”<sup>49</sup> It has noted that health insurer use of most-favored-nation clauses may create disincentives for providers to lower rates.<sup>50</sup> Federal antitrust investigations have also covered the use of “all-product clauses.”<sup>51</sup>

While federal antitrust investigations are typically non-public, and data on investigations are unavailable, there are no facts indicating that the DOJ has been less aggressive in investigating health insurers relative to other sectors. The statements of DOJ officials suggest the opposite—that health insurer conduct has been among the highest enforcement priorities.<sup>52</sup>

The McCarran-Ferguson exemption also has not stopped private plaintiffs from enforcing federal antitrust law and bringing lawsuits, including class action lawsuits, against health insurers. In the past five years, private plaintiffs have brought over twenty-five federal antitrust lawsuits against

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<sup>45</sup> Klein, *supra* note 29, at 3.

<sup>46</sup> Complaint, *United States v. UnitedHealth Group, Inc.* (D.D.C. Feb. 25, 2008); Complaint, *United States v. UnitedHealth Group Inc.* (D.D.C. Dec. 20, 2005); Complaint, *United States v. Aetna Inc.* (D.D.C. June 21, 1999).

<sup>47</sup> Complaint, *United States v. UnitedHealth Group, Inc.* (D.D.C. Feb. 25, 2008); Complaint, *United States v. UnitedHealth Group Inc.* (D.D.C. Dec. 20, 2005); Complaint, *United States v. Aetna Inc.* (D.D.C. June 21, 1999).

<sup>48</sup> Complaint, *United States v. UnitedHealth Group Inc.* (D.D.C. Dec. 20, 2005); Complaint, *United States v. Aetna Inc.* (D.D.C. June 21, 1999).

<sup>49</sup> Klein, *supra* note 29, at 4.

<sup>50</sup> Press Release, Justice Department Challenges Rhode Island Dental Group’s Agreements that Discourage Discounting (Feb. 29, 1996), *available at* [http://www.justice.gov/atr/public/press\\_releases/1996/0556.htm](http://www.justice.gov/atr/public/press_releases/1996/0556.htm).

<sup>51</sup> Deborah Platt Majoras, Dep. Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Address to Health Care and Competition Law and Policy Workshop 2 (Sept. 9, 2002), *available at* <http://www.justice.gov/atr/public/speeches/200195.pdf>.

<sup>52</sup> *See, e.g.*, J. Bruce McDonald, Dep. Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Before Senate Judiciary Comm., Examining Competition in Group Health Care 2 (Sept. 6, 2006) (referring to health insurer collusion as one of “the kinds of anticompetitive restrictions we are on the lookout for as we monitor health care markets”); Klein, *supra* note 29 (“Thus, federal antitrust enforcement must ensure that neither health insurance plans nor health care professionals utilize anticompetitive means to distort the competitive outcome in the health care industry. The Antitrust Division has been active in pursuing that important role.”).

the leading health insurers.<sup>53</sup> This number understates the magnitude of federal antitrust litigation in this sector because it omits cases classified based on a different type of lead claim (e.g., RICO), as well as antitrust counterclaims brought against health insurers.

**Enforcement of State Law.** The McCarran-Ferguson antitrust exemption explicitly depends upon the regulation of insurance by the states. More precisely, the Sherman, Clayton, and Federal Trade Commission Acts “shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.”<sup>54</sup> It is not possible to understand the context of the McCarran-Ferguson exemption without understanding this regulatory scheme. Therefore, it seems fair to ask whether such business is regulated by state law and, if so, in what manner, and to what extent.

The answer is that the business of insurance in general, and of health insurance in particular, is regulated in a manner that is detailed, thorough, and constant.<sup>55</sup> State regulation of health insurers begins with the licensure process, and includes, among other things, ongoing oversight, audits, filing requirements, and solvency standards. State laws and regulations also cover a wide range of health insurer conduct—from what must be covered, to how their networks are formed and maintained, to how their products are priced. These rules often are enforced by the state insurance department, but other state agencies (such as the treasurer, the labor department, the health department, the secretary of state, and the attorney general) also can have oversight responsibilities and enforcement authority.

Any consideration of the relevance of federal and state antitrust laws to state insurance markets must take note of the detailed nature of this regulation.<sup>56</sup> A good example can be found in state regulation of “pricing” in small group markets.<sup>57</sup> Price is a key concern of antitrust law and a vital area of competition in any industry. In health insurance, however, state regulation of premium rates and rating means that competition is not the sole determinant of prices in such markets. States have used a variety of approaches to regulating premiums, including community rating, adjusted community rating, and rate bands. Thus, insurers must charge policyholders the same rate, subject to variations based on certain defined factors, or must set initial premiums within a certain percentage above or below an index.<sup>58</sup> Any antitrust activities in this area must be informed by, and should not undermine, the state’s regulatory goals.

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<sup>53</sup> I identified the ten largest health insurers from an industry trade publication. See AIS Market Data, Health Plan Enrollment, <http://www.aishhealth.com> (top 25 U.S. health plans by medical enrollment). The source for the federal court lawsuits is LexisNexis Courtlink for the time period 2004 to the current. Lawsuits are classified as antitrust based on the plaintiff’s completion of a civil docket sheet form (JS 44) approved by the U.S. Judicial Conference. This form requires plaintiffs to identify the “nature of suit,” selecting a single type of suit (e.g., RICO, antitrust, employment, bankruptcy, etc.).

