Defending “The Last Man Standing”: Trench Lessons from the 2008 Criminal Antitrust Trial United States v. Swanson

Gary Swanson, a senior sales executive of Hynix America, was indicted for conspiring to fix Dynamic Random Access Memory (DRAM) computer chip prices in violation of Section 1 of the Sherman Act.¹ He was represented by the authors, and was tried before a jury earlier this year.²

The government investigation of the DRAM cartel began in early 2002, and by the time of the Swanson trial, four companies, Samsung, Infineon Technologies, Hynix, and Elpida Memory, and fourteen out of sixteen “carved out” individuals, had pled guilty resulting in fines and penalties of over $731 million.³ The four-week trial ended with a hung jury, and a mistrial was declared on March 6, 2008, after seven days of deliberations. According to juror interviews and contemporaneous press reports, ten jurors favored acquittal and none found the government’s key witness credible.⁴ Shortly thereafter, on March 19, 2008, the government announced its decision not to retry the case and the court granted the government’s motion to dismiss the indictment with prejudice.

Despite the high stakes and huge investment of government resources, defendants in criminal antitrust cases, such as those flowing from the DRAM investigation, can mount a credible defense and even win against the odds when the defense team directly takes on the government’s evidence and witnesses.⁵ Three critical lessons, gleaned from the successful defense of Mr. Swanson, illustrate how charges of criminal antitrust violations can be defeated.

- First, the defense team can and must credibly challenge and undercut the testimony of the prosecution’s key witnesses, who likely will have received immunity in exchange for the incriminating testimony.
- Second, to provide a convincing, alternative explanation of the government’s evidence, such as writings with sinister implications, the defense must gather useful information from an intelligent search of all the documents that the government produces.⁶

⁵ “Criminal cartel enforcement is the Division’s top priority . . . .” Press Release, U.S. Dep’t of Justice, supra note 3. Thomas Barnett recently stated that “By all measures, the Division’s cartel enforcement program had a banner year that broke new ground.” Message from the AAG, Spring 2008, at 1, available at http://www.usdoj.gov/atr/public/231424.pdf. However, since 1996, “not even half of all criminal antitrust defendants who have gone to trial have been convicted.” F. Joseph Warin et al., To Plead or Not to Plead: Reviewing a Decade of Criminal Antitrust Trials, ANTITRUST SOURCE, July 2006, at 1, http://www.abanet.org/antitrust/at-source/06/07/Jul06-Warin7=20f.pdf.
⁶ One critical discussion of the recent KPMG fraudulent tax haven suit focuses on the onerous and expensive task associated with a “mountain of discovery” and “near-ceaseless document production.” Defense counsel there estimated that the cost of a “proper defense,” given as many as 5 million produced pages and 2,000 trial exhibits with 150,000 pages, should be $15–$20M for at least one defendant. Julie Triedman, Buried Alive, AM. LAWYER, Fall 2007, at S80.
Third, the defense team must distinguish and distance its defendant from the others who have pled guilty, received jail terms, and paid fines and other penalties for criminal conduct.

Attacking Amnesty and Undermining the Credibility of Immunized Witnesses

The Antitrust Division’s Corporate Leniency Program attracts as many as two violator-applicants each month. The program offers corporations, their officers, and their employees amnesty in exchange for their full and candid cooperation. There is a great incentive for corporations to participate: companies and protected officers and employees can avoid fines, felony convictions, and prison time, as well as treble damages in follow-on civil cases. The program is viewed as an invaluable tool for identifying and curbing illegal activity. To be eligible, the reporting corporations must meet six conditions:

1. The Department of Justice has not already received information on the illegal activity from any other source;
2. The corporation took effective action to stop its participation in the illegal activity once it discovered the activity;
3. The corporation offers full cooperation with the Antitrust Division and reports the “wrongdoing with candor and completeness”;
4. The whole corporation must come forward, not merely some individuals;
5. The corporation needs to make restitution with the victims where possible; and
6. The corporation could not have “clearly” been an instigator or leader of the activity.

The DRAM investigation was publicly launched by subpoenas issued in June 2002, and Micron sought amnesty quickly, becoming a corporate participant in the Antitrust Division’s Leniency Program. Micron executives provided lengthy interviews to the government to obtain individual amnesty and to discharge their cooperation obligations under the Program. Michael Sadler, Micron’s Senior Vice President for Marketing, was the only co-conspirator identified by the government’s bill of particulars to say he directly fixed a specific price with Mr. Swanson. Pursuant to the Leniency Program, he was immunized from prosecution as long as he cooperated with the government. All of the government’s “open file” interview notes were turned over to the defense as part of the government’s mammoth production. How the Swanson defense team successfully challenged the immunized witness’ credibility was pivotal to its success.

Using the government’s interview notes of Mr. Sadler in cross-examination at trial, the defense caused him to admit that he had told the government of a worldwide tour he initiated to seek the cooperation of other manufacturers to restrict production. Mr. Sadler had described this trip to the

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8 Lisa Phelan, Chief, National Criminal Enforcement Section, U.S. Dep’t of Justice, recently stated that the Amnesty Program “has been a huge case generator” and a “huge, huge source of cases for the division,” Lesson VII: Navigating the Department of Justice Corporate Leniency Program, ABA Brownbag Audio (Apr. 30, 2008), available at http://www.abanet.org/dch/committee.cfm?action=YL508000.

9 When the DOJ has received some, but insufficient information, it applies substantially the same six conditions to allow latitude regarding the role of the participating amnesty applicant. U.S. Dep’t of Justice, Corporate Leniency Policy 2–3 (Aug. 10, 1993), available at http://www.usdoj.gov/atr/public/guidelines/0091.pdf. For a summary history of the Leniency Program, see Klawiter & Everett, supra note 7, at 1–6.

10 U.S. Dep’t of Justice, Corporate Leniency Policy, supra note 9, at 1–2.
DOJ as “slam-dunk” illegal, and acknowledged that he was an “originator of that idea.”11 All of this was placed before the jury, and while the government urged this conduct was ‘different’ than the conspiracy alleged in the indictment of Mr. Swanson, it later became clear that the jury was highly skeptical of the bona fides of Micron—and Mr. Sadler—as a consequence.12

The government relied heavily on Mr. Sadler’s testimony. He testified that he discussed pricing at two “core accounts” with Mr. Swanson, and that those discussions “set a benchmark” for discussions with other customers.13 Based on their discussions, Mr. Sadler concluded he had an “understanding” with Mr. Swanson that Micron and Hynix were “on the same page.”14 Mr. Sadler also testified that on one occasion Mr. Swanson confirmed to him that Hynix was going to raise certain prices and that Mr. Sadler responded indicating that Micron would do the same.15 As a key witness, and the only competitor who allegedly engaged in conspiratorial activity directly with Mr. Swanson, the defense cautioned the jurors that they should seriously question Mr. Sadler’s credibility.

Our complete review of the government’s production uncovered a number of documents that colored Mr. Sadler’s testimony as self-interested, including evidence of Mr. Sadler’s contradictory view of Hynix as a vicious competitor, not a price fixer,16 which is what he earlier testified in an International Trade Commission (ITC) proceeding that concerned the same time period as the alleged conspiracy. A trial graphic that was used in the opening statement suggested that Mr. Sadler had been willing to say different things in different fora:


14 “Q. Now, you indicated in your example about when prices were going up, that Mr. Swanson told you that prices were going up and you said, ‘Yeah, we are on the same page.’ What did you mean by that expression? . . . .

A. That’s my slang terminology to say, ‘Yeah, I agree with you.’”

Id. at 1121–22.

15 “Q. And was that part of the reason why you wanted to make sure that was correct and you called Mr. Swanson?

A. Yes. As I recall, it was, again in a strong market environment when prices were going up and this was a very significant—significant amount of increase. And of course it was significant in my mind now because there was a specific price mentioned.

Q. And what did you say in response to his indication that he would be raising prices in a significant way?

A. I said, ‘Yeah. Sounds good to me.’ Or ‘Just wanted to confirm that’s what you were doing,’ or something along those lines.

Q. Now, when you said ‘Sounds good to me’, what did you mean to convey to him?

A. That we were going to do the same thing.”

Id. at 1128.

16 “Although the government may seize an enormous volume of documents from targets pursuant to grand jury subpoenas, most of them may never be read as prosecutors make their cases based on cooperation from amnesty applicants and their witnesses and still other co-conspirators who may subsequently plead guilty and also cooperate.” William J. Blechman, Why Twombly Does Not (and Should Not) Apply to Hard-Core Cartels, ANITRUST SOURCE, Oct. 2007, at 6 n.34, http://www.abanet.org/antitrust/at-source/07/10/Oct07-Blechman10-18f.pdf.
A cornerstone of Mr. Sadler’s testimony was an alleged phone call in which Mr. Swanson supposedly gave him a future Hynix price of $40 for a DRAM product to be sold to IBM. Mr. Sadler’s story was corroborated at trial by another Micron executive who testified that he was present in Sadler’s office at the time and heard the conversation on a speakerphone. The story they presented together was sufficiently detailed, was cross-corroborated, and fit the government’s theory—in all it appeared credible. But this specificity also allowed the defense to establish that the particular call could not have happened.

The corroborating Micron witness, who had responsibility for IBM, was based on the East Coast. He testified that he was present in Mr. Sadler’s office at Micron headquarters in Boise, Idaho, at the time the phone call took place. Extensive searches of the government’s document production reflecting the prices charged to IBM for that product established a timeframe when the $40 price range was obtained. Other records within the production universe, including travel and hotel receipts for the corroborating witness, further pinned down the only time when the telephone call could have taken place.

Through an FBI expert, the government had presented a large chart, detailing fifty-plus phone calls between Mr. Sadler and Mr. Swanson. Using the government interview notes at trial, Mr. Sadler on cross-examination admitted he told the DOJ that over a two-year period, there was only one call between them in which Mr. Swanson reportedly agreed to a specific future price. Using the government’s own FBI-sponsored telephone log chart, we established that there were no phone calls between Mr. Sadler and Mr. Swanson at the only time (February 2002) when (i) the corroborating witness was in Boise and (ii) the product that was the subject of the call was in the $40 range. Graphics were presented in closing to highlight that the defense had proved “beyond a reasonable doubt” that the critical telephone call on which the government had pinned its conviction goal had not happened:
Last, but not least, the defense emphasized in closing the court’s jury instructions relating to the credibility of immunized witnesses under the amnesty program:

> [Y]ou should consider the extent to which or whether their testimony may have been influenced by the grant of immunity from prosecution. . . . [and] whether the witnesses’ testimony may have been influenced by any of the benefits they received and, in addition, you should examine their testimony with greater caution than that of other witnesses.¹⁷

The trial result and post-trial juror reactions indicated that this graphics evidence was significant to undercutting the government’s case.¹⁸

### Debunking Cryptic E-Mails

At the heart of any price-fixing case is an alleged agreement to collude. In this case, a conspiracy was easily established by the earlier guilty pleas, and the only question was whether Mr. Swanson had knowingly joined that conspiracy intending to further its objectives. The government put to the jury a broad variety of e-mails to and from the defendant that included vague, obscure, or coded words, and argued they reflected illegal mutual understandings showing knowledge of the conspiracy by Mr. Swanson and efforts by him to assist it.

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¹⁸ The Antitrust Division philosophy, according to the Director of Criminal Enforcement, “has always been that, whenever possible, we will tilt our program in favor of finding ways to make companies eligible for our program rather than looking for ways to keep them out.” Scott D. Hammond, Dir. of Criminal Enforcement, Antitrust Div., U.S. Dep’t of Justice, Cornerstone of an Effective Leniency Program, Remarks to the ICN Workshop on Leniency Programs 19 (Nov. 22–23, 2004), available at http://www.usdoj.gov/atr/public/speeches/206611.htm. The jurors in the Swanson case, on a pragmatic basis, were apparently concerned about the ‘free ride’ to an admitted conspirator.
In cross-examination, the defense team successfully challenged these writings by presenting detailed and more plausible, less sinister interpretations. This was only possible because the defense had been able to locate contradictory documents through an intelligent search of a document dump that had the effect of leaving the defense drowning in paper. The government’s code-word focus also allowed the defense in both opening and closing to tell the jury what was not an agreement: competitors can legitimately talk to each other and even exchange price information without violating antitrust laws, absent agreement.

The government’s opening statement conditioned the jury that there would not be direct writings showing illegal agreements.19 As noted above, the government focused heavily on numerous superficially incriminating e-mails supported by testimony that permitted strong inferences of the defendant’s participation in the conspiracy.20 This evidence included such problematic statements as: “if [the competitor] leads the charge, [the defendant’s company] can follow”; the defendant being instructed to employ “diplomacy” with competitors; advising the defendant that competitors are in the “same mood” on price; the defendant being told there is price “consensus” with competitors; and other Hynix executives noting that competitors are in the “same suit” on pricing.21 All of the government witnesses testified pursuant to plea agreements, corporate cooperation agreements, or under amnesty immunity. Several of those witnesses testified that they had reached “mutual understandings” with competitors on price, and that they had told the defendant about their pricing discussions. When pressed on cross-examination, however, they acknowledged that the term “mutual understanding” was the government’s language, not theirs. They confirmed that this phrase had been introduced into their vernacular during government interviews and trial preparation, which permitted the defense to defuse much of the “mutual understanding” sting.22 Through deliberate word-by-word cross-examination and strategic use of searched records offering parallel, legitimate explanations, the defense was able to refute the government’s effort to shoehorn loaded terms into the nebulae of “agreement” or “mutual understanding.”

The defense theme of permissible communications on price was reinforced by the jury instructions,23 and the Swanson case teaches how carefully crafted instructions are of great importance.

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19 “You have to remember this is an illegal agreement so, of course, it wouldn’t have been written down. People wouldn’t have wanted to leave a paper trail.” Transcript of Record at 319–20, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 5, 2008).

20 Judge Hamilton ruled that employee/employer e-mails are in themselves not admissible as business records, see Order at 17–18, United States v. Swanson, No. CR 06-0692 PJH (N.D. Cal. Nov. 16, 2007) (Final Pretrial Order, Document 247), but were admissible if they were proved up under the co-conspirator exception to the hearsay rule, Federal Rule of Evidence 801(d)(2)(e). This allowed for advance screening by the defense and the court of each co-conspirator statement before testimony by its author or recipient, including information from the government as to how and why the statement met the standards for the exception. See United States v. Swanson, No. CR 06-0692 PJH, order at 7 (N.D. Cal. Jan 22, 2008) (Third Addendum to Final Pretrial Order, Document 283). This procedure was of great assistance to the orderly presentation of the evidence.


22 “Q. Now, this term ‘mutual understanding,’ is that a term that was developed between you and the government during your interview sessions, or is that a term that you used before you were interviewed with the government? . . .

23 “It is not unlawful for a person to obtain information about competitors’ prices, or even to exchange information about prices, unless done pursuant to an agreement or mutual understanding . . . .” Jury Instruction 17, United States v. Swanson, No. CR 06-0692 PJH (N.D. Cal. Mar. 10, 2008) (Document 337, at 23).
in antitrust jury trials. The court gave preliminary instructions about permitted price discussions before opening statements, and the same but more detailed instructions were shown in graphics and read slowly by the defense to the jury at the trial’s closing.\textsuperscript{24} The instructions made clear that price exchanges with competitors only violate the Sherman Act \textit{if} done pursuant to an agreement or mutual understanding.

Rather than avoiding potentially troublesome documents or ignoring these phrases, defense counsel highlighted them to the jury. Both in the opening statement\textsuperscript{25} and closing argument,\textsuperscript{26} we urged that it would be a great injustice to convict a defendant for knowing that his company’s senior executive was in a “common mood” with a competitor’s executive who had pled guilty. To further emphasize the ambiguous nature of the code-word evidence, the defense elicited testimony from a government witness, a Korean Hynix executive, that there were “delicate differences” between his native language and English, and that these differences might have affected his intention and understanding of the government’s code words.\textsuperscript{27} Based mostly on documents contained in the government’s production, we contextualized each troublesome term in the government e-mails by showing that at the time of each e-mail or other communication there was an equally likely, potentially benign, purpose or meaning. This approach showed that Mr. Swanson might have known his competitors were ‘aligned’ on product or pricing issues, yet he did not perceive that an agreement or mutual understanding on price existed.

For example, two of the more troublesome e-mails, Exhibits 128 and 182, seemed to show that (i) Mr. Swanson told his Korean colleagues that a competitor wanted to “meet to discuss the measures to stabilize the market price,” and (ii) Mr. Swanson knew another competitor had “agreed to gap-based pricing.”

\textsuperscript{24}“They are fixed because they are agreed upon.” Transcript of Record at 2793, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 22, 2008). See also id. at 2296, 2152.

\textsuperscript{25}“What the government would like to do in the context of any international company is to say, if some American representative doesn’t look carefully at their e-mail—like the e-mails I told you about Mr. Swanson telling his staff before they talked to Korea, they have to talk to him first—then that person may wind up sitting here just like Mr. Swanson.” Transcript of Record at 355, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 5, 2008) (Defense Opening Statement by John Bartko).