<sup>54</sup> 15 U.S.C. § 1012.

<sup>55</sup> In arguing against current repeal efforts, Iowa Commissioner Susan Voss noted that “all 50 states have rules regulating health insurance carriers, and states require them to justify rates based upon rating factors and experience.” She wrote that “[f]or example, in the state of Iowa, there are statutes which specifically outline the rate guidelines and restrictions allowed by health insurance providers.” *Democrats Push to Strip Insurers of Antitrust Protections*, *supra* note 43.

<sup>56</sup> The NAIC letter to Congress noted that “insurance companies are different than other businesses in terms of current state oversight. The rates insurance companies charge are typically reviewed by the insurance commissioners, which is very different from other business sectors. If an insurance rate is not justified by claims experience, it is not permitted. As to other business sectors, they set their rates without any oversight.” NAIC Letter, *supra* note 44.

<sup>57</sup> Small groups typically consist of 2–50 individuals.

<sup>58</sup> “Community rating” means that each policyholder is charged the same rate, with adjustments only for family size, benefit plan design, and possibly geographic location. “Adjusted community rating” means that no variation is allowed for health status, claims experience, or duration of coverage, but variation is allowed for demographic or other objective factors. “Rating bands” allow the use of health status and claims experience, but limit the impact of such factors to a set percentage above or below an index rate for initial premiums. In addition to renewal of initial rates, many states regulate renewal rate increases.

*Health insurance is an industry in which the government, or more precisely various state governments, have made numerous decisions to displace competition with regulation.*

Health insurance is an industry in which the government, or more precisely various state governments, have made numerous decisions to displace competition with regulation. This complicates the role of antitrust, particularly when the source of the antitrust law is outside of the state scheme.<sup>59</sup> Within the state scheme, however, state antitrust and other law enforcement has been tailored to complement, rather than supplant, state regulatory authority with respect to insurance.<sup>60</sup> For example, Nevada reached a settlement with respect to the United-Sierra merger, imposing additional conditions to those imposed by the DOJ.<sup>61</sup> In the area of conduct, a review of the National Association of Attorneys General Web site reveals a significant number of bid-rigging antitrust cases brought by state attorneys general against insurance companies.<sup>62</sup> In addition, state attorneys general do not limit their activities to antitrust laws per se, but engage in a broader range of oversight of conduct of health and other insurers.<sup>63</sup> Such “enforcement” activities are not limited to state attorneys’ general, but can also include state insurance commissioners.<sup>64</sup>

States do engage in antitrust enforcement and related activities with respect to health insurers. In addition, however, states maintain detailed and reticulated regulatory schemes with respect to health insurers, reflecting, at times, a decision to displace “pure” competition with regulation. As with other industries in which such regulation exists and such a decision has been made, there is a logic to ensuring that antitrust laws and regulatory schemes are not at cross-purposes—logic that is reflected in the McCarran-Ferguson Act itself.

### Potential Consequences from Health Care Legislation

Repeal of the McCarran-Ferguson antitrust exemption for health insurance may have unintended consequences. Specifically, repeal may increase legal and regulatory uncertainty and consequently chill interest in, or limit the scope of, new initiatives and activities that could reduce costs, improve quality, and otherwise benefit consumers.<sup>65</sup> While such procompetitive initiatives likely could be pursued even in the absence of McCarran-Ferguson, replacing settled law and policy

<sup>59</sup> Thus, the NAIC noted to Congress that, “[u]nder McCarran-Ferguson, state regulation of insurance has proven effective and beneficial for consumers. State regulators are more familiar with the activities of the insurance companies they license and are closer to the consumers. They better understand the state-based markets and have the resources to conduct investigations should the need arise. Insurance regulators across the country have the authority to review rates and market conduct and they constantly monitor insurance company practices to ensure state laws are followed and consumers are protected.” NAIC Letter, *supra* note 44.

<sup>60</sup> The protection afforded by this complementary scheme was summed up by Colorado Insurance Commissioner Marcy Morrison, who, as noted earlier, said she is “‘comfortable’ that the industry is regulated appropriately and that it’s unlikely price-fixing or bid-rigging has taken place.” Brown, *supra* note 43.

<sup>61</sup> Press Release, Nevada Office of Attorney General, Mastro Announces Divestiture and \$15 Million Charitable Contribution in the Proposed Acquisition of Sierra Health Services, Inc. by United Health Group Incorporated (Feb. 25, 2008), available at <http://www.naag.org/assets/files/pdf/antitrust.NV.UnitedHealthPressRelease.pdf>.

<sup>62</sup> National Association of Attorneys General, Antitrust Press Releases, [http://www.naag.org/press\\_releases.php](http://www.naag.org/press_releases.php).

<sup>63</sup> For example, New York Attorney General Andrew Cuomo has a Healthcare Industry Task Force that has focused on various issues related to health insurers. See New York Office of the Attorney General, About the Health Care Industry Taskforce, [http://www.oag.state.ny.us/bureaus/health\\_care/HIT2/about.html](http://www.oag.state.ny.us/bureaus/health_care/HIT2/about.html).

<sup>64</sup> Thus, Pennsylvania’s Insurance Commissioner announced plans to examine whether certain health plans violated Pennsylvania’s Unfair Trade Practices Act. See, e.g., Bill Toland, *State to Probe Blue Cross, Blue Shield Insurance*, PITTSBURGH POST-GAZETTE, July 18, 2009, available at <http://www.post-gazette.com/pg/09199/984765-28.stm>.

<sup>65</sup> For example, a recent article quoted experts as indicating that “[t]here would be quite a bit of confusion and legal action on the state and federal level as regulators try to figure out who’s responsible for regulating what” and that a repeal of the McCarran-Ferguson exemption for health insurance “doesn’t seem like it has been thoroughly thought through.” Esmé E. Deprez, *Reviving an Old Threat in Health-Insurance Battle*, Bus. Wk., Oct. 19, 2009, available at [http://www.businessweek.com/bwdaily/dnflash/content/oct2009/db20091019\\_699982.htm](http://www.businessweek.com/bwdaily/dnflash/content/oct2009/db20091019_699982.htm).

with uncertain and potentially shifting boundaries of legal analysis and regulatory authority may slow, limit, or unfavorably alter such efforts.<sup>66</sup>

The ABA has recommended adopting certain safe harbors “to serve the important objective of deterring private litigation that might, post-exemption, challenge conduct that, in the unique circumstances of the insurance industry, may actually promote competition.”<sup>67</sup> Similarly, even proposed repeal legislation implicitly recognizes the potential for chilling beneficial activities by including carve-outs for the sharing of loss data, an activity that the DOJ suggested could be pursued in the absence of the McCarran-Ferguson exemption.<sup>68</sup>

Current ongoing federal efforts to reform the health care system may create a uniquely inappropriate environment for repealing the McCarran-Ferguson exemption. Two clear by-products of health care reform are change and uncertainty, including new relationships between federal and state regulators, new approaches to the delivery of health care, and new structures for the delivery of health insurance.<sup>69</sup> Until these are settled, the risk of unintended consequences from repeal increases because of the uncertainty about just what health care and health insurance markets will emerge from reform and what types of goals the McCarran-Ferguson exemption would further in such an environment.

While the specific procompetitive activities that the McCarran-Ferguson repeal bills could chill may require a crystal ball, certain areas are more likely to raise concern. The ABA has focused on four specific areas of activities as appropriate for “safe harbor treatment” because of their procompetitive nature. Broadly speaking, those areas relate to: (1) past loss-experience data, (2) standardized policy forms, (3) voluntary joint-underwriting arrangements, and (4) residual market mechanisms.<sup>70</sup> For example, the sharing of past loss-experience data can both make smaller companies more effective competitors and facilitate entry, by providing smaller companies and new entrants data that allow them to price their products appropriately.

Until the dust has settled on health care reform, it is hard to know whether these risks will materialize. I believe that the clearest way to avoid such unintended consequences would be to leave the McCarran-Ferguson exemption in its current form or, at least, to await completion of the current health care reform process to better understand the specific impact of a McCarran-Ferguson repeal for health insurance. A less preferable approach, but one that may have some benefits, could be to empower the federal antitrust agencies to establish “safe harbors” for certain activities by health insurance companies.<sup>71</sup> This may mitigate, but not eliminate, concerns about increased uncertainty and is consistent with an approach the federal agencies have utilized in the

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<sup>66</sup> Depending on the structure of the initiative, and the particular state legal and regulatory environment, the conduct may fall within the protections of the state action doctrine or the conduct may be determined to be procompetitive under rule of reason analysis.

<sup>67</sup> Gotts, *supra* note 21, at 4.

<sup>68</sup> Varney, *supra* note 33, at 5 (“Some forms of joint activity that might have been prohibited under earlier, more restrictive doctrines are now clearly permissible, or at very least analyzed under a rule of reason that takes appropriate account of the circumstances and efficient operation of a particular industry.”).

<sup>69</sup> For example, health care reform contemplates new delivery mechanisms, such as exchanges, and a wide range of new rules related to health insurance.

<sup>70</sup> Gotts, *supra* note 21, at 4–5. The ABA also suggests the possibility that Congress may identify other areas appropriate for safe harbor treatment.

<sup>71</sup> See, e.g., S. 618, 110th Cong., available at <http://www.thomas.gov/cgi-bin/query/z?c110:S.618>. (indicating that “[t]he Department of Justice and the Federal Trade Commission may issue joint statements of their antitrust enforcement policies regarding joint activities in the business of insurance”).

past with respect to other markets.<sup>72</sup> Finally, safe harbors, which Congress is considering, may make it easier for certain procompetitive proposals to proceed.

### Conclusion

The proponents of altering competition law should carry the burden of explaining how existing law has failed consumers, leading to low quality or high prices. However, the proponents of the Health Insurance Industry Antitrust Enforcement Act of 2009 and similar bills have not provided any empirical evidence showing that existing law has led to any anticompetitive outcomes despite over sixty years of experience with the McCarran-Ferguson Act. While there may be many effective methods of reforming health care in our country, this proposed change in antitrust policy should not be undertaken given the absence of sound empirical support. ●

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<sup>72</sup> See, e.g., U.S. Department of Justice and Federal Trade Commission, *Statements of Antitrust Enforcement Policy in Health Care* (1996), available at <http://www.justice.gov/atr/public/guidelines/0000.htm>.