\textsuperscript{26}“You know, ladies and gentlemen of the jury, if you can be convicted of a crime in the courts of the United States because somebody tells you they are in the same mood and you’re supposed to know it means an agreement, and the witness who sent the e-mail says otherwise, and he’s required to cooperate with the government, and the e-mail itself says there wasn’t agreement, it says they’re in serious consideration, if that’s a crime and you can be convicted of it in the courts of the United States we’re all in peril.” Transcript of Record at 2217–18, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 22, 2008).

\textsuperscript{27}Transcript of Record at 844, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 8, 2008).
The defense’s response to these e-mails was threefold. First, the e-mails’ authors were cross-examined, and it was established that Mr. Swanson did not attend any meeting to stabilize price, and that any “agreement” on gap pricing was nothing more than concurrence among competitors that new products should command an undefined market premium, or ‘gap’ over existing product pricing reflecting the development costs for new products. Second, other documentary evidence uncovered by the electronic document review was introduced to place the troublesome e-mails in a more sympathetic context. Third, Mr. Swanson testified in detail about each of the challenging e-mails, offering an explanation for the events that countered a criminal agreement on price. Substantial preparation ensured that Mr. Swanson was a congenial, soft-spoken witness who maintained eye contact with the jury.

Creating Distance from Guilty Pleas
Another major challenge was to distinguish Mr. Swanson from the executive and corporate guilty pleas, which in addition to the $731 million in fines and penalties had also resulted in 3,185 days of combined jail time.28 In order to distance Mr. Swanson from those admitting guilt, including Hynix and several of its executives, the defense solicited admissions from those government witnesses that they had greater knowledge than Mr. Swanson of conduct the government claimed was criminal, and that they had concealed significant facts from him.

Each of the government’s nine witnesses was an employee of companies that had either pled guilty or worked for Micron, which participated in the DOJ’s Leniency Program. Accordingly, each of these witnesses was obligated to cooperate with the government (and none of them was willing to be interviewed by the defense). Three of Mr. Swanson’s Korean superiors testified for the government as part of their plea arrangements that imposed prison time, fines, plus ongoing cooperation in the case against Mr. Swanson.

To support its argument of complicity, in its opening statement the government produced building floor plans showing that Mr. Swanson sat a few feet away from Korean executives who had pled guilty. They also used visual presentations of Hynix organization charts showing Mr. Swanson as a senior executive in the direct line of reporting between executives who either pled guilty or who would testify that they had reached “mutual understandings” on price with competitors. Because the plea agreements were admissible29 (with exceptions for the amount of penalties or fines) and would create an inescapable conclusion of global wrongdoing, the defense acknowledged the pleas and the conspiracy from the beginning, and asked the jury to hold an open mind as to why persons in the same company might have different levels of knowledge and participation. The court’s carefully crafted jury instructions stated:

In considering the charge in the indictment you must consider whether the evidence shows beyond a

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29 In the Ninth Circuit a plea agreement may only be “considered by the jury in evaluating witness credibility” and shall not be considered as substantive evidence of the defendant’s guilt. United States v. Halbert, 640 F.2d 1000, 1004 (9th Cir. 1981). Courts recognize the jury’s possible misuse of evidence of a witness’s guilty plea and caution that trial courts must be “sensitive to the possibility of prejudice, and therefore both trial and reviewing courts have responsibility to insure that evidence of the plea is being offered by the prosecutor and used by the jury only for a permissible purpose.” Id. at 1005. Admission of a plea agreement to assess a testifying witness’s credibility is a “permissible purpose,” where an appropriate limiting instruction has been given to that effect. United States v. Smith, 790 F.2d 789, 793 (9th Cir. 1986). Thus, the plea deals all came in.
reasonable doubt that defendant knowingly and intentionally became a member of the charged conspiracy to fix prices.\textsuperscript{30}

and:

Presence at the scene of the crime and knowledge that a crime may be committed by others are not sufficient to establish a defendant’s guilt. \textit{Mere association} with conspirators or those involved in a criminal enterprise is insufficient to prove a defendant’s participation or membership in a conspiracy.\textsuperscript{31}

While the defense conceded the existence of price fixing, we sought to create “distance” between Mr. Swanson and the others who pled guilty or acknowledged wrongdoing. The goal was to create a bubble for Mr. Swanson in between the Korean executives who pleaded guilty and his salesmen who testified to reaching “mutual understandings.” This was done on several levels, including use of the geographic separation between the U.S. subsidiary and the Korean parent, and individual separation between Mr. Swanson and the ‘inner circle’ Korean Hynix executives, through a series of trial graphics such as:

![Image of a map showing distances between countries.]

Although the Korean Hynix witnesses spent considerable time at the company’s San Jose office, we succeeded in establishing the image of a foreign, hence distant, conspiracy in which Mr. Swanson was not knowingly involved beyond a reasonable doubt.

Second, we drew attention to the “delicate differences” between Korean and English, and how speakers use and understand the same English words differently. We pointed out how this had a direct bearing on Mr. Swanson’s being a \textit{knowing} and \textit{intentional} participant in the conspiracy, which the government was required to prove. The defense repeatedly questioned Korean witnesses about conducting important international meetings almost exclusively in Korean, despite the presence of Mr. Swanson and other U.S. executives who did not read or speak Korean. While many meetings attended by Mr. Swanson were conducted in English, questions were deliberately raised for the jury about what could have been said in the Korean language meetings that was \textit{not} said in the English language meetings.

\textsuperscript{30} Final jury instructions, Transcript of Record at 2296, United States v. Swanson, No. 3:06-00692 PJH (N.D. Cal. Feb. 22, 2008) (emphasis added).

\textsuperscript{31} \textit{Id.} at 2297–98 (emphasis added).
Third, and most importantly, we offered evidence that Mr. Swanson and other Americans were not privy to important Korean corporate communiqués, highlighting the importance of the “inner circle” illustrated in the above trial graphic. We used to advantage an important directive distributed to Mr. Swanson and the U.S. sales force at the beginning of the indictment period. This was a summary of a May 2001 international conference call, led by the parent company president, memorialized in an original Korean language version sent with an English translation. The company-provided English translation for the U.S. subsidiary offered a benign directive “to not sell below cost.” However, an accurate government-stipulated forensic translation of the same Korean words, showed that the original Korean language version actually instructed company executives (who understood Korean) to “cooperate with the applicable regional competitors” to stabilize prices. A graphic was used to illustrate this dichotomy:

![Sales Conference Call – May 2001](image)

These Korean documents were identified from an original government production that included 55 million electronic pages and 1,123 boxes of hardcopy materials. By initially focusing primarily on Hynix and Micron documents, we sorted and prioritized over 19 million pages, from which over 580,000 pages of documents were selected for further issue and relevancy review by trial counsel. Nuances and subtleties inherent in verbal communications made it necessary to marry high-tech forensic data analysis with traditional fact investigation—eyes on paper.

The review attorneys were guided by issue matrices developed under the direct supervision of trial counsel. Even with a highly sophisticated and reliable forensic process, the review and judgment of trial counsel were necessary to develop the materials that permitted effective direct and cross-examinations.

In the end, some 1,500 Korean language documents required preliminary translations, and then a narrower subset received certified translations—which, with interaction between the government and defense-retained experts, resulted in favorable stipulated translations.

Finally, the inference that Mr. Swanson must have known about anticompetitive agreements between his company and other DRAM makers was refuted by market and expert testimony. Mr. Swanson (and other witnesses) testified that in 2001 and 2002, the DRAM market was no-holds barred and very competitive on price, since DRAMs were a fungible commodity product. The defense introduced testimony that Mr. Swanson and Mr. Sadler had both testified at the 2002–2003 ITC proceeding (which Micron brought against Korea, based on Hynix’s alleged “under selling” DRAMs at artificially low prices through government subsidy), about the high degree of price competition between the companies.
To support our position, the defense called Professor Jerry Hausman of MIT, who had testified as an expert witness on behalf of Micron before the ITC. Professor Hausman testified about the level of competition in the marketplace at the time, and submitted a chart (replicating what he had done in the ITC proceedings for the same time period.) This ‘corroborated’ Mr. Swanson’s view and state of mind: he did not know the DRAM producers were colluding to stabilize price, but rather it appeared to him that Hynix was fighting for survival in a highly competitive declining market.

### Conclusion

The challenges in defending Mr. Swanson are similar to those faced in many large, white-collar, data-intensive cases where other individuals and corporate coconspirators have pled guilty or obtained amnesty in the face of the overwhelming power and resources of the United States.33

The ability to launch an effective defense rests in these cases on a defense counsel’s ability to sift through and manage, analyze, and assimilate vast amounts of data and documents so as to painstakingly distinguish the defendant at trial from others pleading guilty, and to attack in cross-examination the government’s immunized witnesses and often cryptic written evidence.

In the end, the Swanson case teaches that (i) the government, after a robust investigation as in DRAM, that produces huge fines, penalties, and jail sentences, will insist on trial against the last man standing, and (2) such a defendant can prevail.

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32 The government tried, without success, through a Daubert hearing, to block Professor Hausman’s expert testimony, arguing it was not admissible to “justify” illegal agreements, yet that was not the offered purpose. As Judge Hamilton confirmed in pretrial rulings, Professor Hausman’s testimony was admissible to show the reasonableness of Mr. Swanson’s perception and lack of knowledge about anticompetitive price-stabilizing agreements, since the same would not be readily apparent to someone like the defendant engaged in daily intense competition in a steeply declining market. See United States v. Swanson, No. CR 06-0692 PJH, order at 3 (N.D. Cal. Dec. 18, 2007) (Second Addendum to Final Pretrial Order, Document 266) (citing Continental Baking Co. v. United States, 281 F.2d 137 (6th Cir 1960)).

33 As District Judge Lewis A. Kaplan has noted, we have moved “from a system in which prosecutors prosecuted and courts and juries decided guilt or innocence to a system in which prosecutors as a practical matter threaten business entities with unbearable extrajudicial consequences and thus exact acquiescence in the government’s demands.” Lewis A. Kaplan, Some Reflections on Corporate Criminal Responsibility, ANTITRUST SOURCE, Oct. 2007, at 1, http://www.abanet.org/antitrust/at-source/07/10/Oct07-Kaplan10-18f.pdf.
The Volume of Commerce Enigma

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For more than ten years, the U.S. Department of Justice Antitrust Division has enjoyed a sustained period of astronomical fines against corporate antitrust defendants. Before 1994, the record for the largest corporate fine ever imposed for a single Sherman Act count stood at $6 million.1 Since 1995, there have been at least fifty-six Sherman Act violations yielding corporate fines of at least $10 million, with eleven of those yielding fines of $100 million or more.2 In 1999, F. Hoffman-La Roche was fined $500 million for its participation in the vitamins cartel, and the last few years have seen fines of $300 million to Samsung, British Airways, and Korean Air.3 More astronomical fines are surely on the horizon.

In large part, the Division’s success in obtaining these huge fines is due to the alternative fine provision in 18 U.S.C. Section 3571, which arguably allows the Division to obtain fines in excess of the Sherman Act maximum—now $100 million—up to “twice the gross gain or loss caused by the conspiracy.”4 But while this statute and the Sherman Act define the uppermost limit for corporate fines, they do not prescribe the mechanism for determining the actual fine in any given case. For that, the Division uses the United States Sentencing Guidelines (USSG) in the same way today as it did before the Supreme Court’s Booker decision, which made the USSG advisory.5

The fine calculation for corporations is a multi-step process. The first step is determining the “base fine.” USSG Section 2R1.1 sets the base fine at “20 percent of the volume of affected commerce.”


merce." After the base fine is set, the sentencing court determines minimum and maximum “multipliers”—numbers between 0.75 and 4.0—that are generated by reference to a “culpability score.” A “fine range” is then calculated by multiplying the “base fine” by the “multipliers.”

Given that the starting point of the fine calculation is determined entirely by the “volume of affected commerce” (VOC) concept, one might expect this to be a carefully defined term in the USSG, in policy statements from the Division, or in case precedent. In fact, however, the USSG and its commentary do not offer any explanation of how to calculate the VOC, other than to note in Section 2R1.1 that “the volume of commerce attributable to an individual participant in a conspiracy is the volume of commerce done by him or his principal in goods or services that were affected by the violation.” Likewise, the Division has given scant guidance, while the case law is scarce and inconsistent.

The absence of any definition of VOC, much less a precise one, is puzzling. The concept of VOC is not self-evident, especially in the context of a globally integrating international economy. According to the Division, “[i]nternational cartel investigations account for over 40% of the Division’s grand jury investigations.” More importantly, a vast majority (52 out of 56) of the Sherman Act violations producing the biggest fines involve international cartels, and most (46 out of 56) corporate defendants in those cases are foreign.

The Division’s efforts to clarify the meaning of VOC as applied to international cartels and foreign defendants are not sufficient. In a 2008 panel program on this issue—transparency in the VOC calculation—the DOJ explained its complex methodology for calculating VOC in its high-profile air cargo cartel investigation. This explanation came some seven months after the Division announced the first plea agreement with an air cargo cartel participant. Moreover, it appears that the air cargo “methodology” was chosen because it produced a VOC calculation that the Division and the first pleading carrier could agree upon. Thus, its general applicability is limited by its ad-hoc genesis.

For defendants caught up in international cartels, anticipating the Division’s calculation of VOC remains a difficult task. This lack of transparency, and the aggressive positions taken by the Division on the issue, cause companies to be reluctant to cooperate with the Division and negotiate a plea agreement. As a result, the lack of clarity as to what does or does not constitute VOC is a disservice to those defendants and to the Division.

Courts Have Not Allowed the Division Free Reign in Calculating VOC
To this point, VOC has not been an extensively litigated concept, and, as a result, there are very few cases addressing VOC. However, the courts that have taken up the issue have grappled with the question of what the Division must prove to include a sale within VOC.

On one end of the spectrum, in *Hayter Oil* the Sixth Circuit permitted a presumption that “affected” commerce was all sales “during the period of the conspiracy, without regard to whether individual sales were made at the target price.” *Hayter Oil* has been criticized by a number of com-

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6 See USSG § 8C2.6; see also id. § 8C2.5 (determining culpability score by several factors, including the extent and level of involvement of certain corporate executives, the corporation’s past antitrust history, and the corporation’s cooperation with the investigation).

7 See USSG § 8C2.7.

8 Hammond, Recent Developments, supra note 1, at 17.

9 See Antitrust Division Chart, supra note 2.

10 United States v. Hayter Oil Co., 51 F.3d 1265, 1273 (6th Cir. 1995).
mentators, and the Second Circuit, in *United States v. SKW Metals & Alloys, Inc.*, rejected its expansive approach, explaining that “a price-fixing conspiracy that fails to influence market transactions, notwithstanding overt acts sufficient to support criminal responsibility has affected no sales within the meaning of the Guidelines.” For instance, “[i]f the conspiracy was a non-starter, or if during the course of the conspiracy there were intervals when the illegal agreement was ineffectual and had no effect or influence on prices, then sales in those intervals are not ‘affected by’ the illegal agreement, and should be excluded from the volume of commerce calculation.” SKW Metals thus stands for the proposition that only sales above the market price (whether or not at or above the conspirators’ target price) should be included in VOC.

The Seventh Circuit, in *United States v. Andreas*, preserved SKW’s focus on the Government’s burden to prove an affect on commerce. Noting that “the purpose of the § 2R1.1 enhancement is to gauge the harm inflicted by the illegal agreement,” the Andreas court concluded that “sales that were entirely unaffected did not harm consumers and therefore should not be counted for sentencing because they would not reflect the scale or scope of the offense.” However, the court also observed that “few if any factors in the world of economics can be held in strict isolation,” so “the presumption must be that all sales during the period of the conspiracy have been affected by the illegal agreement.” This presumption is, of course, a rebuttable one, and the government bears the ultimate burden of proof.

One element common to all three of these cases, however, is that only sales within the United States were counted within the VOC calculation. Thus, the conclusions to be drawn from the scant available case law are that—even before *Booker*—the courts were searching for the right burden to place on the government for proving VOC, and the balance of authority required the Division to prove an effect on the sales to begin to calculate the VOC. In a post-*Booker* world where the government must prove sentencing factors by at least a preponderance of the evidence, we believe that, if put to the test, the Division will have to prove not just that its requested VOC was “affected” by the conspiracy, but that the sales sought to be included within VOC actually fall within the jurisdictional reach of the Sherman Act.

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13 *Id.* at 91.

14 United States v. Andreas, 216 F.3d 645 (7th Cir. 2000).

15 *Id.* at 677–78.

16 *Id.* at 678.