# Does the Tail Wag the Dog?

## Sixty Years of Government and Private Antitrust In the Federal Courts

**Paul E. Godek**

Much has been made recently of the short-lived Department of Justice report on Section 2 of the Sherman Act and the antitrust enforcement stance of the new administration.<sup>1</sup> While federal government antitrust policy is of enormous interest to practitioners and to the particular defendants, government cases have long comprised only the veneer of the overall antitrust structure; private antitrust cases have long dominated the totality of antitrust cases filed in federal courts.<sup>2</sup> Here I present the pertinent data on the number of cases filed so as to describe the relative sizes of the government and private antitrust sectors. I also examine the frequency of antitrust case filings according to the political party of the President, so as to gauge the likely direction of the new administration.

### Civil Antitrust Cases Filed in Federal Courts: 1949–2008

The history of private and government antitrust case filings since 1949 is described in the chart below.<sup>3</sup> Government cases are a small slice of the antitrust pie. The flat line at the bottom of the chart shows the number of government civil cases, those brought by either the Department of Justice or the Federal Trade Commission. The mountainous-looking line shows the number of private antitrust cases, excluding the cases arising from the “electrical-equipment” conspiracy. The column shows the number of those private electrical-equipment cases.

The private electrical-equipment cases followed the government antitrust case brought in 1960 against twenty-nine corporations supplying electrical equipment.<sup>4</sup> More than 1,900 individual private cases were filed against those corporations from 1962 through 1967. These cases are shown as a separate category because no other industry cartel before or since has generated anything approaching that level of private litigation. Similar cases since then have been consolidated and handled by groups of plaintiffs, either through class-action litigation or by voluntary groupings.

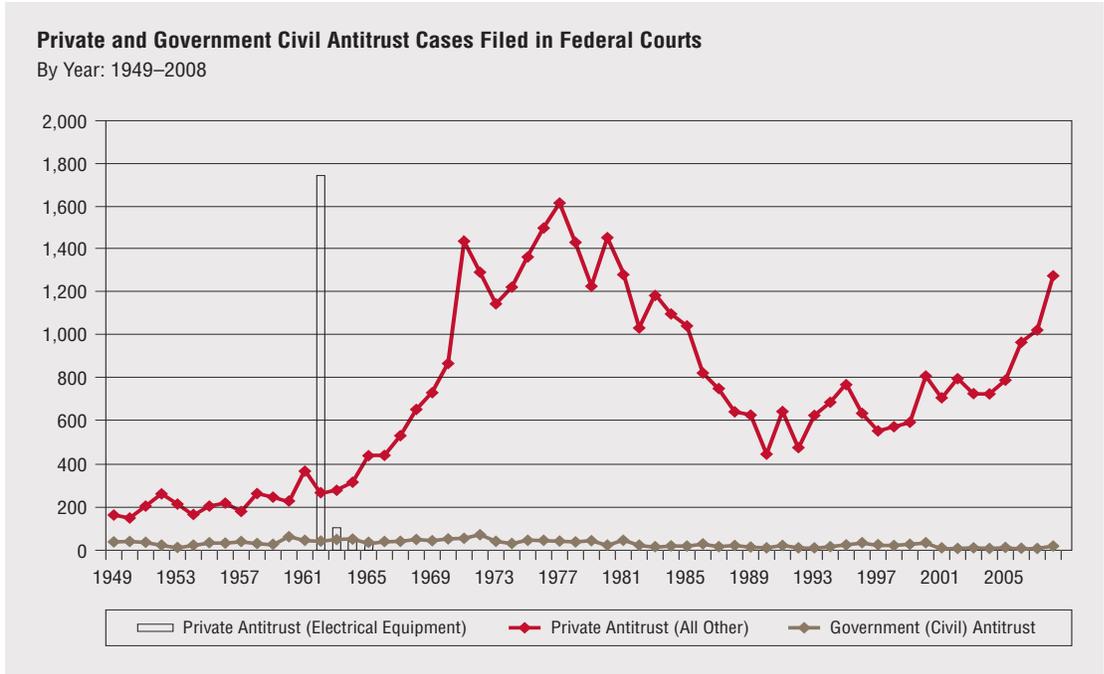
<sup>1</sup> See, e.g., Daniel A. Crane, *Obama’s Antitrust Agenda*, REGULATION, Fall 2009, at 16; Andrea Agathoklis, *In Their Own Words: Predicting Enforcement Under Varney and Leibowitz*, ANTITRUST, Summer 2009, at 5; Daniel A. Crane, *The Brief Life of the Section 2 Report and the Uncertain Future of Bundled Discounts*, GLOBAL COMPETITION POL’Y, July 2009; Gregory K. Leonard & Maria A. Lopez, *Farrell and Shapiro: The Sequel*, ANTITRUST, Summer 2009, at 14. An article that touches on some of the same themes discussed here, but from a broader perspective, is Daniel A. Crane, *Technocracy and Antitrust*, 86 TEX. L. REV. 1159 (2008).

<sup>2</sup> This article deals only with cases filed in federal district courts as opposed to appellate courts and state courts. The term “government cases” refers to cases brought by the federal antitrust agencies, either the Antitrust Division of the Department of Justice or the Federal Trade Commission. The term “private cases” refers to cases brought either by private parties or non-federal public entities. The number of government cases does not include FTC administrative proceedings or those few cases in which the federal government is listed as the defendant.

<sup>3</sup> The source for the data is *Judicial Business of the United States Courts, Annual Report of the Director*, published by the Administrative Office of the United States Courts, various issues 1949–2009.

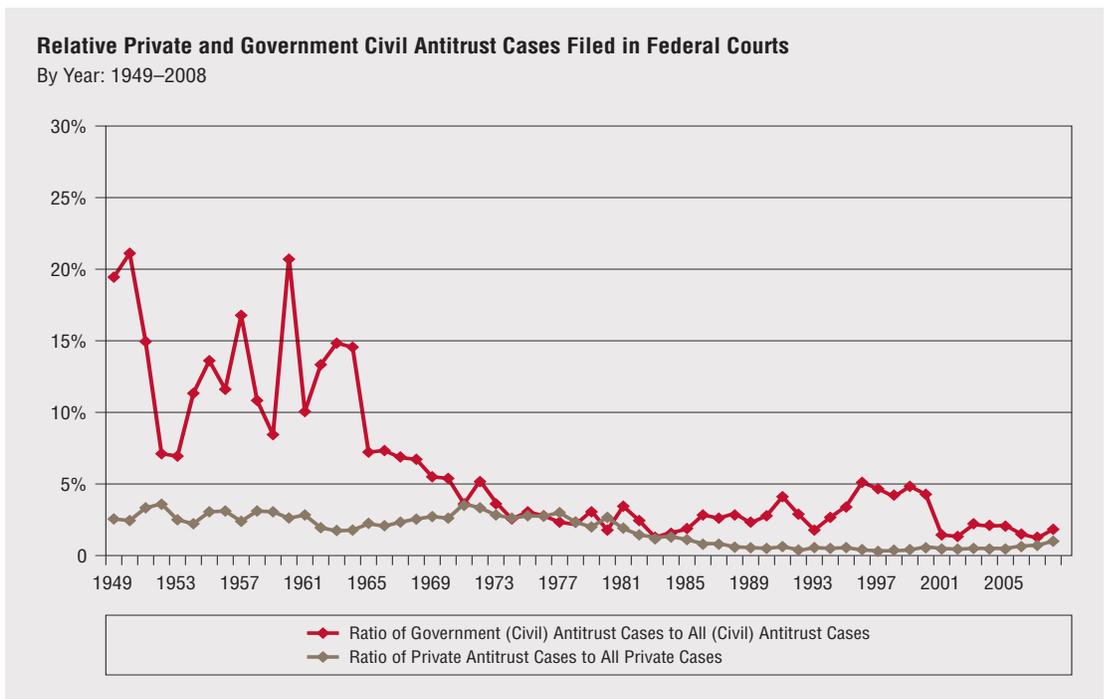
<sup>4</sup> For a discussion of the electrical-equipment cases, see DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 128–30 (4th ed. 2005).

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Note as well that these data are limited to civil cases. That is, they do not include any criminal antitrust cases—those cases brought by the DOJ primarily under Section 1 of the Sherman Act and limited to allegations of explicit collusion among competitors. The number of criminal cases is discussed below. In addition, the number of government civil cases includes merger challenges filed in court by either the Department of Justice or the Federal Trade Commission. While it would be interesting to separate merger and non-merger cases, as well as DOJ and FTC cases, there is no source for those bifurcations over the entire period.

The chart below shows private and government antitrust cases expressed in relative terms. Government antitrust cases are shown as a fraction of all civil antitrust cases, government plus pri-



vate. Private antitrust cases are shown as a fraction of all private civil cases, antitrust plus all other. The private electrical-equipment cases are excluded from the calculations.

In this chart, the uppermost line is the ratio of government civil antitrust cases to all civil antitrust cases. Note that government civil antitrust cases have seldom accounted for more than 20 percent of all civil antitrust cases. The government share of antitrust cases has been below 10 percent since 1964. The lower line shows the ratio of private antitrust cases to all private civil cases filed in federal courts. That ratio has declined slowly and fairly steadily from 1971 through 1997 and has increased slightly since then. Over the last thirty years, antitrust cases have accounted for less than one percent of all civil cases.

To summarize the results so far: government cases, including merger cases, have long been a small share of total antitrust cases. Private antitrust cases as a share of all civil cases have been fairly stable, though sizable increases in the absolute number of private antitrust cases have occurred in recent years.

### Democratic Versus Republican Administrations

The conventional wisdom seems to be that Democratic administrations are more pro-enforcement when it comes to antitrust. The recent pronouncements regarding the enforcement stance of the new administration are consistent with that impression. It may be informative to examine how much more “pro-enforcement” the antitrust agencies have been under Democratic administrations. The following table shows the average annual number of government cases, both civil and criminal, filed in federal courts by the party of the administration in power.<sup>5</sup>

**Government Antitrust Cases Filed per Year 1949–2008**

	AVERAGE	DEMOCRATIC	REPUBLICAN	DIFFERENCE
Civil	31.1	34.8	28.6	6.2
Criminal	33.1	28.9	35.9	-7.0
Total	64.2	63.7	64.5	-0.8

On average, relative to Republicans, Democrats bring 6 more civil cases per year and 7 fewer criminal cases. The total number of cases is virtually identical. The differences in the civil and criminal averages are close but not quite equal to the usual standards of statistical significance.<sup>6</sup>