17 Other commentators have in the past looked upon the Andreas formulation approvingly (see Herron, supra note 11, at 953), and we note here that it is likely the most consistent with the Supreme Court’s recent opinion in *Rita*, which held that a district court is entitled to attach a rebuttable presumption of reasonableness to sentences imposed within the applicable Guidelines’ range. See *Rita v. United States*, 127 S. Ct. 2456 (2007) (reasoning that a rebuttable presumption is not binding and does not infringe on the right to a jury). Indeed, the DOJ acknowledged in the DRAM cases that certain sales may not be included in VOC, even if those sales took place during the period of the conspiracy. In the *Hynix Semiconductor Inc.* case, for instance, the joint sentencing memorandum states that “[b]ecause of factors unique to Hynix, th[e] volume of commerce calculation excludes commerce during the 14-month period October 2000 through November 2001,” even though the period of the conspiracy was April 1999 through June 2002. Sentencing Memorandum at 3, 5, *United States v. Hynix Semiconductor Inc.*, No. CR 05-249 (PJH) (N.D. Cal. May 4, 2005). The DRAM “price war” credits within the charged conspiracy period suggest that the Andreas presumption was either ignored or the DRAM defendants that received the credit overcame the presumption. We are left to guess without specific guidance from the parties or the DOJ.
Division Guidance Focuses on Domestic Commerce

In line with these considerations, in 1999, the Division’s then chief of criminal enforcement, Gary Spratling, announced that the Antitrust Division “will normally use the volume of U.S. commerce affected by the defendant’s participation in a conspiracy when calculating that defendant’s Sentencing Guidelines’ fine range.”18 Consistent with this announcement, in 2002, the U.S. Government filed an amicus brief on petition for certiorari in Statoil ASA v. Heeremac V.O.F., stating that “[i]t is the policy of the United States to calculate the Base Fine by using only the domestic commerce affected by the illegal scheme, and in all but two of the dozens of international cartel cases prosecuted, fines obtained by the government were based solely on domestic commerce.”19

More recently, the Division asserted that “domestic sales” should be used to calculate VOC for purposes of setting the fine range, but that foreign sales can be considered to determine the exact level of the fine within that range. The Division’s position is that in circumstances where 20 percent of domestic sales would understate the impact of a defendant’s conduct on U.S. victims, “the Division has used foreign sales only as an aggravating factor requiring an increase in the fine.”20 Implicit in these policy pronouncements is a recognition by the Division that foreign sales are not commerce within its jurisdiction to regulate, which is a necessary position for the Division in light of other countries’ competition laws.

With this precedent, we would expect the consensus position to be that only domestic sales be counted. Unfortunately, as many of the practitioners who have faced this issue in international cartel cases have recognized, there is no consensus. That is because, as with most things, the devil is in the details. Precisely what constitutes “U.S.” or “domestic” commerce is a constant struggle between defense lawyers and the Division.

What Constitutes “Domestic Commerce” Is Unclear. To illustrate the potential ambiguities of VOC under the Sherman Act, consider a foreign widget manufacturer with a U.S. sales division that is responsible for selling to consumers throughout North and South America. The foreign manufacturer makes the widgets, which it transfers to its sales division in a nominal “sale” at a pre-arranged and consistent transfer price, set primarily for tax and internal accounting allocation purposes. The sales division then re-sells the widgets to end users throughout the Americas and, in doing so, books its own profit—calculated as the contract or transaction price over the transfer price “paid” by the sales division in the intra-company transaction.

To complicate things further, one can easily conjure up a host of other variables:

- Perhaps the domestic selling entity is not a division, but a wholly-owned subsidiary of the foreign manufacturer.
- Perhaps the customer’s purchase order issues from a U.S. affiliate but the product is to be shipped to a South American subsidiary.

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Perhaps some of the sales documents are negotiated and signed in a foreign country, while others are consummated in the United States. Perhaps some of the widgets are shipped directly from the foreign manufacturer to the South American end-users, never touching U.S. soil, while others are briefly stored in the sales division's domestic warehouse.

What combination of elements results in sales that should be factored into the foreign defendant's VOC? Potentially relevant factors may include: (1) location of, and relationships between, the manufacturing and sales arms of the defendant; (2) location of, and relationships between, the purchasing and end-user branches of the buyer; (3) location of the invoiced entity; (4) location of the bank accounts to and from which money is transferred in the transaction; (5) location of contract negotiations and signing; and (6) physical transfer of the product, including entry of the product into the United States. The relative weight, if any, of these factors has never been articulated by the Division.

The Division's recent plea agreement with Qantas—stemming from the Division's Air Cargo investigation—is a recent example of the confusion. According to the agreement, "[t]he volume of affected commerce [$244.4 million] does not include commerce related to the defendant’s cargo shipments on routes into the United States." That is not to say that the Division agreed with Qantas’s “position that any agreements reached with competitors with respect to cargo shipments on routes into the United States should not be included in the defendant’s volume of affected commerce calculation.” To the contrary, the Division argued “that a Guidelines fine calculation that fails to account for cargo shipments into the United States affected by the conspiracy charged in the Information would understate the seriousness of, and the harm caused to U.S. victims by, the offense and would not provide just punishment.”

Despite its stated position, the Division ultimately accepted a definition of VOC—and thus a base fine—according to the defendant’s methodology. Strangely, the Division accepted a VOC definition with which it does not agree because of the “complexity of litigating the issues.”

The Division recently explained its approach to air cargo VOC at the 2008 ABA Antitrust Law Section Spring Meeting. The Deputy Assistant Attorney General in charge of the Division’s criminal enforcement regime, Scott Hammond, while participating on a panel program entitled “Sentencing Issues in Today’s Global Economy” with one of the authors of this article, made transparent what we could only surmise from Qantas and the other air cargo convictions. Mr. Hammond’s comments, in our opinion, however, only highlight the ad-hoc, case-specific approach to determining VOC that might be useful to the subjects of that investigation, but to few others.

Mr. Hammond confirmed that the Division (and the cargo defendants) agreed VOC would include only U.S. outbound shipments. The reason, although not entirely clear, appears to be that outbound shipments were what the Division and the defendants thought were most closely within the Division’s jurisdictional reach. Yet, contracting for air cargo services is a complex, Byzantine system, where middlemen (called freight forwarders) sit between the carrier and the person looking to move his or her goods from Point A to Point B. The questions arising from the Division’s

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21 This list is not intended to be exhaustive. Indeed, the point is that, in today’s complex global economy, the list of potentially relevant factors is nearly limitless. It is therefore all the more important that actually relevant factors be defined.


23 Id.

24 Id. at 7–8.
“choice” for calculating VOC in the air cargo cases are numerous: Which flights are imports, exports, or purely domestic commerce, and how does that impact the VOC determination? Should we assume from Qantas that to be included in the VOC calculation the sale must originate in the United States? Was it the location of the customer/purchaser that mattered? Was Qantas a “wheels up” or “wheels down” approach?

To explain what really went on with the Qantas plea, Mr. Hammond took the opportunity at the ABA Spring Meeting to publicly set forth the following complex methodology for the treatment of in-bound shipments as an “aggravating factor” necessitating an upward adjustment:

(T)he Division could explain which factors
relevant to determining whether a particular transaction may be included within the VOC determination.

In calculating the upward adjustment, the Division considered the company’s revenue from cartelized U.S. inbound shipments. In this [hypothetical] example, U.S. inbound commerce represents 57% of the company’s total U.S. inbound and outbound commerce. Rounding downward, the Division used the midpoint (50%) of the Guidelines fine range as the starting point . . .

Thus, in that example, the Division’s VOC and sentencing method looked like this:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Guideline Fine (outbound only)</td>
<td>$168 million</td>
</tr>
<tr>
<td>50% Upward Adjustment for Harm to U.S. Inbound</td>
<td>$84 million</td>
</tr>
<tr>
<td>Fine before Cooperation Discount</td>
<td>$252 million</td>
</tr>
<tr>
<td>Subtract 30% Cooperation Discount</td>
<td>($76 million)</td>
</tr>
<tr>
<td><strong>Total Fine</strong></td>
<td><strong>$176 million</strong></td>
</tr>
</tbody>
</table>

Mr. Hammond’s transparency with respect to the air cargo VOC and sentencing “methodology,” though admirable, is limited; it exists as a “methodology” only because the first carrier to plead guilty thought it was a good deal. The point remains that the VOC-derived base fine in Qantas was computed solely on outbound U.S. cargo flights, using inbound flights as an aggravating factor, and that the Division has produced little guidance as to why that is the correct approach. Left unexplained is the rule, law, or even policy support for it. The Division will follow that methodology in subsequent air cargo plea agreements because of its success with it in this case. The problem is that it may not help in other matters.

What is needed is clear, generally applicable guidance from the Division on the subject. The ABA Spring Meeting panel discussion on VOC was an important step in the right direction. More is needed: The Division should publicly state the factors it believes are most significant in assessing whether a transaction falls within VOC and clarify the jurisdictional basis for calculating VOC in international cartel cases. While prospectively providing definitive answers in light of the highly variable factual scenarios is not possible, the Division could explain which factors it believes to be most relevant to determining whether a particular transaction may be included within the VOC determination.

If the Division cannot provide such guidance, the alternative—that the VOC calculation will remain a free-for-all, with every case sui generis—should be acknowledged. To date, the Division has allowed itself the flexibility to assert different positions in different cases without acknowledging any inconsistencies. This has cast a shadow on the transparency of the plea-negotiation process and has led to inconsistent results—results based in part on international, if not “foreign” commerce, despite the Division’s public statements to the contrary.

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In setting forth the factors for determining the VOC in its cases, the Division needs to be mindful that the reach of the Sherman Act, as established in *Empagran*, does not extend to injury only to markets beyond our borders. We offer some proposals for how to approach factors to be used in calculating VOC.

**VOC Must Take into Account the Division’s U.S. Jurisdiction, as Well as Comity Among the Ever-Increasing Number of Nations that Enforce Competition Laws.** The landmark *Empagran* case set significant limits on the jurisdictional reach of the Sherman Act in cases involving international cartels and therefore necessarily limits the potential scope of VOC as well.26 At issue in *Empagran* was the interpretation of the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA),27 which defines the jurisdictional boundaries of the Sherman Act in cases involving international trade or commerce. As explained by the *Empagran* Court, “[t]he FTAIA seeks to make clear to American exporters (and to firms doing business abroad) that the Sherman Act does not prevent them from entering into business arrangements (say, joint-selling arrangements), however anticompetitive, as long as those arrangements adversely affect only foreign markets.”28

One of the principal grounds for the *Empagran* Court’s decision was comity.29 The Court first noted that “[n]o one denies that America’s antitrust laws, when applied to foreign conduct, can interfere with a foreign nation’s ability independently to regulate its own commercial affairs.”30 Such interference, the Court explained, could be justified to the extent that foreign anticompetitive conduct causes domestic injury.31 “But why,” the Court asked, “is it reasonable to apply [U.S. antitrust] laws to foreign conduct *insofar as that conduct causes independent foreign harm and that foreign harm alone gives rise to the plaintiff’s claim?*”32 The Court could find no good answer, and so held that the Sherman Act should be construed not to cover solely foreign injuries.33 These same concepts apply in the criminal context and manifest themselves perhaps most directly in the calculation of VOC.

In an international cartel case, the defendant’s U.S. fine will not exist in a vacuum, especially given the current landscape of sharply escalating foreign enforcement. The European Commission’s fines for conduct affecting Europe are now frequently larger than U.S. fines.34 Countries in Asia and Oceana, plus Canada, have increased their maximum fines.35 And recently, Brazil has become an active enforcer. Indeed, as the Division has recognized:

> Antitrust authorities around the world have become increasingly aggressive in investigating and sanctioning cartels that victimize their consumers. Seemingly with each passing day, the antitrust commu-

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28 See id. at 164 (holding that statutes must be construed “to avoid unreasonable interference with the sovereign authority of other nations”); *see also* id. at 169–73 (holding that another basis for its decision was that the Sherman Act had never before been applied to redress foreign injury).

29 Id. at 165.

30 Id.

31 Id.

32 Id. at 166.


34 Hammond, Charting New Waters, supra note 20, at 2.
nity learns of a foreign government that has enacted a new antitrust law, created a new cartel investigative unit, or obtained a record antitrust penalty.\textsuperscript{36}

To the extent that the Division’s VOC calculations would sweep in commerce attributable to the countries that are now actively enforcing competition laws, defendants run the risk of paying portions of multiple fines that are based on the same underlying sales. Beyond this “double counting” issue, foreign nations understandably bristle against the notion that the United States applies its antitrust laws to commerce occurring within their borders, or affecting their citizens and companies.\textsuperscript{37} In light of all this, the \textit{Empagran} Court’s concern for comity among nations seems all the more relevant, and all the more applicable to the proper measure of VOC.

Consistent with the notion of comity, an approach for determining U.S. commerce should focus, as a starting point, on the nationality and residency of the affected customers. And in line with this guiding principle, an approach that considers only U.S. customers taking delivery in the United States can already be found in Division precedent. For example, in 2005, in the DRAM cases, the Division consistently agreed to calculate defendants’ VOC by aggregating sales to original equipment manufacturers (OEMs) actually located and taking delivery in the United States.\textsuperscript{38} Similarly, during the \textit{Hydrogen Peroxide} investigation in 2006, the Division based VOC on sales within the United States. In the plea agreement for \textit{United States v. Solvay S.A.},\textsuperscript{39} the Division explained that the basis for Solvay’s VOC was its sales to U.S. customers.\textsuperscript{40} Likewise, in the plea agreement for \textit{United States v. Akzo Nobel Chemicals Int’l B.V.},\textsuperscript{41} the Division explained that Akzo Nobel’s VOC was based upon sales to “U.S. customers.”

The \textit{Chloroprene Rubber} case in 2005 led to the Division’s filing a plea agreement in \textit{United States v. Dupont Dow Elastomers, LLC},\textsuperscript{42} in which the Division again calculated VOC based on sales to “U.S. Customers.” And the \textit{Fine Art Auction} case in 2004, the plea agreement and sentencing memorandum in \textit{United States v. Sotheby’s Holdings, Inc.},\textsuperscript{43} indicate that VOC was based on commissions made on auction sales in the United States. This was true even though the defendant participated in an international conspiracy involving worldwide sales over $11.6 billion during the relevant time.

\textsuperscript{36} Id.
\textsuperscript{37} For instance, the governments of Germany, Belgium, Canada, Japan, the UK, Ireland, and the Netherlands all filed briefs as amicus curiae in \textit{Empagran}, arguing against U.S. interference in the antitrust regulation of sovereign nations.
\textsuperscript{40} Available at http://www.usdoj.gov/atr/cases/solvay.htm (emphasis added).
\textsuperscript{43} No. 1081 (LAK) (S.D.N.Y. 2004).
The trial of Mitsubishi stemming from the Graphite Electrodes investigation resulted in a similar calculation methodology. Having obtained a conviction, the Division’s Sentencing Memorandum in support of its joint sentencing recommendation calculated the portion of Mitsubishi’s fine stemming from its role as a sales agent of Tokai Carbon by looking to the “only United States customer during the duration of the conspiracy.”\footnote{Sentencing Memorandum of the United States at 4, United States v. Mitsubishi Corp., No. 00-033 (MK) (E.D. Pa. Apr. 19, 2001), available at http://www.usdoj.gov/atr/cases/indx216.htm.} Thus, even after a successful trial, the Division sought to impose a fine on Mitsubishi based only on sales to U.S. customers.

Finally, the Division recently re-emphasized its focus on sales to U.S. purchasers in a press release related to air cargo conspiracy plea agreements. On August 1, 2007, Associate Attorney General William W. Mercer stated that the Division’s current investigative and prosecutorial focus is to “ensure that American consumers and businesses are not harmed by illegal cartel activities” and that “American consumers and businesses” won’t “pick[] up the tab.”\footnote{See DOJ Press Release, supra note 3 (emphases added).}

All of this illustrates to us that the DOJ has already taken the position in its plea agreements that its conception of domestic commerce uses the nationality and residency of the affected customers as a touchstone for determining the issue. Publicly stating that is the case, following that position consistently in plea negotiations, and articulating other relevant factors the Division considers is appropriate, long overdue, and, put simply, the right thing to do.

In doing so, the Division should enumerate the factors that will lead to enhancement or reduction of the VOC calculation. In terms of the variables listed above, the end-user focus dictated by jurisdictional and comity considerations leads to the following conclusions:

- The nationality, residence, and internal structure of the defendant are relevant factors, but should not conclusively determine whether the defendant’s actions harmed domestic commerce.
- By contrast, the location of, and relationships between, the purchasing and end-user branches of the buyer should be of greater critical consequence. The fact that the transaction touched the United States in a nominal way does not mean that domestic commerce was affected. Where, for example, a foreign purchaser uses a U.S.-based purchasing entity, the invoiced entity and the end-user will be different, and the invoiced entity may be from the United States. Because the end-user of the product is foreign, the sale should be treated as a foreign sale.
- Location of contract negotiations and signing should be of very little consequence. In today’s global marketplace, contract negotiations can take place at the location of the seller, the location of the end-user, some other location, over the phone, and on-line. Where the contract of sale is negotiated says little, if anything, about whose consumers were harmed by anticompetitive pricing.
- Physical transfer of the product should serve as powerful evidence of the end-user’s location. If products touch U.S. soil and title is considered to transfer then, a rebuttable presumption might arise that the sale affected domestic commerce. By contrast, products that never touch U.S. soil cannot fall into the hands of a domestic end-user, and so should not affect domestic commerce. Accordingly, a conclusive presumption should then arise that the sale did not affect domestic commerce, and so should not be included in VOC.
The Necessity and Benefits of Transparency and Certainty

Certainly, getting to the “right” answer to the VOC enigma is a noble goal. Even more important, however, is that the Division generate a consistent answer, and in a transparent manner. That is, the Division should articulate the factors that will enter into its determination of which sales will be included in VOC where the defendant is a participant in a worldwide antitrust conspiracy. Doing so would serve not only the fairness interests of antitrust defendants, but also the deterrence and enforcement initiatives of the Division.