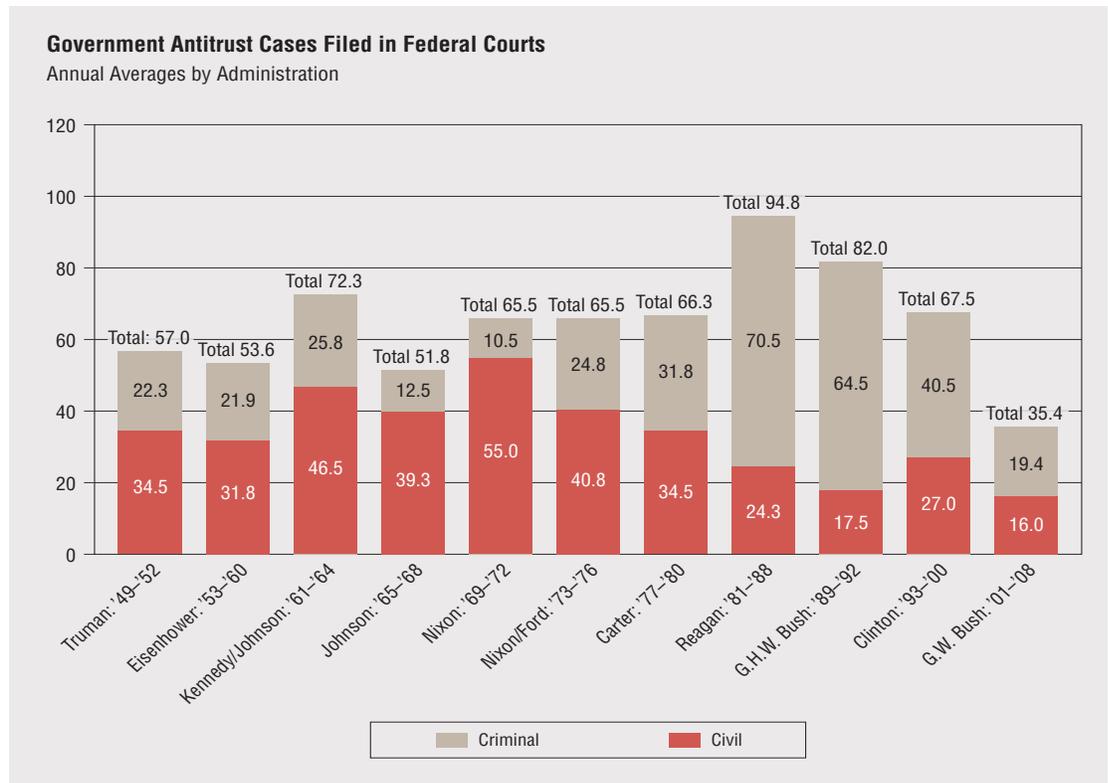
The details by administration are shown in the following chart. The chart shows the average number of government cases filed per year for the last eleven administrations. The dark portion of the column shows civil cases; the light portion shows criminal cases. The total number of cases is shown at the top of each column.<sup>7</sup>

Measured by the pace of case filings, the most activist civil-case enforcement occurred during the Nixon administration; the most activist criminal-case and overall enforcement occurred during the Reagan administration.

<sup>5</sup> The party of the administration is assigned based on the calendar year. For example, all cases filed in the years 2001 to 2008 are assigned to the George W. Bush administration. This approach, of course, offers an imperfect measure of the policy intentions of an administration. Early in an administration, case filings may be generated by investigations that occurred in the previous administration. In addition, the composition of the FTC is less directly controlled by an administration than is the leadership of the DOJ.

<sup>6</sup> Neither difference is significant at the 95 percent level; the difference in the number of civil cases is significant at the 90 percent level.

<sup>7</sup> The total values may not equal the sum of the civil and criminal values due to rounding. The source for the data on criminal cases is the same as civil cases. See *supra* note 3.



Of course, these comparisons do not take into account the number of enforcement “opportunities” presented to the agencies—the supply of cases as opposed to the demand. For example, the volumes of merger cases and price-fixing cases are, to some extent, exogenously determined by the amount of such activity occurring in the economy. The same can be said of civil cases, although the enforcement priorities of the administration may be more relevant to civil cases. In any case, the nearly identical values for total cases across the two parties is consistent with the idea of an overall capacity constraint on government enforcement, with Democratic administrations showing a relative preference for civil over criminal cases.

**Conclusion**

Based on historical experience, the current antitrust administration may bring a few more civil cases than average and a few less criminal cases. That level of activity would represent a substantial increase over the preceding administration, however, which was well below the average in the number of cases brought. In any event, the number of government cases is likely to remain a small share of the totality of antitrust litigation in the United States. ●

## Book Review

# Filling a Void in Latin American Antitrust Literature

Eleanor M. Fox and D. Daniel Sokol, Editors

**Competition Law and Policy in Latin America 2009**

Hart • 2009

### Reviewed by Ricardo Jungmann

Lawyers and academics who want to learn about competition law in Latin America will be disappointed to find that, with few exceptions, the literature does not adequately discuss each country's current regime. *Competition Law and Policy in Latin America* helps fill this void. The book consists of articles written by experts in their respective countries that describe substantive and procedural antitrust issues in each author's country. The editors have integrated the contributions well.

While most of the articles refer to Argentina, Brazil, and Chile, there are also interesting discussions of Mexico, Colombia, Panama, Ecuador, and Bolivia, as well as multiple comparisons to the United States. It would have been interesting to include an analysis of other Latin American countries, such as El Salvador, Uruguay, and Peru, but the articles were selected after an open call for papers, and the call did not suggest subjects to the authors.

The book offers important insights about antitrust in Latin America. First, it emphasizes the positive evolution of antitrust institutions in Latin American countries. At the same time, it suggests greater investment in the training of antitrust authorities and the possibility of hiring specialized professionals to assist these authorities in complex antitrust matters.

Second, several authors highlight an important Latin American reality: the existence of highly oligopolistic markets. This condition complicates the detection of tacit collusion and increases the risk of condemning legal practices or exonerating anticompetitive practices.

Third, the countries of this region have a similar approach to determining which practices should be condemned. However, there are important differences in the standards of proof and procedures they apply. Some countries' higher tribunals have simply confirmed the decisions of antitrust authorities, while others have overturned decisions for lack of evidence. Examples of the former have occurred in such countries as Colombia and Panama, and the latter, in countries like Chile.

Fourth, several authors suggest the need to strengthen leniency programs and increase the budgets of antitrust enforcement agencies to improve the gathering of hard evidence of cartels. The book shows that most of the cartels uncovered in Latin America are local or national in scope rather than international. This result tends to confirm the need for improved detection because the same multinational companies that have been sanctioned for antitrust violations in the United States or the European Union (in such industries as pharmaceuticals, chemicals, telecommunications, computers, fuel, food and beverages, to name a few) are present in most Latin American countries.

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The analyses of individual countries raise important issues. The discussion of Argentina shows that it is evolving away from American antitrust law toward European law. Under Argentine law, anticompetitive practices, including mergers, may be held illegal only if they affect the “general economic interest,” which has been interpreted loosely as total welfare. The book criticizes Argentinean antitrust authorities for imposing low penalties for monopolization and vertical restrictions, and for failing to block or impose conditions on conglomerate mergers.

Chilean competition policy developed during an early liberalization and privatization process and was understood as a means to promote this process. However, the book argues that antitrust authorities should not always seek to achieve liberalization, but should also consider other goals like efficiency. The book also argues that the Chilean Supreme Court should defer to the antitrust tribunal because that is a specialized authority with the necessary expertise to deal with antitrust issues. The authors support Chile’s recent adoption of a leniency program and the conferral of new powers on the “Fiscalia Nacional Economica,” under which governmental agents, with prior judicial authorization, may enter public and private institutions, register, and seize objects and documents, and intercept communications.

Brazil’s antitrust analysis is more advanced than the rest of the jurisdictions discussed in the book. For example, while authorities in most Latin American countries are still discussing whether to implement a leniency program, Brazil has not only done so, but has studied the program’s effects and how it can be improved. Additionally, in Brazil, there is an interesting discussion about the problem of information exchange between companies that may be disguised as an attempt to merge. Other papers emphasize the high efficiency in standards enforcement that Brazil has obtained and its successful experience with leniency programs.

The book also analyzes other countries, although not to the extent of the ones mentioned above. It highlights Mexico’s institutional evolution and the questions raised by its merger review process, Antitrust issues in Colombia’s agricultural sector are explored, and Ecuador and Bolivia are shown as countries where institutional development remains a challenge.

Overall, this book shows that there has been significant progress in the development of antitrust in Latin America. Future authors may consider why countries that belong to the same continent exhibit significant differences in their antitrust systems, particularly in the organization of antitrust institutions, the independence of antitrust authorities, standards of proof of anticompetitive conduct, the quality and quantity of available instruments to prosecute cartels, and sanctions. They also might consider whether the same standards and concentration indexes should be applied for merger review and for dominant position cases in small and large economies. Finally, they might consider whether it would be useful to create a Latin American association to promote antitrust research and competition culture.

*Competition Law and Policy in Latin America* is an excellent contribution to a field with scarce available literature. This book is a useful resource for libraries, law firms, and academic private collections interested in antitrust matters. ●

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# Paper Trail: Working Papers and Recent Scholarship

**Editors' Note:** In this edition, we review a study that is apparently the first to measure the deterrent effects of merger enforcement on the frequency of future mergers. Send suggestions for papers to review 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

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**Jo Seldeslachts, Joseph A. Clougherty & Pedro Pita Barros,**

**Settle for Now but Block for Tomorrow: The Deterrence Effects of Merger Policy Tools**

<http://www.journals.uchicago.edu/doi/pdf/10.1086/596038>

In this paper, economists Seldeslachts (Amsterdam), Clougherty (Berlin), and Barros (Lisbon) study the effects of merger enforcement actions on future mergers. Their statistical model confirms their theoretical prediction that the answer depends on the type of action: actions blocking mergers deter future mergers, while negotiated settlements do not. The study is apparently the first to measure the deterrent effects of merger enforcement on the frequency of future mergers. The authors provide an interesting discussion of their methodology, data, and results, and propose a tentative policy implication.

Previous studies of the deterrent effects of enforcement actions have generally focused on cartel prosecutions. The authors note, however, that a few studies examine whether merger enforcement affects the “composition” or form of future mergers. George Stigler, for example, found in 1966 that the Cellar-Kefauver amendments to Section 7 of the Clayton Act deterred horizontal mergers, but stimulated vertical and conglomerate mergers.<sup>1</sup> Others have found that the stock of rivals of merging firms traded at lower premiums after the adoption of premerger notification, suggesting that more effective enforcement deterred inefficient mergers. Still others have tried, not very successfully, to determine whether merger enforcement reduces or increases price/cost margins.