First, a lack of certainty and transparency in the calculation of VOC—which in turn creates a lack of transparency in sentencing—is unfair to antitrust defendants. Such unfairness is a risk to the Division as much as it is a concern to defendants. In the wake of the recent opinions in Gall v. United States,46 and Kimbrough v. United States,47 in which the Supreme Court reinforced the wide latitude judges have to depart downward from the sentence calculations of the USSG, district courts have a clear mandate to reduce sentences they perceive to have been arrived at in an arbitrary manner.

Second, certainty and transparency are essential to accomplish the deterrence goals of criminal sentencing. As the Comments to USSG Section 2R1.1 explain, “Tying the offense level to the scale or scope of the offense is important in order to ensure that the sanction is in fact punitive and that there is an incentive to desist from a violation once it has begun.” An antitrust conspirator that knows precisely what type of sales will lead to an increased fine has a strong incentive to cease such sales. By contrast, unclear standards as to VOC may lead to over- or under-deterrence of anticompetitive conduct as defendants struggle to distinguish harmful from harmless conduct.

Third, as the Division has long recognized, a transparent process encourages “[p]rospective cooperating parties [to] come forward in direct proportion to the predictability and certainty of their treatment following cooperation.”48 Thus, transparency is critical to the success of the Division’s Corporate Leniency Program, which depends on the cooperation of defendants. Refining VOC standards will further the Division’s priority of enacting “transparent policies on sentencing and calculating fines” to encourage cooperation.49

Whatever the factors—and we have listed several potential considerations—guidance and some ground rules the Division will follow to decide the issue are needed. Manipulation of VOC and VOC determinations made on an ad hoc basis do not further the Division’s long-term goals of a transparent process, nor do they allow the defense practitioner to counsel with sufficient clarity.

In the event that the Division simply cannot, or will not, resolve the outstanding VOC controversy, it should acknowledge as much. At least such an announcement would achieve minimal transparency, and put the antitrust bar on notice that VOC will be an issue calling for advocacy in each and every case.

Implications of *Norris* for UK-U.S. Extradition and Future UK Cartel Prosecutions

Julian M. Joshua

On March 12, 2008, the Appellate Committee of the House of Lords in London overturned the extradition of Ian Norris (the former Chief Executive Officer of The Morgan Crucible PLC) to the United States to face trial on antitrust charges.1 A UK national and resident, Mr. Norris had been indicted in U.S. district court on one count under Section 1 of the Sherman Act for allegedly masterminding a global cartel in carbon products from his base in England from 1989 to 2000. Had the extradition proceeded, he would unwillingly have made legal history as the first individual to be extradited to the United States from any jurisdiction on price-fixing charges.

Apart from the impact on the credibility of U.S. long-arm antitrust enforcement, the judgment probably also puts an end to U.S. attempts to extradite UK antitrust suspects for alleged price-fixing conduct that occurred before the United Kingdom criminalized cartels in the Enterprise Act of 2002. The U.S. enforcers had harbored expectations that a favorable decision would pave the way to the extradition of at least one other high-profile Sherman Act fugitive.

But *Norris* has implications going far beyond extradition. It could have important ramifications in English domestic law. At issue was a novel legal theory, advanced by British prosecutors to provide the necessary “dual criminality” component required for Norris’s extradition, that the conduct alleged against him in the United States would also have constituted the English common law offense of conspiracy to defraud had it occurred in Britain. The Lords’ judgment in *Norris* not only places important conditions on charging the common law offense against suspected price fixers; some of the language in *Norris* on “dishonesty” in the context of treating cartel conduct as conspiracy to defraud could spill over to the legal analysis of the new—and as yet untested—cartel offense in Section 188 of the Enterprise Act of 2002 to which the concept of dishonesty is central.

Extradition and U.S. Enforcement

An understanding of the full significance of the *Norris* opinion for the U.S. enforcement program calls for a brief explanation of the dilemma in which the very success of the Antitrust Division’s drive against international cartels had placed it regarding the prosecution of foreign defendants and the key role of extradition in resolving the quandary.

Incarcerating overseas executives who conspire to fix U.S. prices from abroad plays a key role in the DOJ’s domestic antitrust enforcement strategy.2 Over the past ten years, more than thirty for-

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1 Norris v. Government of the United States of America, [2008] UKHL 16. Mr. Norris could still be extradited on charges of obstructing justice. The House of Lords referred the case back to the extradition judge for a decision on that.

Fewer overseas defendants may be willing in the future to trade their freedom to travel for such sentences. Against the holdouts, the threat of extradition is probably the most powerful weapon in the DOJ’s considerable armory.

The U.S.-UK Extradition Arrangements

The United States has concluded 120 bilateral extradition treaties, more than any other nation, and its relations cover virtually the whole developed world. But such treaties invariably require so-called double criminality in one form or another: for present purposes, this sometimes tricky concept can be understood as requiring the conduct constituting the crime for which the extradition is sought to be treated as a criminal offense not only by the requesting jurisdiction but also by the requested jurisdiction. The DOJ has made it something of a foreign policy mission to encourage other jurisdictions across the globe to legislate to make price fixing a serious criminal offense. So far, however, only a dozen or so countries provide for criminal prosecution of cartels, and many of those will not extradite their own nationals.

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5 The investigative tools aggressively deployed by the DOJ to exert leverage on foreign defendants also include border watches, Interpol Red Notices, and increasing assistance and cooperation with overseas enforcement agencies. See Hammond, Recent Developments, supra note 3.


7 Before the comprehensive reform of Britain’s extradition laws in 2003, to be an “extradition crime,” an offense had to feature in a list of generic crimes set out in Schedule 1 to the Extradition Act of 1870 as periodically updated or have been made “extraditable” by some other means. The “list” system was replaced by a provision making any offense extraditable if the conduct is punishable in both states by at least one year’s imprisonment.

8 See, e.g., Hammond, Recent Developments, supra note 3; Hammond, Charting New Waters, supra note 2.

9 For further comments by the author on extradition and antitrust, see Julian J. Joshua, Cartels, Criminalization and Extradition, Speech at the ABA Antitrust Section International Cartels Workshop (Feb. 5–6, 2004); Julian J. Joshua, Extradition: The DOJ’s New Foreign Policy Weapon, COMP. LAW INSIGHT (2005); Julian J. Joshua, The Brave New World of Extradition: North Atlantic Treaty Alliance Against Cartels? Speech Before the Can. Bar Ass’n, 2005 Annual Fall Conference on Competition Law (Nov. 3–4, 2005).
Britain, always the main U.S. extradition partner, at least in an eastbound direction, has no inhibitions about extraditing its own citizens. However, its attitude toward cartels has historically been one of the most benign among developed legal systems. The United Kingdom’s creation of the “cartel offense” in section 188 of the Enterprise Act of 2002 was thus regarded as a major diplomatic coup on the part of the senior Antitrust Division officials who had toured the globe beating the drum of cartel criminalization. As was then required under the old UK extradition laws, Section 191 of the Act expressly provided for the cartel offense to provide the equivalent offense in terms of the then extradition treaty with the United States. But in English law, dual criminality is not retroactive. The conduct has to be an offense in England at the time it occurred, not when the application is made. Before the Enterprise Act, there was no statutory offense of price fixing. Accordingly, most lawyers believed that any fugitive whose alleged Sherman Act crimes pre-dated the implementation of the Enterprise Act was safe from extradition.

The sole Sherman Act count on which Mr. Norris was indicted in the United States related to the period from 1989 to 2000. To get around this seemingly insurmountable obstacle, the Norris prosecutors devised the ingenious idea of using the old common law crime of conspiracy to defraud as the English offense for the purposes of double criminality. The Antitrust Division had put Sir Anthony Tennant, the former Chairman of Christie’s, on top of its “wanted list” after he declined to submit to U.S. justice in the Fine Art Auctions case, so had it succeeded in extraditing Ian Norris, other applications could have been expected to follow in short order.

Was Price Fixing Conspiracy to Defraud?
The main legal question for the courts in Norris was whether the offenses with which Mr. Norris was charged in the United States were “extradition offences” as defined in Section 137 of the Extradition Act. To qualify, the “conduct” comprising the alleged offense in the United States would have to constitute an offense in English law punishable by imprisonment for twelve months or more had it occurred within the jurisdiction of the English courts. Underlying the narrow dual-criminality issue under the Extradition Act was a novel question of fundamental importance for English criminal and

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10 From 2003–2006 there were twenty-two requests by the United Kingdom to the United States and sixty-nine by the United States to Britain, of which five were refused. See Home Office FOI Release (Feb. 12, 2007), available at http://www.homeoffice.gov.uk/about-us/freedom-of-information/released-information/foi-archive-crime/5008-extradition-uk-us?view=Html.

11 Until the relevant part of the Competition Act of 1998 came into force in May 2000, there was not even a system of administrative fines on companies for breaches of Competition law. As the House of Lords said in Norris: “It is clear that from 1946 until 2002, Parliament, like the courts, did not regard cartels . . . as necessarily being contrary to the public interest.”

12 Scott D. Hammond welcomed enthusiastically the United Kingdom’s adoption of criminal laws against cartels. See Hammond, Charting New Waters, supra note 2.

13 It requires some familiarity with British extradition practice to appreciate that the words “the offences to which an Order in Council under Section 2 of the Extradition Act 1879 . . . can apply . . . include an offense under section 188” made the offense extraditable, thus satisfying the requirements of the then U.S.-UK extradition treaty of 1972 and the Order in Council implementing it in UK domestic law. See R v. Bow Street Stipendiary Magistrate ex parte Government of the United States, [2000] A.C. 21.


15 The 2003 Extradition Act had overhauled Britain’s extradition arrangements and removed a quirk in the old law that prevented extradition to the United States for conspiracy to defraud. By a strange oversight, conspiracy to defraud had never been added to the list of extradition crimes: R v. Secretary of State ex parte Gilmore, [1999] Q.B. 611.

16 United States v. A. Alfred Taubman and Anthony J. Tennant, CR Criminal No. 01 CR 429 (GBD) (S.D.N.Y.) (indictment filed May 2, 2001), available at http://www.usdoj.gov/atr/cases/8100/8177.htm. Taubman was convicted and imprisoned for a year. Invoking conspiracy to defraud as the “British offense” to extradite Sir Anthony was excluded at the time since it was not an extradition crime under the Extradition Act of 1989. See supra note 13.
antitrust law; was price fixing already capable of being a crime at common law even before the creation of the cartel offense in 2002?

Despite that in the 200-year history of the offense in its modern form, prosecutors had (at least until very recently) never used it against cartels, the extradition judge at Bow Street Magistrates Court had found that the alleged conduct would have amounted to conspiracy to defraud, had it occurred in England. Both the extradition judge, and later the Divisional Court, cited with approval an article published just before the extradition hearing suggesting that in certain circumstances making and operating a price-fixing agreement in secret could of itself operate dishonestly so as to constitute a common law conspiracy to defraud. On appeal to the Divisional Court (basically a two-judge court of appeals), Mr. Norris’s lawyers argued that as a matter of law the common law criminal charge of conspiracy to defraud had never applied to cover price fixing without some extra aggravating element like deception.

While the offense of conspiracy to defraud in English law eludes both easy and comprehensive definition, the Divisional Court embarked on an analysis of the House of Lords cases on the development of the offense since the seminal decision in Welham v DPP in 1961. Welham disposed of the notion that deceit was an essential ingredient of the offense. The Divisional Court thought that Viscount Dilhorne had captured the post-Welham essence of conspiracy to defraud in Scott v Metropolitan Police Commissioner:

In a great many and it may be the vast majority of fraud cases the fraud has been perpetrated by deceit . . . . It does not, however, follow that it is an exhaustive definition of what is meant by ‘defraud’ . . . (A)n agreement . . . to deprive a person of something which is his or to which he is or would be or might be entitled and an agreement by dishonesty to injure some proprietary right of his, suffices to constitute the offense of conspiracy to defraud.

Therefore, the critical component of the offense since at least the mid 20th century was not deceit but dishonesty.

Tackling the dishonesty question directly, Norris’s counsel had advanced the proposition that secrecy in itself—as found in the “typical cartel”—was not dishonest. The Divisional Court disagreed, finding that it was quite open to a jury to find that the mere secrecy inherent in a cartel was enough to constitute the “dishonesty” that is the core component of the offense, and citing a number of early precedents where criminal liability had been found. In contrast, the old civil cases Mr. Norris cited for the proposition he advanced had lacked “plain dishonesty.” For Lord

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17 In April 2002, the Serious Fraud Office (SFO) announced that it was using this charge as the basis for prosecuting a number of generic pharmaceutical producers suspected of defrauding the National Health Service by fixing prices. Press Release, SFO, Suspected Fraud on the National Health Service (Apr. 10, 2002), available at http://www.sfo.gov.uk/news/prout/pr_510.asp?id=510. On April 5, 2006, criminal proceedings were instituted against nine individuals and five companies. Following the judgment in Norris and a parallel case in the House of Lords, which is subject to reporting restrictions, the SFO announced it would amend the Generic Pharmaceuticals indictment and continue the prosecution. See TIMES ONLINE, Apr. 21, 2008, http://business.timesonline.co.uk/tol/business/industry_sectors/health/article3789126.ece?token=null&newImage=true. A preliminary hearing was opened on April 28, 2008, and has been adjourned until July 2008.


22 See, e.g., R v. De Berenger, [1814] 3 M&S 67 (conspiracy to cause public mischief by spreading false rumors of Napoleon’s death to drive up prices of government stock); R v. Lewis, [1869] Cox CC 44 (conspiracy to deceive by holding a mock auction with sham bidders).
Justice Auld, delivering the judgment of the Divisional Court, the critical point was not one of law at all, but simply one of degree; in his view, it was for the finder of fact to evaluate whether the conduct was dishonest on a case by case basis under *R v. Ghosh*. The Divisional Court saw no distinction between deceiving potential customers by secrecy or any other form of dishonesty; in its view, secrecy in the price-fixing context must nearly always have as its object misleading customers into believing they were paying a market, and not a rigged, price.

If the court went out of its way to distinguish the classic authorities, it may have been driven by a perception that attitudes to cartels and anticompetitive restraints had changed out of all recognition since the Victorian era when the paradigmatic *Mogul Steamship* case had established the principle that agreements in restraint of trade were not on their own actionable, still less indictable. In the view of the Divisional Court, under the law as it stands today, an agreement dishonestly to fix prices so as to cause prejudice to others is a conspiracy to defraud.

The House of Lords overturned the Divisional Court’s order, holding that as a matter of settled law price fixing could not constitute the common law offense of conspiracy to defraud unless accompanied by “aggravating features,” such as fraud, misrepresentation, violence, intimidation, or inducing a breach of contract. Agreements in restraint of trade might otherwise be void, but were not actionable at common law. The Lords noted that the line of civil cases ruling out conspiracy to defraud as a cause of action in cases involving restraint of trade, of which *Mogul Steamship* was the exemplar, had been affirmed as recently as 1985 in *British Airways v Laker*.

As for the criminal law, the Lords held that it was not “plain dishonesty” that distinguished from *Mogul Steamship* the cases where conduct had been found to be criminally indictable, but the aggravating features of misrepresentation and deception. In their view, the Divisional Court had misread the case law and failed to “address the principles for which *Mogul* has long stood as classic authority. . . . At no time up to the present has anyone . . . been successfully prosecuted for being a party or giving effect to a price-fixing agreement without aggravating features.”

In their Lordships’ view, where dishonest misstatement is connected with price fixing, it is the deceit, not the price fixing as such, which constitutes the criminal conduct of the conspiracy to defraud; the price fixing would simply be the occasion of the dishonesty and criminality. Moreover, even if “secrecy” could provide the necessary aggravating factor, it would be necessary to establish that it was the secrecy that caused the loss. As for the dynamic view the Divisional Court had taken of the development of the common law, the House of Lords stressed that the criminal law had to be certain, and that the requirement of certainty was not met if courts subscribed to the notion that at some later date the offense might evolve so substantially that they could take a different view in the future. For good measure, the Lords stressed that all the legislative materials relating to the passage of the Enterprise Act established the clear view of Parliament that cartels were previously outside the ambit of the criminal law.

**Commentary on the Lords’ Judgment**

In reviewing the opinion in *Norris*, one is left with the impression that the Lords were uncomfortable with modern perceptions of the underlying criminality of hard-core price fixing; inherent in their whole approach is the assumption that a cartel is little different from a contract in restraint of

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25 *British Airways v. Laker*, [1985] A.C. 58. The case was not brought to the attention of the Divisional Court.

trade. Nor, in focusing on the classic case law, with its emphasis on the need for deception and aggravating factors in price-fixing cases, did their Lordships consider their own more recent line of authority on conspiracy to defraud indicating that deception is not required for the offense. Since the mid-20th century, there has been a shift in emphasis in the case law on conspiracy to defraud; dishonesty, rather than deception, now appears to be the core element of the offense. Lord Diplock summed up the shift in legal position pithily in Scott:27

\[\text{[T]he purposes of the conspirators must be to cause the victim economic loss by depriving him of some property or right, corporeal or incorporeal, to which he is or would or might become entitled. The intended means by which the purpose is to be achieved must be dishonest. They need not involve fraudulent misrepresentation such as is needed to constitute the civil tort of deceit. Dishonesty of any kind is enough.}\]

The House of Lords now seems to have identified in Norris a special and more narrowly defined type of conspiracy to defraud that does require deception when price fixing is involved. True, they did not expressly state in Norris that “mere” price fixing is not dishonest; the rationale seems to be that as a matter of law price fixing cannot be conspiracy to defraud unless accompanied by aggravating elements like lies and deception. Some of the language at least suggests sympathy for the broader proposition advanced by Mr. Norris’s lawyers that secrecy on its own is not dishonest, so the opinion still leaves the whole issue of dishonesty as it applies in the cartel context shrouded in uncertainty.