The authors suggest that their approach is an advance over previous work because it examines the effects of merger enforcement on the frequency of future mergers, not their form; it focuses on deterrent effects, not the direct effects of regulation on affected firms; it considers data from many countries over more than a decade rather than simply comparing conditions in countries with and without antitrust regimes or conditions before and after the adoption of an anti-merger regime; and it adopts a sophisticated “dynamic panel data” method of statistical analysis. The authors acknowledge, however, that something significant is lost by not examining the effect of enforcement on the composition of mergers. While they surmise that merger enforcement deters mainly anticompetitive mergers, their results do not prove this; they only tell us the effect of enforcement on the frequency of all mergers.

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<sup>1</sup> George Stigler, *The Economic Effects of the Antitrust Laws*, 9 J.L. & ECON. 225 (1966).

The authors develop a model for analyzing the deterrent effects of enforcement tools. They are especially interested in the dramatic recent shift by agencies away from outright blocking of mergers and toward negotiated settlements. Mergers, the authors observe, can generate profits for the surviving firm from increased monopoly power, reduced costs, or both. Blocking the merger forecloses all profits; a negotiated settlement aims to minimize monopoly profits, but to preserve cost savings; and a clearance permits all profits. Thus, the authors infer, unsurprisingly, that blocking creates greater deterrence than a negotiated settlement, and a negotiated settlement creates greater deterrence than a clearance.

In the authors' model, firms determine the restrictiveness of a merger by various means, including the choice of merger targets and the structuring of the transaction. At one extreme, firms may aim for an outright monopoly; at the other extreme, they may try to eliminate any anticompetitive effects by fix-it-first divestitures. The agency, in turn, determines the levels of restrictiveness at which it will block, negotiate a settlement, or permit, but the lines between these levels are unclear to potential merging firms *ex ante*. Firms decide whether to propose a merger by taking account of the probable profit (given the restrictiveness of the merger), the likelihood of an enforcement response, and the direct costs of formulating the proposal. If the firms observe the enforcement agency shift away from blocking and toward the kinder and gentler negotiated settlement, they will be more likely to propose the merger. Firms update their estimates of the degrees of restrictiveness that will induce blockings or negotiated settlements based on their observations of the agency's enforcement actions. Thus, "a spike in blocked mergers leads to positive updating of the perceived probability of eliciting a block" and "a spike in negotiated settlements will lead to positive updating of the perceived probability of a settlement." (p. 615) In the former case, the spike should deter proposed mergers; in the latter case, the spike could deter or encourage mergers, depending upon whether the spike in settlements comes at the expense of blocks or clearances.

The authors examine 2-year averages of blockings, negotiated settlements, and "monitoring" (clearances subject to oversight) in 28 jurisdictions, including the United States, from 1992 to 2005. They find that the agencies as a group greatly increased the number of enforcement actions during the merger wave of the 1990s, in both absolute and relative terms. Thus, the rate of enforcement actions went from 1.5 percent to 5 percent of mergers over the studied period—either because the agencies were applying stricter standards or because there were narrowing reporting requirements to encompass mergers that are more likely to raise antitrust concerns. In addition, however, the data show that agencies disproportionately relied on settlements rather than blocking to resolve these concerns.

In estimating the effects of enforcement actions, the authors develop a sophisticated statistical model that controls for numerous factors that affect merger frequency: the merger wave of the 1990s, the increases in GDP and the stock market indexes, and changes in reporting thresholds and substantive merger standards. They report four regressions that instrument for different variables that might bias the results. They find that:

[b]locked mergers have a statistically significant and negative impact on future merger behavior in all four regressions. The consistent strong impact of this variable suggests that spikes in the use of blocked mergers send a clear signal of toughness by antitrust authorities—a signal that significantly reduces future merger proclivities.

On average, a 10 percent increase in blockings results in a drop in mergers in the following year between 1 and 2 percent. The authors calculate, for example, that an increase in blockings of mergers in 2003 in the U.S. resulted in a 4.7 percent reduction in mergers in 2004; a sharp drop

in blockings in the EU in 2003 led to a 13 percent increase in mergers. In contrast to the results for blockings, negotiated settlements appear to have no significant deterrent effect. The authors' results for both antitrust actions survive four different statistical tests for robustness.

The authors suggest that these results "imply that antitrust authorities should be cautious with regard to overusing negotiated settlements" (p. 630) because, even if they mitigate the anticompetitive effects of proposed mergers, they provide no deterrent effect on future mergers. As this highly qualified policy recommendation suggests, the authors stop short of recommending a major shift toward blocking mergers rather than reaching negotiated settlements. This caution is appropriate for two reasons. First, negotiated settlements are supposed to capture the cost savings from mergers while preventing their anticompetitive effects. If settlements were effective in accomplishing both of these tasks, a shift from negotiated settlements toward blockings would sacrifice cost savings that negotiated settlements might have permitted. (On the other hand, as the authors point out, prior studies have sharply questioned whether negotiated settlements actually prevent the anticompetitive effects of mergers.) Second, a spike in blocking may deter efficient mergers along with anticompetitive ones. The authors acknowledge that their results do not exclude this possibility. Until we know more about what kinds of mergers are actually deterred by blocks, it is inappropriate to treat all deterrence as an unalloyed social benefit. ●

—WHP