**Implications of the Norris Judgment for the U.S. Enforcement Program**

The Norris ruling is a setback for the DOJ’s international anti-cartel enforcement strategy. The DOJ had regarded the original ruling as a precedent for further extraditions from other European jurisdictions where price fixing is not criminal but fraud is.28 The setback may, however, prove to be only temporary. The bid to extradite Mr. Norris himself is by no means ended. He could still be extradited on three related charges of obstructing justice and witness tampering for which the Lords upheld the extradition order. The case now goes back to the extradition judge to reconsider the Human Rights exceptions to extradition, which he had already decided against Mr. Norris.29

Moreover, while Mr. Norris’s supporters have publicly dismissed as “subsidiary” the three obstruction charges on which he still faces possible extradition,30 the Antitrust Division might not share their view of the gravity of the obstruction charges. The DOJ prizes its policy of bringing add-on charges against suspected price fixers who allegedly obstruct its investigations.31 Antitrust Division prosecutors may not be willing to abandon their campaign yet. The allegations made in the indictment and extradition application of destroying evidence, creating false records, and tam-


28 See Hammond, Charting New Waters, supra note 2.

29 Section 87 (1) of the Extradition Act 2003 requires the extradition judge to decide whether the person’s extradition would be compatible with his Convention Rights under the Human Rights Act 1998. The House of Lords believed that the issue should be revisited because the district judge had exercised his judgment on the basis that Norris was to be extradited on the main price fixing count, not just the “subsidiary counts.”


pering with witnesses paint a picture of deliberate contempt for the law.\(^32\) If extradited, Mr. Norris could yet be tried on serious charges carrying a maximum sentence twice as long as the Sherman Act allows.

\textit{Norris}, however, probably signals the end of the determined U.S. efforts to extradite Sherman Act “fugitives” from the United Kingdom on pre-2003 price-fixing charges. It is of course still possible, if prosecutors include in any application the sort of “aggravating factors” that the Lords insisted on (active lying and the like), that a future U.S. request for extradition relating to pre-Enterprise Act conduct based on conspiracy to defraud could be made to meet the requirements for dual criminality. Given the controversy surrounding any extraditions to the United States under the new fast track arrangements, it would take a very clear case, however, in the author’s view to persuade the British authorities to advance a “conspiracy to defraud” theory again on behalf of the United States after the drubbing they received in \textit{Norris}.

**Implications for UK Prosecutions**

If the \textit{Norris} judgment is a serious but temporary setback for the DOJ, the implications for anti-cartel enforcement in the UK are broader. To be sure, pre-2003 price fixing could still in theory be prosecuted as conspiracy to defraud if the Crown alleges and can show aggravating elements like positive deception and lies.\(^33\) The potential impact on extradition applications and prosecutions in England for conspiracy to defraud aside, \textit{Norris} casts some doubt on the robustness of criminal prosecutions for the cartel offense under the Enterprise Act.\(^34\) Section 188 of the Enterprise Act was not directly at issue in \textit{Norris}, but the judgment did not enhance the prospects of obtaining convictions in any future contested trial for the dishonesty-based cartel offense may have receded.

Central to the cartel offense is the use of “dishonesty”—a concept borrowed from the law of offenses against property—to encapsulate the underlying criminality of cartel conduct. Section 188 provides that an individual commits the offense if he “dishonestly agrees” with one or more persons to make or implement, or cause to be made or implemented, arrangements of the prohibited kind.

Dishonesty is nowhere defined in the Act. Commentators agree however that by default, juries will be directed to apply the two-stage \textit{Ghosh} standard: whether (1) the defendant’s actions were dishonest “according to the ordinary standards of reasonable and honest people;” and (2) if so, whether he realized those actions were dishonest according to those standards. The government’s declared objective in framing the offense was to make it “understandable to juries.” Whether the intellectual gymnastics demanded by \textit{Ghosh} achieve that laudable object is a matter of opinion.

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\(^{33}\) See supra note 17.

\(^{34}\) On June 11, 2008, three British nationals pled guilty to charges under the cartel offense and were sentenced to terms of imprisonment between two-and-a-half and three years. The guilty pleas were largely the product of a complex deal between the defendants, the DOJ, and Office of Fair Trading. The British executives sentenced in the United States in the \textit{Marine Hose} case have agreed to be immediately returned to the United Kingdom where they will plead guilty to the cartel offense. See Press Release, OFT, Three Imprisoned in First OFT Criminal Prosecution for Bid Rigging (Jun. 11, 2008), available at http://www.oft.gov.uk/news/press/2008/72-08. The sentences imposed by the English court mean that the defendants will not have to serve prison time in the United States and will be released after serving half their sentences. As the individuals saw it, there was a powerful incentive to plead guilty in England. And given that their cooperation made much of the case against them, the relative severity of the prison terms handed down on the guilty pleas—which involve a mandatory 30 percent sentencing discount—could even encourage future defendants to take their chance before a jury.
The British Law Commission struggled unhappily with the notion of dishonesty for years.\(^35\) In simple cases of “obvious dishonesty” under the Theft Act, English judges trying mid-level crimes have avoided \textit{Ghosh} and just told juries to “use their common sense.”\(^36\) A pragmatic option but one which could cause problems in cartel cases where juries specifically have to consider the mores of the murky cartel world that is alien to most of them. While the \textit{Ghosh} test resonated with the Divisional Court in \textit{Norris}, the Lords never saw fit to mention it at all, and its tortuosities could yet complicate any prosecution under the Enterprise Act.

Although the Lords made it clear they were talking of common law conspiracy to defraud, language in \textit{Norris} like “there are problems with the notion that mere secrecy can of itself render the price fixing agreement criminal”\(^37\) could prove a boon to defense lawyers in any Enterprise Act prosecution.\(^38\) Presumably, juries will have to decide what is “dishonest” on a case-by-case basis with nothing better to guide them by way of judicial assistance than the gnomic \textit{Ghosh} direction. The Office of Fair Trading, which has the main responsibility for investigating and prosecuting the cartel offense, cannot have been heartened by a recent poll showing that only 60 percent of the British public think price fixing is dishonest.\(^39\)

It would be remarkable if the thinking behind \textit{Norris} did not spill over to the cartel offense. It might not be enough for the prosecution to argue that the cloak of secrecy alone is the touchstone of criminality. Few companies reveal their legitimate business strategy to customers. Many cartels, however brazen, do not exhibit the sort of “aggravating factor” referred to by the House of Lords. Their underlying criminality lies in the element of secret and conspiratorial planning. The participants are not usually called upon to represent expressly to their customers that their prices are not rigged, but surely that is not the point anyway. Of course, to be effective, cartels have to keep their machinations from customers. However, the “spiral of delinquency”\(^40\) of underground cartels is encapsulated in the conspiratorial determination of its members to defy the legal prohibition and to take steps to avoid detection by the authorities.

After \textit{Norris}, it would take a bold prosecutor to invite a jury in a Section 188 case to find that “mere” secrecy equals dishonesty. How, defense counsel might plausibly argue, could their clients be expected to have realized their cartel was “dishonest” when no less a body than the House of Lords has held that typical price fixing could not be conspiracy to defraud? To convict, juries would have to find that the accused knew that the conduct was dishonest according to the notional standards of honest people. Moreover, the burden of proof lies on the prosecution to negate any clever defense arguments denying dishonesty on the basis of entirely subjectivized beliefs.\(^41\)

\(^{35}\) \textit{Law Commission, Legislating the Criminal Code: Fraud and Deception, Consultation Paper No. 155 (1999)}, available at http://www.lawcom.gov.uk/docs/cp155.pdf. The Law Commission finally decided to retain the concept partly because rejecting it might unsettle the law and partly because it believed that in practice in property cases the \textit{Ghosh} test was unproblematic. This may be because judges do not use it in cases of “obvious dishonesty.”


\(^{37}\) \textit{Norris}, [2008] UKHL at 16, at ¶ 60. Observers of hard core cartels may also be puzzled by the assertion by the Lords in the same passage that “it is not as if secrecy is always necessary for a price fixing agreement to be effective.”

\(^{38}\) Defense lawyers in \textit{Norris} argued that as a general proposition “the average cartel” was not dishonest since it did not usually involve direct misrepresentations to customers.


Extradition with the Cartel Offense as the British Offense

After *Norris*, the outcome of DOJ extradition efforts in reliance, not on conspiracy to defraud, but on the new cartel offense, might be less predictable than previously supposed. If conspiracy to defraud has been found wanting as the vehicle for extraditing pre-2003 price-fixing suspects, then the concept of “dishonesty” could prove equally troublesome for future extradition attempts using the Enterprise Act to provide the British offense. The Sherman Act does not require “dishonesty,” merely an intention knowingly to enter the criminal conspiracy with awareness of its likely consequences. Of course, the notional offense in the United Kingdom does not have precisely to match the elements of the offense for which extradition is sought by the United States. The absence of dishonesty as an ingredient in the Sherman Act offense does not prevent the defendant’s alleged conduct from being an extradition offense within Section 137 of the Extradition Act of 2003.

The question is whether the *conduct* alleged by the United States in the extradition request would constitute an offense in English law. Most Sherman Act violations will not involve more than the normal secrecy adopted by cartels to cover their tracks. Would that be sufficient, in the wake of *Norris*, to constitute the necessary “dishonesty” required by the cartel offense, or would additional circumstances have to be alleged in the request, such as positive deception or express representations that the price was not the product of collusion? The House of Lords in *Norris* confirmed that the extradition request may add the necessary color to the bare indictment description of the allegations so as to elevate the “conduct” alleged to have occurred within the jurisdiction of the United States to a notional British criminal offense. If, however, as a practical matter the bar for what constitutes dishonesty has been raised, it may not be easy even under the streamlined “no evidence” procedure for extradition judges in the United Kingdom to conclude that dual criminality is satisfied.

Reflections on the Concept of Dishonesty

Commentators remain perplexed by the selection of dishonesty as the defining element of the cartel offense. In the White Paper heralding the Enterprise Act, viable alternative approaches, such as building on the established law of conspiracy, were mentioned only in order to be dismissed. The only other option discussed—and also rejected—was to make a breach of Article 81 of the European Community Treaty and the national equivalent under the Competition Act a criminal offense. It made sense, of course, to avoid merely criminalizing existing administrative competition provisions and thus allowing clever defense arguments based on economics. Yet making dishonesty the key element achieves unintentionally exactly that undesired consequence and more besides. In an attempt to convince doubters in the business constituency that prosecutions would...
be rare and brought only in the worst cases, the White Paper even volunteered the suggestion that “[a] defendant could use as his defense the claim that he honestly believed he was acting in accordance with Article 81 or Chapter 1 (of the Competition Act).” Not only does this invite arguments of mistake of law inadmissible in prosecutions for most offenses; it also opens the back door to introducing precisely the sort of “economic” defenses the legislators wanted to avoid to justify the defendant’s “honest belief.”

The architects of the Act apparently believed that importing “dishonesty” would underscore the gravity of the conduct involved. To be sure, the term connotes moral opprobrium. But is it the right standard to establish the criminality of cartels? For some commentators, the explanations in the White Paper were incomplete, lacked cogency, and failed to identify or address any of the significant difficulties that arise. The steering group appears to have paid little attention to the considerable legal literature pointing out the pitfalls of a dishonesty standard. The notion does adequate service in straightforward offense against property cases, but seems unnecessary and confusing as a requisite mental element of the cartel offense.

As the Law Commission observed, the Ghosh approach requires the fact finder to set a moral standard of honesty and determine whether the defendant's conduct falls short of that standard. It calls for a moral inquiry and the making of a moral judgment: “to say that something is dishonest is to characterize the existing facts, not add another fact.” In the English legal system, this is an unusual function for a jury, whose normal role is to determine whether the defendant's conduct falls within the definition of the offense. Using the concept as a determinant of guilt must very likely also result in endemic inconsistency from case to case.

While the advocates of the UK legislation presented the concept of dishonesty in simplistic terms, the first leg of the Ghosh direction (“ordinary standards of reasonable and honest people”) introduces an undefined populist element far removed from any frame of reference relevant to cartel analysis, while the second subjective limb of the test “allows an unacceptably open-ended range of defenses—in particular, it does not exclude the ‘Robin Hood’ defense and it allows something like a mistake of law to be a defense.” There is an inherent contradiction in an assessment that requires first a value judgment that conduct was dishonest according to some notional standard and then allows defendants to deny liability on the basis of a subjective belief state. And paradoxically, while the Ghosh test introduces an essentially populist judgment of dishonesty, its practical result is most likely to favor those individuals with the sophisticated mindset.

46 Id. at Point 7.31.
47 See, e.g., Fisse, supra note 41, at 253.
50 See supra note 35.
and financial resources to exploit the myriad avenues for escaping responsibility for their actions in a manner not available to less well-heeled defendants.\textsuperscript{52} No other country, with the exception of Australia, which is now reportedly having second thoughts, has even considered using “dishonesty” to capture the criminality of cartels.\textsuperscript{53}

The guilty pleas in the \textit{Marine Hose} case have provided a boost to the Office of Fair Trading and the cartel offense. How future contested prosecutions may fare is less obvious. It is certainly legitimate to ask whether, in embracing the dishonesty concept, the framers of the Enterprise Act too readily dismissed the option of adapting from the “trusty but not rusty” weapon of conspiracy the concept of the conspiratorial agreement, with its connotations of secret planning in smoke-filled rooms, to provide the necessary “spiral of delinquency.”

\textsuperscript{52} See Fisse, \textit{supra} note 41, at 265–66, exploring the implications of the “inegalitarian bias” built into the dishonesty concept.

Resale Price Maintenance and the Rule of Reason

Howard P. Marvel

Wayne Woodrow (Woody) Hayes, the longtime football coach of The Ohio State University, famously maintained that “[t]here are three things that can happen when you pass, and two of them are bad.” Hayes implemented his aphorism by relying heavily on running plays—his offense was widely known as “three yards and a cloud of dust.” The aphorism remains true, but its relevance has declined steadily as football teams, including Ohio State, have come to rely more heavily on their passing games.

Woody’s legendary intransigence cannot compare to the conservatism of a Supreme Court dealing with resale price maintenance (RPM). Economists have long recognized three possible effects of RPM, and, as with passing, two of them are bad. RPM can increase the efficiency of distribution and in so doing, it can afford suppliers a powerful tool with which to compete more effectively with rival brands, thereby stimulating interbrand competition. The two bad outcomes involve furthering a cartel, the first at the manufacturer level and the second among retailers. Manufacturer cartels may be facilitated when pass-through retail pricing makes cartel cheating at the supplier level more transparent. Alternatively, retailers may be in position to force a manufacturer to serve as the cat’s paw of their cartel agreement.

The probabilities attached to each of these outcomes appear to be changing. Economists have posited an ever-widening set of conditions under which RPM can increase efficiency. The emergence of a panoply of discount retailers means that a supplier who shuns a retail cartel can expect to have available a number of distribution alternatives. The number of cases in which RPM can plausibly be alleged to have facilitated a manufacturer cartel can be counted on one’s fingers. These changing assessments of the likelihood of good and bad outcomes yield the conclusion that it makes economic sense to finally convert the per se outcome of *Dr. Miles*¹ into a rule of reason treatment, as the Court did in *Leegin*.² No longer are firms subjected to a rule that Judge Richard Posner has characterized as a “sad mistake. There is neither theoretical basis, nor empirical support, for thinking the practice generally anticompetitive.”³

The task at hand is now to predict how the post-*Leegin* rule of reason should and will be structured. The goal of that rule should be to permit efficiency-enhancing uses of RPM while simultaneously minimizing the damage from RPM used to facilitate either a manufacturer cartel or a dealer cartel. The Court has suggested screens that would help to remove a number of instances of RPM from consideration. But safe harbor screening leaves out the interesting cases in which either a dominant manufacturer employs RPM, a large retailer or a group of retailers insists on margin protection, or RPM is widespread among firms in a particular category. In such cases,

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¹ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).
the difficulty of obtaining evidence of the efficiency or anticompetitive effects of RPM means that the default rules incorporated in rule of reason assessments will shape case outcomes to an unusual degree.

A presumption that RPM is anticompetitive unless rebutted by a showing of efficiencies will not move the needle far from per se illegality, given the difficulties of conclusively proving efficiencies. In contrast, a default rule requiring proof of anticompetitive impact will also be tough to overcome, mostly because such anticompetitive outcomes appear to be rare. A rule between these polar defaults will be difficult to implement, as comparison periods with and without RPM are unlikely to be available. Indeed, when firms have agreed to drop RPM, the results for interbrand competition have ranged from troubling to disastrous. Without such comparisons, efficiency explanations for RPM run a significant risk of being dismissed as pretextual. If the problem of sorting uses of RPM according to their economic effects is tough, shortcuts can result in very inefficient outcomes. For example, we will see below that the states have continued to espouse an economically inappropriate price effects test.

At the end of this article, I provide suggestions for dealing with the transition period between illegality and the emergence of an agreed-upon rule of reason framework.

Some Economic Preliminaries

The efficiency-enhancing uses of RPM have the effect of shifting the demand schedule for the product to the right—that is, if the price of the product to consumers remains the same as before, consumers increase the number of units they demand. But such demand promotion is costly. Retail margins, however, are protected from erosion by RPM. Thus as the demand schedule shifts right, the price of the product at retail will rise unless the manufacturer imposing RPM reduces its wholesale price by an offsetting amount. It is thus possible that the price of the product to consumers will rise as a result of RPM enforcement, even when no cartel is present.

This effect is no different than any other investment in demand shifting behavior. A firm that advertises to increase the demand for its products may be able to pass some portion of its advertising cost through to consumers in the form of higher prices. Similarly, a firm that invests heavily in R&D in hopes of improving its product may increase its price if consumers value the resulting improvement. These investments in increasing demand are the same as those of RPM used to increase the competitiveness of a firm’s product relative to its rivals. Any of these sorts of increases in interbrand competition may yield higher prices. The two cartel explanations for RPM have the same implication for prices. In each case, a cartel takes actions to increase prices, but since the demand schedule is unchanged, higher prices are coupled with lower volumes. The movement is along a given demand schedule, rather than a shift in demand, but note that the result for prices is indistinguishable from that resulting from efficiency-enhancing RPM. Prices will rise in consequence of a cartel, and may rise in response to RPM. This means that price changes have no value in sorting bad from good outcomes of RPM.

What distinguishes bad from good RPM? The answer is simple: the output effect. A cartel shrinks output, while efficiency-enhancing RPM increases it. Implementing the test is not so simple, as we will see below. In most cases, one would need to experiment with limiting RPM to dis-

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4 Note that the possibility that prices “may” increase does not mean that retail prices must increase. The effects of RPM on prices will depend on the nature of the demand shift that higher margins elicit. The manufacturer may choose to offset the margin increase by lowering its wholesale price.
cover output effects, harming the brand capital of a manufacturer that was competing by pro-
tecting margins.

Nonetheless, simple economics provides the first component of a sensible—that is, econom-
ics-oriented—rule of reason for RPM. A trier of fact who sees that with RPM, prices rose, can con-
clude nothing about whether or not RPM was efficiency enhancing. If, in addition to a price
increase, consumers bought more of the product, then the demand schedule for the product must
have shifted out, and cartel explanations can therefore be rejected.

**Previous Rules of Reason for Vertical Restraints**

If the history of the treatment of past vertical restraints is a useful guide to forming predictions
about the shape of the rule of reason in the post-*Leegin* world, it may pay to consider two previ-
ous evolutions from per se to rule of reason treatment for such restraints.

**Non-Price Vertical Restraints.** The antitrust treatment of non-price vertical restraints is a much
compressed mirror of that of vertical price restraints. In 1963, no broad condemnation of non-price
restraints was deemed appropriate because “too little was known about the competitive impact
of such vertical limitations to warrant treating them as per se unlawful.”

Apparentl, however, this perceived lack of knowledge did not extend to those teaching or trained at Harvard. Within four
years, the Court faced a similar challenge to exclusive territories in *Schwinn* and responded with
a per se rule against the practice. The arguments for imposition of per se status came from
impeccable sources—the Assistant Attorney General for Antitrust, Donald Turner, supported a
brief written by a young Harvard-trained lawyer in the Solicitor General’s office, one Richard A.
Posner. The Court thus was encouraged to endorse “then prevailing thinking of the economics
profession [to bear] on restricted distribution.”

Posner, benefiting from remedial training at the University of Chicago, soon came to see the
errors of the Harvard view, flaws well summarized by Oliver Williamson:

Alas, what Turner and Posner took to be the then prevailing thinking of the economics profession was
deeply confused. . . . [T]he prevailing thinking was self-limiting in three respects: (1) there was little
appreciation for the possibility that product differentiation (as opposed to homogeneous product
market exchange) might be the source of economic benefits, (2) there was even less appreciation for the
possibility that the integrity of a distribution system could be compromised by subgoal pursuit among
the parts (in this case, the individual franchisees), and (3) there was a preference for internal organi-
zation (hierarchy) over market organization (interfirm contract) if vertical restrictions, for whatever rea-
son, were to be applied.

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8 **Id.** It is worth noting that the Harvard view that animated *Schwinn* was derived from the Structure-Conduct-Performance (SCP) view that was coming under strong attack from the Chicago School and elsewhere. Williamson reports that “Turner and Posner were confident that SCP thinking on which they relied for authority was entirely sufficient.” It is interesting in this regard to note the extensive reliance of Justice Breyer’s dissent in *Leegin* on the work of Professor F.M. Scherer, the author of the canonical treatment of that approach (F.M. SCHERER & D. ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 558 (3d ed. 1990)). *Leegin*, 127 S. Ct. at 2729. Breyer also relies on a brief coauthored by Scherer, see, e.g., *Leegin*, 127 S. Ct. at 2730; see also Brief for William S. Comanor and Frederic M. Scherer as Amici Curiae, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (No. 06-480).
Nine years later, the Court fixed its error in *Sylvania*, returning to a rule of reason.\(^9\) Some commentators argued that the *Sylvania* Court did not go far enough—that per se legality was appropriate.\(^10\)

What happened? The answer is provided by the title of Douglas Ginsburg’s catalog of post-*Sylvania* decisions, *Vertical Restraints: De Facto Legality Under the Rule of Reason*.\(^11\) Not all non-price vertical restraints are, however, automatically legal.

The treatment of exclusive dealing is the principal exception to the strong presumption that non-price vertical restraints are efficiency enhancing. This exception is sensible, since other vertical restraints typically enable manufacturers to create property rights that protect promotional investments of dealers. More restrictive rights can harm the manufacturer’s interest, thereby placing a check on the manufacturer’s willingness to define and enforce the right. Exclusive dealing works similarly, but the promotion protected is the manufacturer’s own, and the check to providing too expansive a property right is accordingly weaker.

**Maximum RPM: The Post-Khan Rule of Reason.** Just as for exclusive territories after *Sylvania*, the rule of reason that has emerged for maximum RPM after *Khan* is essentially per se legality. This is sensible, for the harm done by a manufacturer that places a cap on resale prices is not likely to be large, and the benefits to the prevention of double marginalization by retailers can be substantial for consumers. For a rule of reason computation to yield a condemnation of maximum RPM, it would be necessary to have an example of an inefficient outcome arising from a manufacturer-enforced price cap. None has been forthcoming. Indeed, the most noteworthy aspect of the *Khan* decision is how long it took the Court to overturn *Albrecht*.\(^12\)

Part of the reason for the dilatory response to *Albrecht* may have been the relative insignificance of maximum resale price maintenance. A Shepard’s citation analysis of *Schwinn* yields twenty-nine decisions that followed the opinion, or approximately three per year for its effective life. In contrast, *Albrecht* was followed seventeen times, or slightly more than one time every two years. But once *Khan* was handed down, similarly to the *Sylvania* outcome, the emergent rule of reason has been virtually indistinguishable from per se legality. For instance, in *Mathias v. Daily News*,\(^13\) in a complaint against a newspaper distribution system raising issues reminiscent of *Albrecht*, the defendant was granted summary judgment on plaintiff’s maximum resale price maintenance claim. Maximum RPM of this type is the least likely to find favor in a rule of reason world. Now that newspaper distribution has passed scrutiny, little else is likely to fail.

**An Unreasonable Rule of Reason: The States and Nine West**

The initial skirmish in the coming war over the RPM rule of reason has already occurred. Nine West, a manufacturer of women’s shoes, petitioned the FTC to modify an order preventing it from employing RPM. The petition claims that

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\(^9\) In doing so, the Court flip-flopped on its earlier abandonment of the holding in *White*. It is interesting to note that the Court characterized its *Schwinn* opinion, coming four years after *White*, as a “sudden change in position.” *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 (1977). Yet in his *Leegin* dissent, Justice Breyer treats the decision to change a long-established precedent based on dubious economic reasoning as unjustified. *Leegin*, 127 S. Ct. at 2730–34. Had each of these views been adopted, we would have had an emerging “Goldilocks” doctrine of reversing precedent neither too soon nor too late, but only when the time was just right.


Nine West is at an unfair competitive disadvantage because it is prohibited from entering into minimum resale price maintenance agreements of the kind now available to its competitors under the *Leegin* decision. Continuing to prohibit only Nine West from entering into minimum resale price maintenance agreements that the Supreme Court has acknowledged have procompetitive effects is decidedly not in the public interest and therefore such prohibitions should be vacated.\(^{14}\)

In a supplemental declaration, Nine West explained that it did not seek a declaration that it could do what it pleases in regard to setting resale prices, but that it merely wished to take its chances in rule-of-reason land instead of the pricing prison it agreed to enter.

On numerous occasions, Nine West executives have been forced to decide between unilaterally terminating deep-discounting retailers that were harming brand integrity and other service-providing retailers, or abiding the discounters’ harmful pricing. In such instances, less extreme measures, such as suspension of—or at least discussion with—the deep-discounting retailer would have been preferable, but would not have been protected under *Colgate*, or permitted by the Order.\(^{15}\)

RPM was thus offered by Nine West as a less restrictive alternative for structuring distribution compared to the draconian *Colgate* approach.

In a response to the Nine West Petition, twenty-seven states joined in asserting that “Nine West's activities are ‘inherently suspect’ because they raise prices for consumers and violate the antitrust laws because nothing in the Petition justifies those higher prices.”\(^{16}\) The states argued that when they confronted Nine West with the per se illegality club and demanded “your money or your life,” Nine West forked over its wallet to the tune of $34 million, $31 million of which was contributed to the women’s charity of choice in each state. The states apparently considered it churlish that when the threat of the club is gone, Nine West no longer considers the contract it signed under considerable duress to be valid.

The states argued that “Minimum vertical price-fixing is a restraint that usually raises prices for consumers—the very opposite of consumer welfare. Because Nine West’s activities did that to the tune of $45.7 million, Nine West's activities should be deemed ‘inherently suspect’ under the *PolyGram* framework.”\(^{17}\) But note that the approach of the states would gut the *Leegin* decision. Interpreting the states’ concern about prices as instead regarding margins, it is clear that no imposition of RPM for purposes of preventing free riding would pass muster under this unreasonable rule of reason. As we discussed above, acceptance of the states’ position requires that economics be consigned to the same irrelevance that it occupied under the per se standard.

A simple example will illustrate why. Years ago, before Marshall Field & Co. was swallowed by Macy’s, Field’s was widely considered to be a leading arbiter of taste for Chicagoans. But inspection of the Maxwell Street flea market located conveniently to the University of Chicago campus often yielded merchandise that bore the Field’s imprimatur. Indeed, one could obtain speaker systems that still had Field’s packaging and stickers affixed. Such merchandise was typically offered in close proximity to vendors selling like-new tires conveniently pre-mounted on wheels (another

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\(^{17}\) Id. at 5–6.
instance of nearly free riding). The author can attest that the prices at which the Field's-labeled speakers were available were substantially below those for identical merchandise at the Field's State Street emporium located not far to the north. The consumers who purchased at bargain prices appeared to find their welfare enhanced by their ability to do so.

The states simply argue that a supplier whose price rises in response to RPM is conferring a benefit on its dealers that provides no benefit to consumers. According to the most basic law of demand, this will reduce the amount of the product that consumers purchase. If they wish to maintain this position, the states should at least be required to show some reason why the supplier wishes to impose RPM that is not in its interest. Even if a full output test is not required, there should at least be a requirement that it is plausible that the supplier somehow benefits by selling less of its product as it receives the same or a lower wholesale price owing to higher dealer margins.

As a fall-back, the states then argue that even if RPM works, it may not be the most efficient way to generate promotional services. So what are the alternatives? We could tell the manufacturer to avoid RPM, which suppresses distributor price competition, encouraging the manufacturer instead to establish exclusive territories that eliminate all intrabrand competition. Less restrictive? No. Legal? Likely, yes.

Another alternative is to tell the manufacturer to pay retailers for services rendered. The plan would work something like this: The supplier identifies a fancy chain store as a trendsetter, and the hole-in-the-wall discounter down the street as of no particular value in encouraging consumers to buy its product. So it offers the fancy chain store a lower price than the shoestring discounter. Not only does this require considerably more monitoring than RPM (the fancy store can pocket any payments and not push the product), but it also is rather cavalier about the Robinson-Patman issues raised.

Nine West suggests that the next best alternative is one of keeping RPM in place through adherence to the Colgate doctrine. Terminating dealers who discount one’s products is not a less restrictive approach than encouraging them to continue to sell the products at the preferred price.

In the end, the states’ proposed rule of reason is unreasonable because it is incapable of distinguishing between procompetitive and anticompetitive uses of RPM. It will be nearly impossible to distinguish the two with pricing evidence. We will need a standard based on economics. Unfortunately, that will be difficult to provide because, as we shall see in the next section, it is not an easy task to evaluate whether an efficiency explanation for RPM is to be credited.

Affirmative Cases for Efficiency
Nine West has argued that its inability to enter into RPM agreements with its dealers prevents it from competing successfully with other shoe manufacturers. There are a number of such competitors. Defining the market as women’s footwear sold through department and national chain stores, Nine West reported its own market-leading share as 10.4 percent. Brown Shoe ranked second at 6.2 percent, with reported shares of ten other rivals accounting for a collective share of just under a quarter of the market.

These shares are not strikingly large, but in the aggregate, resale price maintenance is a widely practiced tactic in selling shoes. According to Nine West:

I am told by Nine West executives that they believe that Coach, Inc., Deckers Outdoor Corporation, C&J Clark International Limited, Born Footwear, Ecco and Brown Shoe Company all use some type of minimum resale price maintenance. Also, Coach, Merrell, Born, Ecco, Sofft, Clarks, Kate Spade, UGG
and BCBG/BCBG Max Azria are all competitor brands that have been excluded from department store point-of-sale coupons, based on a review of fine-print exclusions in Macy’s, Bloomingdale’s and Lord & Taylor’s point-of-sale coupons appearing in publications such as The New York Times, the Stamford Advocate, and direct mail promotions.18

Does this parallel behavior mean that the manufacturers are colluding? Not likely—many of them market different lines through discounters.

Shoe manufacturers that are more significant in other segments also appear to employ RPM. Keds, primarily a producer of children’s sneakers, was stepping out in the early 1990s, but the Keds brand peaked at that point.19 Why? It could be coincidence that in 1993, Keds “agreed to pay $7.2 million to settle sneaker price-fixing suits brought by 50 states, the Federal Trade Commission and the District of Columbia. . . .”20 Reebok, at the time the second largest athletic shoe company, has also paid an RPM settlement.21 Reebok’s decline to number 3 in the athletic shoe market likely began prior to its RPM settlement and derived from a variety of factors, but one is particularly relevant: “in the last few years Reebok has been unable to increase shelf space with retailers.”22 Prospective Air Jordan purchasers are apt to conclude that Nike has a good grasp of the Colgate requirements.

Nine West focuses on the widespread use of RPM to sell shoes as evidence that its consent order places it at a competitive disadvantage. But in terms of the application of a rule of reason to RPM for shoes, the widespread use of the practice could indicate either that shoe retailers are powerful enough to force manufacturers to enforce a dealer cartel, or, alternatively, that the manufacturers adopt RPM for purposes of increasing enforcement of their own cartel scheme.

For shoe marketing, neither of these anticompetitive alternatives seems plausible. Does the Foot Locker chain dictate to Nike and rivals? Nike does not sell shoes through Target stores, but it certainly could. A manufacturer cartel is even less likely than a retailer cartel. If there were an agreement to maintain retail shoe prices in order to ease policing of a supplier cartel, Nine West would be legally obliged to cheat on the cartel—not an undesirable outcome.

If Nine West were required to prove that its RPM is efficiency enhancing, it would face a considerable challenge. Consider the services that it identifies as necessary to its success: “desirable location, hours, floor space, etc.” Will a customer partake of the location offered by a retailer only to purchase at a discount elsewhere? If a store has convenient hours, will a customer shop at times when a discounter is closed while deferring a purchase until the discounter opens? These services are not subject to free riding and are, in any event, difficult to prove. It is clearly possible to free ride on the reputation of a highly regarded retailer, identifying the brands that the

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19 Shawn Neville, President of the Keds Corporation, told shareholders in 2007 that “We believe that that young 20 year old consumer is so important, and it was very important for us when the brand peaked in the early 90s . . .” Collective Brands Inc. Shareholders Meeting—Final FD (Fair Disclosure) Wire, Sept. 27, 2007. Keds shoes have moved down the price/value distribution, and now sell for lower prices and margins than the sneakers of rival firms. But the company is trying hard to increase both prices and margins as part of a drive to increase its “premium-ness” (Neville’s term).
retailer carries and then purchasing them elsewhere at a store that is distinguished only by its low price point. But such a service is intangible—how is the manufacturer to prove that it sells more shoes due to the willingness of the high-reputation dealer to carry its products? It is hard to see how proof can rise beyond assertion by the manufacturer’s marketing managers. It will be even tougher to establish an efficiency explanation based on free riding, though inventory and intangible services arguments are each plausible.

The FTC’s Decision
On May 6, 2008, the FTC granted Nine West’s request to permit it to enter into RPM agreements with dealers. Nine West was not required to demonstrate the existence of procompetitive efficiencies. The Commission focused instead on the possibility that RPM could have anticompetitive consequences, a possibility that was dismissed summarily: “Nine West has demonstrated that it lacks market power and that Nine West itself is the source of the resale price maintenance.”23 The willingness to dismiss the possibility of a manufacturer cartel is somewhat surprising, given the widespread use of RPM in conjunction with the sale of women’s shoes. Likewise, Nine West’s interest in employing RPM was taken to be enough to rule out the possibility of its knuckling under to retailer pressure. It would appear that any firm willing to enforce a Colgate RPM scheme would likely be able to demonstrate that it was acting in its own interests, not that of retailers.

The unanimous decision by the Commission was particularly surprising in view of Commissioner Harbour’s previously expressed view that “Vertical minimum price fixing is almost always harmful to consumers . . . it typically leads to higher prices without bestowing countervailing benefits.”24 The Commission’s sensible threshold inquiry made it unnecessary for Nine West to embark on the difficult task of proving, rather than merely suggesting, that its RPM would yield efficiencies. But the future will likely hold tougher challenges, including cases with large-share suppliers and/or very significant retailers. The Nine West outcome is encouraging, but far from the final word on the RPM rule of reason.

Coping with a Rule of Reason World

Proving Efficiencies. The difficulty with proving efficiencies is that the strongest proof will be available after your client goes belly-up. The hearing aid manufacturers that agreed to drop their use of exclusive dealing disappeared within a year. The channel within which they operated shrunk substantially and would have disappeared had not one manufacturer chosen to fight. Interbrand and interchannel competition was crushed.25

Levi, Strauss fared better after eschewing RPM. Its sales and profits rose, albeit briefly, as its distribution expanded and prices fell. But the company lost the top end of the market to the fashion jeans brands that stepped into the upscale void that resulted. Its short term success eroded and was followed by a lengthy decline. The Gap, Levi’s’ nemesis, emerged as an integrated marketer/retailer, converting from a free-rider to a strictly limited distribution alternative effective in an era hostile to RPM. Levi’s tried the same tactic, but the dual distribution it employed proved unwieldy.


Firms that did not adjust to the anti-RPM world, like Arrow Shirt, the long-time leader in men’s shirts, simply crumbled. Vertical integration in place of RPM showed up in department stores as well, as they increasingly relied on private brands.

The carnage has continued. When the states attacked Salton’s RPM and exclusive dealing, the company ruled segments of the small appliance market. No more. By 2005, the company was described by Business Week as “on the ropes.”26 Were prices lower once Salton dropped RPM? An Internet search suggests that the answer is yes: Salton’s George Foreman grills are now much cheaper than competing versions from Cuisinart. Notice, however, that the low prices of the George Foreman grill have been associated with the demise of the company. It is difficult to argue that such low prices benefit consumers who no longer choose to purchase Salton’s products.

Nine West’s market share used to be 20 percent. It is now 12.5 percent. There is no easy way to determine whether these figures are commensurate. Even if Nine West’s share has fallen with its inability to protect quality certifying retailers, one cannot tell with a sample size of one whether a Nine West decline stems from the absence of RPM, from marketing incompetence, or from poor product design. Nor do we know if the consumers simply tired of George Foreman commercials at 3:00 a.m. But as the number of cases mounts, it becomes apparent that at least in some such cases, antitrust policy has substantially impaired competition.

It is, however, difficult to prove that a particular instance of RPM is efficiency enhancing. An efficiency explanation risks being judged a pretext for some other nefarious goal. Some examples can illustrate the problem.

- When Levi’s was charged with RPM, the company’s experts sought services that they could argue that RPM would protect. The search yielded two candidates, fitting rooms and inventory. Neither of these was a very attractive candidate. Would a customer try on jeans in a fancy department store fitting room and then buy at the Gap store? Did the Gap fail to provide so much as a closet? And would a customer try on a pair of hard-to-find 60" waist, 22" inseam Levi’s in a department store and then free ride on that inventory elsewhere? If the free-rider avoided the inventory cost of the jeans, then how could the customer find those odd jeans more cheaply at the discounter?

We now understand that Levi’s might well have wanted to obtain and protect the intangible services of high-fashion stores whose very decision to carry Levi’s provided consumers with certification of the quality and stylishness of their jeans purchases. In addition, it is now apparent that Levi’s expressed desire to foster inventory holdings does rationalize its RPM, even though the mechanism is not through protection against free riding. But the explanations provided at the time of the RPM litigation do, indeed, appear to have been pretextual—or, at a minimum, poorly understood.

- Starter Sportswear offers an illustration of a free-rider explanation for its no-transshipment policy allegedly aimed at maintaining high retail prices, which was accepted by a court even though it was likely pretextual. Here, as in Levi’s, there was an efficiency-enhancing explanation for its distribution policy, but a more likely impetus for the policy is that Starter was attempting to induce its retailers to hold a broader range of its products than those retailers preferred. Trans Sport, a wholesaler, was shipping inventories between retailers, in the process undoing Starter’s preferred inventory holdings. Once again, as in Levi’s, the inventory holdings of Starter retailers were not subject to free riding.27

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Justifications for RPM thus must be formulated with considerable care and must conform to the facts of the market in question. It is useful to think about RPM well in advance of the threat of litigation. Here are some suggestions for initiating such a process.

Judge Frank Easterbrook has provided a clear statement of the problem of proving that a business practice is efficient: 28

It is easy for a judge to find an efficient rationale to be either pretextual or unpersuasive. “Not persuaded” is a common answer. Many times there are no satisfactory explanations. Their development comes too late. Other times the explanation is very difficult. Even when people know why business practices work—which is not very often—the explanation is hard to convey. It may entail some fancy theory or complicated econometrics. What can be conveyed in the academic seminar or the corporate board room is hard to articulate in a trial, when the judge and jury lack economic training and business expertise. The explanations may show how cooperative practices (or practices that exclude or harm rivals), which appear at first glance to be restrictive, will have longer-run benefits in competition. Such explanations meet hostile reactions.

The response “not persuaded” is natural when a judge is presented with a novel and difficult explanation of complex behavior. The benefits will not be precisely measurable. What evidence would suffice? The benefit of any arrangement is its improvement over the next-best method of obtaining the same objective. If it is hard to find what a given practice does, it is impossible to determine the difference in efficiency between a known practice and some hypothetical alternative.

Note that the skepticism can take either the form of “not persuaded,” or an assertion of “pretext”; since the business people need not understand why a practice works—it need merely prove effective—an economic explanation can easily be found pretextual.

But experience with the prohibition of vertical price restraints teaches that their absence is often catastrophic for the firms in question. This experience suggests that a rule of reason should appropriately place a burden (and not simply a market power screen) on those who attack such restraints to provide a plausible explanation for how they might adversely affect competition. Because the Court in Leegin appears to accept that such adverse effects are to be expected at most through facilitation of a dealer or supplier cartel, it seems likely that the emerging rule of reason should require a cartel component.

Note, however, that this cartel evidence requirement will not come into place easily. The states recently extracted a settlement from Herman Miller over its alleged RPM as applied to the company’s iconic Aeron chairs. But Herman Miller cannot collude in a market defined to consist solely of its own chair, and it is implausible to imagine that retailers as a group could force the company to undertake distribution restraints that were not in its interest.29

RPM Advice for the New Rule of Reason World.

1. Ask your clients to explain why they want to impose RPM. The answer may be because its use lets them compete more effectively with rivals in some manner. Such an answer will be unlike-

28 Frank Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 8 (1984). Judge Easterbrook is broadly skeptical about the ability of courts to apply rules of reason successfully.


While the Aeron chair has achieved iconic status, there are a number of rival offerings. Moreover, the consent order covers only sales by the Herman Miller for the Home division, which accounts for only about two percent of Herman Miller sales. Given the relatively small amount that Herman Miller agreed to pay ($750,000) and the express permission in the injunction for a Colgate program (Consent, § IV, D, at 5), the company may have determined that presenting a case for RPM in the post-Leegin world was unlikely to be worth the expected cost. Thus despite the apparent availability of an efficiency defense and the low likelihood that the States could have shown a tangible anti-competitive impact, the States were able to prevail on what appears to be a charge related only to price effects.
ly to be enough to carry the day should litigation emerge. Further reflection is suggested. Do not underestimate the importance of RPM as a competitive tool, but recognize that it carries considerable legal risks in the near term.

2. Listen carefully to what those with marketing responsibility consider important. The answer may be something like the need to obtain adequate floor space or inventory at leading retailers. Since these factors are not subject to free riding, it makes sense to document their success in obtaining distribution, and to document cases where their efforts have fallen short. If litigation does loom, do not immediately embrace the first pre-sale service that comes to mind as an explanation for RPM.

3. Does your client believe that it can unilaterally adopt its distribution restraints? “I cannot control my distribution unless my rivals also do so” is an answer that should trigger considerable investigation into the alternatives available to RPM use. If RPM is employed, it is particularly important to document its procompetitive effects.

4. RPM is just one way of many to structure distribution. Alternative vertical restraints are safer, and may be worth trying even if RPM appears more effective. Have your clients considered direct payment for services or inventory holdings? These payments can be problematic, as 3M discovered in LePage’s, but evidence that the alternative has been investigated may be useful. If these have been considered and rejected, the investigation should be documented. It may be that RPM is in fact less restrictive than alternative restraints. Documentation on this point will likely be valuable in the event of litigation.

5. Be wary of too much success. Sadly, the antitrust laws have long tended to punish firms that come to dominate their market segments. The tendency may have atrophied somewhat elsewhere, but it remains alive and well in the RPM area. The experience of firms that have lost their ability to structure distribution and have shortly thereafter fallen on hard times should be both a cautionary tale and an inducement to consider other restraints as substitutes for RPM, even if they are less effective.

**The Colgate Approach.** It may seem attractive to advise clients to continue to announce price policies and to terminate retailers who deviate, relying on the absence of a contract with dealers to protect against RPM charges. Courts have been hesitant to find contracts due to their need to work around the per se rule. With that rule gone, manufacturer-dealer relationships no longer need to be viewed through Colgate-tinted glasses. The willingness of courts to tolerate implicit agreements will be increasingly difficult to maintain.

**Conclusion**

We do not know the shape of the rule of reason that will emerge for minimum RPM, but it is unlikely to be as lenient as those that appeared for other vertical restraints. RPM is a powerful tool for improving the effectiveness of distribution. For market-leading firms, its use will remain legally problematic for some time. It will be difficult to obtain appropriate recognition that price effects are not useful for the evaluation of RPM.

The past treatment of vertical restraints has been characterized—accurately, in my view—as “an intellectual failure of imposing dimensions.” But we know from the difficulty of overturning Dr. Miles that old intellectual errors die hard. The emerging rule of reason should reflect our understanding of the potential efficiency gains available from RPM. The difficulty of establishing those gains in particular settings suggests that caution should be exercised in embracing those gains.

30 Richard A. Posner, Antitrust Law, supra note 3, at 188.
Practitioners have had little guidance on how a jury would actually evaluate a challenge to resale price maintenance (RPM) under the rule of reason—and what a jury's evaluation might teach the counselor about structuring an RPM program in the first place. That is because, for almost a century, RPM agreements have been treated as illegal per se under both state\(^1\) and federal antitrust laws\(^2\)—illegal, that is, because courts presumed, rather than required proof of, actual anticompetitive effects in the particular factual setting of the agreement.

For decades, however, economists have urged various justifications for RPM programs, suggesting that in many cases an RPM program can be procompetitive. These arguments have been in the ascendency for many years and played a major role in the Supreme Court's 2007 decision in *Leegin*,\(^3\) overruling the per se rule established in its 1911 *Dr. Miles* decision.\(^4\)

The rule of per se illegality for RPM agreements meant that real-life litigation always turned on whether there was an *agreement* between the manufacturer and one or more of its resellers, as opposed to the manufacturer's unilateral adoption and announcement of a *policy*. If the finder of fact determined there was an "agreement" to charge a specific price or price level, the agreement was judged illegal per se, eliminating the need to ascertain whether it had actual, unreasonable economic effects in the particular circumstances. In contrast, a manufacturer's unilateral policy was not an "agreement" to which Section 1 of the Sherman Act could apply, even if the resellers chose to follow the policy—presumably yielding the very same economic effects as a banned agreement and, once again, no occasion to investigate whether it produced actual, unreasonable economic effects.

Elimination of the per se rule (at least in cases brought under Section 1 of the Sherman Act\(^5\)) means that issues that have lain dormant for almost a century must now be addressed. These include (1) what must be proven to establish that an agreement between a manufacturer and its individual resellers on resale prices violates the rule of reason, (2) how will juries respond to evidence offered to show or rebut a rule of reason violation, and (3) how do the outcomes shape advice to sellers considering such resale price agreements?

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1. Only one state statute expressly provides that RPM agreements are judged under the rule of reason. See Gilbert's Ethan Allen Gallery v. Ethan Allen, Inc., 620 N.E.2d 1349, 1356 (Ill. App. Ct. 1993) (vertical price-fixing agreements are to be tested under rule of reason because "per se violations are normally agreements between competitors or agreements that would restrict competition and decrease output"; federal case law is instructive but not binding), aff'd, 162 Ill. 2d 99 (1994). For discussion of state laws, see Michael A. Lindsay, *Resale Price Maintenance and the World After Leegin*, ANTITRUST, Fall 2007, at 32; Michael A. Lindsay, *Overview of State RPM (Complete)*, ANTITRUST SOURCE, July 2007, http://www.abanet.org/antitrust/at-source/07/12/LindsayFullChart11-29.pdf.
2. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
4. 220 U.S. 373 (1911).
The ABA Antitrust Section’s 2008 Spring Meeting Mock Trial program took a first step in addressing these issues. Every year the Trial Practice Committee (TPC) presents a mock trial at the Section’s Spring Meeting. The program presents experienced counsel trying a case—in a highly compressed format—before a live jury and a federal judge. The jury, selected from the Washington D.C. area, hears opening statements, direct and cross-examinations, closing arguments, and jury instructions, all in about two-and-a-half hours. The jury then retires to deliberate for forty-five minutes to an hour, and the audience is able to watch the deliberations through closed-circuit television. The jury returns after its deliberations, renders a verdict, after which each juror tells a little about himself or herself, and audience members are invited to ask questions. This year’s mock trial presented a post-Leegin challenge to resale price maintenance under the rule of reason.

Facts of the Case

Video-game manufacturer Futuristic Multi-Player Gaming, Inc. (FMG) makes multi-player “shoot-em-up” and sports video games. FMG began requiring its resellers to sign agreements with express minimum RPM provisions. An unnamed state, represented by lawyers from the Attorneys General offices of New York and New Jersey, brought suit against FMG in federal district court under Section 1 of the Sherman Act, challenging these agreements under the rule of reason. The price agreement was explicit and undisputed, so the defense could not assert a Colgate defense based on lack of agreement.

In 2000, FMG was the market leader in multi-player gaming products, with a revenue share of about 60 percent. The market was fairly concentrated, with the top three firms accounting for about 90 percent of sales. In 2001, the demand for gaming products collapsed, the result of a weak 2001 holiday shopping season and consumers’ general distaste for ultra-violent shoot-em-up games in the wake of the 9/11 attacks. Retailers were left with excessive inventories of unsold FMG games, which led to extreme retail price cutting.

FMG, after investing substantial resources, succeeded in developing significantly improved features. Nevertheless, most retailers declined to carry FMG products because of personal or institutional memories of the disastrous losses in 2001. As a result, FMG’s performance in 2002 and 2003 was miserable, and the company teetered on the edge of bankruptcy. Then in early 2004, new management was brought in. Management recognized FMG’s significant technological advantages, but the company still had severe difficulties persuading retailers to carry its products.

FMG’s response was the Retailer Protection Program (RPP), introduced before the 2004 buying season. Under the RPP, every retailer that sold FMG products signed an RPM agreement. The agreement said all the “right” things that a well-counseled manufacturer would likely include (or at least most of them). It described the procompetitive purposes for the agreement, specifically, to encourage customer service, premium image, product promotion, prevention of free-riding, and fair returns to retailers. The agreement permitted FMG to set manufacturer’s suggested retail prices and required retailers to sell at or above that price.

6 The Hon. Loretta Preska of the Southern District of New York presided. The states were represented by Bob Hubbard and Andrew Rossner, and the defendant FMG by M. Sean Royall and Margaret Zwiser. The state’s witnesses were portrayed by James Yoon and Tasneem Chipty, and FMG’s by Carol Peterson and Lawrence Wu. Leslie Ellis and TrialGraphix arranged the jury and provided trial support to both sides.

7 The facts were simplified by ignoring any proprietary platforms—the gaming software was compatible with any platform.

8 The agreement stated: “The purposes of the RPP are to promote customer service, preserve and enhance FMG’s brand image as a premium manufacturer of video games, reduce free riding by retailers, ensure that retailers receive sufficient return on their investments to provide the level of customer service necessary to support and promote FMG products, and ensure sufficient retail outlets for FMG products.”
prices (MSRPs) and required retailers to sell at or above that price. The agreement prohibited all
discount devices (coupons, rebates, and the like). FMG could identify products as close-outs, per-
mitting retailers to sell below MSRP. Retailers were required to participate in in-store promotions,
displays, and/or demonstrations of FMG products; they were also required to maintain ample FMG
inventories. FMG could terminate retailers for noncompliance. In fact, FMG sent hundreds of
warning letters and terminated twenty-five to one hundred retailers in each of the three years the
program was in effect. FMG was the only firm in the industry that adopted an RPM program.

Additionally, it was uncontested that prices increased since the product crash of 2001, but
product quality had improved as well. Some competitors complained about the inability to obtain
shelf space for their competing products, but other firms appeared to be expanding.

The Trial
The jury processed in shortly after 1:30 p.m. and retired a bit before 4:00—about two-and-a-half
hours for trial of a complex economic issue. The trial began with opening statements.9 The State
presented two witnesses: a video-game retailer whom FMG had terminated for below-MSRP sales,
and an economist who explained how the program had resulted in higher prices for consumers.
The defense also presented two witnesses: the FMG Vice President of Marketing, who had devel-
oped the program, explained the dire circumstances that had motivated the company’s decision,
and an economist explained the value of the program in promoting interbrand competition.

In closing arguments the State contended that the program was designed to protect retailers
from competition and resulted in higher prices for consumers. The defense argued that the pro-
gram helped consumers by inducing retailers to carry FMG products and to provide retail ser-
vices. In rebuttal, the State argued that an RPM policy was not justified to address demand uncer-
tainty and inventory risk even in the immediate aftermath of the 2001 pricing debacle,10 although
its economist recognized that possibility.

Instructions
The divergent views of the mock trial counsel and their natural (and commendable) desire to win
combined for a potent cocktail when it came time for the jury instructions. After multiple confer-
ence calls and skillful arguments on both sides, the Trial Practice Committee arrived at a fairly bal-
anced set of instructions and verdict form intended to implement the principles of Leegin.11 The

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9 To conserve program time for trial and deliberations, the jury had been instructed on certain procedural matters before the mock trial pro-
gram began.

10 When the demand for a product is uncertain, a retailer cannot reasonably predict how much of the product will be sold at the contemplat-
ed resale price—and thus how much product to order. The retailer will fear being saddled with unwanted inventory, which he may have to
sell at heavily discounted prices, perhaps even at a loss. This fear will cause the retailer to order and carry less inventory. By guaranteeing
stable prices in periods of low demand realization, an RPM program can help mitigate some of the inventory risk. When demand turns out
to be low and the manufacturer’s minimum resale price is higher than the true market-clearing price, retailers will not resort to a discount-
ing war to attract the available consumers because discounting will be prohibited. Sales may be slower, and the retailer may still end up with
unsold inventory, but the profits at the RPM price may be sufficient to cover the excess-inventory losses. See generally Raymond Deneckere,

11 Although agreeing to the instructions for the Mock Trial program, the State’s mock-trial counsel did not concede the propriety of using non-
price vertical restraint principles for an RPM agreement. For an illustration of state views on how Leegin should be construed, see Amended
http://www.oag.state.ny.us/business/new_antitrust/antitrust_amici_new.html. See also Robert L. Hubbard, Protecting Consumers Post-
Leegin, ANTITRUST, Fall 2007, at 41.
instructions and verdict form have been posted on the Trial Practice Committee’s Web site.\footnote{Jury Charge, available at http://www.abanet.org/antitrust/at-committees/at-trial/pdf/jury-instructions/preska.pdf; Special Verdict Form, available at http://www.abanet.org/antitrust/at-committees/at-trial/pdf/jury-instructions/resale-verdictform.pdf. The instructions as actually delivered were modified slightly but not substantively.}

Where possible, the instructions were drawn substantially from the Antitrust Section’s \textit{Model Jury Instructions in Civil Antitrust Cases}\footnote{ABA \textit{Section of Antitrust, Model Jury Instructions in Civil Antitrust Cases} (2005 ed.).}—for example, for basic information on the Sherman Act, unreasonable restraints of trade, the rule of reason, and the balance of harms. The Section’s model instructions pre-dated \textit{Leegin}, however. This required modifying some instructions. Some of this material came directly, or in slightly paraphrased form, from \textit{Leegin}. For example, one instruction offered examples of when an RPM agreement might be lawful and when it might not.\footnote{Instruction No. 9 in Jury Charge at 12, available at http://www.abanet.org/antitrust/at-committees/at-trial/pdf/jury-instructions/preska.pdf (“Agreements establishing minimum resale prices can have either procompetitive or anticompetitive effects or both. A manufacturer may use resale price maintenance for the procompetitive purpose of encouraging retailers to invest in services or promotional efforts that aid the manufacturer’s position as against rival manufacturers. On the other hand, a powerful manufacturer can use resale price maintenance for the anticompetitive purpose of giving retailers an incentive not to sell the products of smaller rivals. If FMG’s contract has not substantially harmed competition in the relevant market, then you should find that FMG’s contract was not unreasonable.”).}

The jury was asked to consider, first, whether the State had proven that FMG’s contract resulted in substantial harm to competition. If so, the jury was asked to determine whether the restraint also benefited competition in other ways. If the jury found competitive benefits, then the jury was next instructed to consider whether the restraint was reasonably necessary to achieve the benefits. Finally, the jury was asked to weigh any competitive benefits against any competitive harm resulting from the contract. The court reminded the jurors that they must consider the benefits and harm to competition and consumers, not just to a single competitor or group of competitors.

To help the jury in its task, the instructions included explanations of interbrand versus intrabrand competition, price versus non-price competition, and the role of market power. At each stage the instructions made clear that the State had the burden of proof; there was no formal burden for the defense to justify the RPM agreements.

\textbf{Deliberations}

What, then, happened when these facts were handed to the jury? Not every jury will have, like this mock jury, a graduate student who talks of “doing a cost-benefit analysis” in an antitrust case. Nevertheless, lawyers who have drunk deeply from the \textit{Leegin} majority opinion had a rude awakening. The scholarly arguments about interbrand versus intrabrand competition, and the need to enable investment by preventing free-riding, did not have much traction with this particular mock jury. Indeed, of the nine jurors, only two were able to see any procompetitive benefit to FMG’s resale price maintenance agreements. Even those two believed these benefits were outweighed by the anticompetitive harm.

The jury reached its decision easily and quickly. They were able to rule in favor of the State after answering the first two questions on the special verdict: “Did the FMG agreement with resellers substantially harm competition in the relevant market?” and “If the FMG agreement substantially harmed competition in the relevant market, did it produce any procompetitive benefits in a relevant market?”\footnote{Special Verdict Form, available at http://www.abanet.org/antitrust/at-committees/at-trial/pdf/jury-instructions/resale-verdictform.pdf.} With the jury’s answers of “yes, substantial harm” and “no benefits,” it was, to use an expression apropos of the fact pattern, “game over.”
Some Real-Life Lessons for Trial Lawyers

The outcome of the mock trial should not be overstated, because the compressed nature of the exercise certainly affected the defense team’s ability to develop its arguments. Nevertheless, the trial did yield some specific lessons and useful reminders of probable juror concerns that counselors and trial lawyers should consider:

1. Know the Audience.

One of the jurors put the point very clearly: “We’re all consumers.” The plaintiff can play to this expressly, as the State's counsel in the mock trial artfully demonstrated. But for a defendant to come in and say “I’m a manufacturer and I want to charge you higher prices” is not an easy sale to make to this audience, even when you add “but it’s good for you—really.” Defense counsel in the mock trial were keenly aware of this issue and addressed it head on. All counselors and trial counsel should think carefully about how they can present to a jury of consumers a case whose consumer appeal may not be immediately apparent.

2. Emphasize Consumer Benefits.

The mock jury’s instinct—that antitrust laws exist to help consumers—is essentially correct. If a defendant plans to argue, “but it's good for you,” the defendant should be able to articulate how—i.e., better services, broader selection, longer store hours, whatever the additional increment the plan is intended to encourage. This depends in the first instance on the reasons behind the program’s conception and implementation. In this trial, the State’s counsel were able to make effective use of the very title of the program—the Retailer Protection Program—as evidence that the program did not help consumers—and thereby to undermine claims of consumer benefits.

3. Embrace the Practical Burden.

The jury instructions made clear that the State bore the legal burden of proving that the agreements illegally restrained trade, but the lopsided view from the jury room made clear that no matter what the instructions said, the defendant will likely have a practical burden to justify the program. A defendant should openly acknowledge, for example, that some consumers (the more sophisticated) may not need the pre-sale services and that all consumers will pay more than they might otherwise pay. An advocate may be better off conceding what jurors are already likely to believe, which may increase the advocate’s credibility when arguing the restraint provides consumer benefits.

4. Explain the Competitive Process.

Jurors bring their own experience to bear, but for the most part they have only been at the consumer end of the purchasing process. Trial counsel should find a good teacher to help the jury to understand the competitive process and the role that RPM plays in it. Given the jurors’ likely consumer-oriented viewpoint, defense counsel should make sure that this teacher has adequate time for the task. (One of the byproducts of our mock trial’s compressed format was that the defense’s excellent testifying economist did not have enough time.)


One variation on consumer benefits is choice—the ability of consumers to decide whether they want the pre-sale services. The plaintiff’s counsel will emphasize that consumers should not have to pay for services they do not want. Defense counsel should counter with two points—first, that many consumers do want these services, and second, that consumers who do not want to pay for these services can buy someone else’s product or go to someone else’s store—there’s usually plenty of choice.

6. Defuse the Injured-Competitor Argument.

Jurors will sympathize with an excluded competitor, even if there are good economic reasons for the exclusion. In this case, the challenged agreements did not explicitly deny shelf-space to FMG’s rivals, but the State was able to argue that they had an exclusionary effect.

7. Explain Adequacies (or Inadequacies) of Alternatives.

Very often, suppliers can use non-price arrangements to provide dealers with incentives to provide point of sale service and other sales.
The mock jury closely scrutinized FMG’s arguments for choosing RPM rather than these alternatives, to the extent that it was willing to give those arguments any credence at all. In a sense, the jury applied a rough “least restrictive alternative” test. A trial lawyer defending an RPM program must prepare to explain why non-price alternatives were unavailable, inadequate, or less desirable.

8. Address Retailer Independence. Shortly after Leegin was decided an anonymous comment posted to the Wall Street Journal’s law blog observed that “the ‘small dealers and worthy men’ argument consistently loses in antitrust, as well it should. [I]f every mom and pop store goes out of business, well, so be it—they can’t compete with [Wal-Mart].” Suffice it to say that this was not the mock jury’s view. Although most of the jurors looked at the case from their perspective as consumers, at least one of the jurors also looked at it from that juror’s perspective as a retired independent business owner—and expressed concern about the retailer’s loss of independence in making business decisions. Trial counsel should remember that the fate of small, independent retailers can still concern jurors.

9. Defend Fairness. An RPM case is like any other—the jury wants to know that the result is fundamentally fair. In the mock trial, defense counsel did an excellent job of explaining the unfairness of free-riding and the fairness of preventing it. But one of the mock jurors spotted something in the facts: FMG’s program required retailers to charge MSRP but did nothing to protect the retailer if the product did not move at those prices. In other words, without some kind of inventory buy-back provision, an RPM program may be perceived as leaving the retailer with all of the inventory risk while depriving the retailer of the ability to manage inventory through price adjustments.

Real-Life Lessons for Antitrust Counselors

The Leegin decision does not make RPM agreements per se lawful, and the mock jury’s deliberations suggest that, in a jury trial, RPM agreements may well be found anticompetitive. Even setting aside the uncertainty caused by some real-life states’ unwillingness to abandon the pre-Leegin framework, successful defense of an RPM agreement in front of a jury is far from assured. Counselors helping companies to develop RPM programs (and advising on whether to adopt such programs at all) should consider how a program is likely to play before a jury, because that will provide practical guidance as to the wisdom and workability of an RPM program. Moreover, it may suggest ways of describing the program and educating company employees and resellers about how and why the program works—and how it helps consumers.

In addition to taking to heart what trial lawyers will ultimately face, counselors should also consider these points:

1. Colgate Is Still a Fine Decision. Given the difficulties that a defendant will face at trial if its RPM program is challenged under the rule of reason, counselors should not be too hasty in abandoning the Colgate principle. A Colgate approach, using a unilateral policy instead of entering into an agreement, provides a first defense against RPM claims and also pays at least nominal tribute to the retailer’s independence. If a client nevertheless decides to implement a program based on agreements with retailers, the counselor should consider first the risk mitigators that might prevent the program’s ever reaching a jury, or help a jury to understand and accept it.

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17 For example, just days before the mock trial, three states entered into an RPM consent decree. See New York v. Herman Miller, Inc., 08 Civ. 2977 (S.D.N.Y. Mar. 25, 2008) (Stipulated Final Judgment and Consent Decree).
2. Market Share Matters. A company’s small market share is one factor that can reduce risk of pursuing an RPM program. Companies with low market shares are less likely to have their programs reach the jury, and if one does, they have an avenue to deflect claims of consumer harm, as the Federal Trade Commission’s recent decision modifying the Nine West consent order suggests. Counselors should be particularly cautious if the company proposing an RPM program has a substantial market share, especially in a concentrated market.

3. Pick the Right Product. Some products warrant pre-sale services, and in those cases consumers can benefit. The mock trial facts and exhibits included material to help strengthen the arguments of consumer benefits—for example, trade press reports of stores hiring unemployed gamers to demonstrate FMG products, share tips and strategies, and play with potential buyers, all resulting in managers claiming that this strategy had increased store traffic. That will not be true for all products. At the end of the day, the jury will ask the same question that senior managers and their counselors should have asked at the outset: do pre-sale services really add value for consumers and result in increased sales and consumer satisfaction?

4. Consider the Alternatives. Many clients have heard about the Leegin decision and may assume that an RPM program is the right tool for them. Counselors should question the client closely on the underlying problem and determine whether an RPM program is a good fit. For example, if the real problem is too many resellers in too close proximity to one another, an RPM program is not likely to be the answer—but cleaning up the distribution network may be.

5. Address the Inventory Problem. Product shortages may not undermine an RPM program, but excess inventory carries that risk. Companies and their counselors should consider the implications of an RPM program on inventory management. Should resellers be limited in how much product they can order? What happens if the reseller orders more product than the RPM program price will permit it to sell? Will the manufacturer have a liberal return policy? Will it buy back inventory from terminated resellers?

6. Get the Program Rationale Right the First Time—and Keep It That Way. A company may some day have to explain its RPM program to a jury. This means that, from the beginning, the company and its counselors need to understand why the company is adopting the program and make sure that it is a defensible rationale. All communications that refer to the program—including internal discussions, as well as external materials such as program materials for resellers, public Web sites, account manager communications—should all reflect and be consistent with the program’s pro-competitive rationale.

Conclusion
RPM programs still run risks for suppliers, as the results of the mock jury trial demonstrated. A successful RPM program therefore will be one whose rationale a jury can understand. That means its rationale should include a convincing and accessible demonstration of how the program, as designed, described, and operated, helps consumers.

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18 Order Granting In Part Petition To Reopen And Modify Order at 15, Nine West Group Inc., FTC Docket No. C-3937 (Apr. 11, 2008), available at http://www.ftc.gov/os/caselist/9810386/080506order.pdf (“Nine West has only a modest market share in any putative relevant product market in which it competes. This suggests prima facie that it lacks market power, and there is no reason to believe that there is collective market power in any putative market. There is also no evidence of a dominant, inefficient retailer in this market, and Nine West states that Nine West itself is responsible for its desire to engage in resale price maintenance; it is based on its wish to increase the services offered by retailers that sell Nine West products. We therefore grant Nine West’s Petition on the basis that Nine West’s use of resale price maintenance is not likely to harm consumers.”).
Editor’s Note: In this edition we review two papers by leading government economists, past, present, and perhaps future. The first paper, by Dennis Carlton and Ken Heyer, takes a cautious policy approach to single-firm conduct based on theory, empirical evidence, and “considerations of administrability and consistency with general and widely held presumptions” and sets out four “underlying principles” that should govern policy toward single-firm conduct. The second paper, on the role of market concentration in modern economic analysis of horizontal mergers, is by Jonathan Baker, in which he explains how market concentration can sensibly be used for merger analysis. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—William H. Page and John R. Woodbury

Recent Papers

Dennis W. Carlton & Ken Heyer, Appropriate Antitrust Policy Towards Single-Firm Conduct

In this paper, Dennis Carlton of the University of Chicago and recently Deputy Assistant Attorney General for Antitrust in the Department of Justice Antitrust Division, and Ken Heyer, Economics Director of the Antitrust Division, articulate a cautious policy approach to single-firm conduct based on theory, empirical evidence, and “considerations of administrability and consistency with general and widely held presumptions.” They distinguish two types of single-firm conduct: extraction, which “capture[s] surplus from what the firm has itself created independent of the conduct’s effect on rivals,” and extension, which “increases the firm’s profit by weakening or eliminating the competitive constraints provided by products of rivals.” They argue that extraction should be per se lawful and that extension should be unlawful only in narrowly defined circumstances.

In the course of developing this distinction, the authors articulate four “underlying principles” that should govern policy toward single-firm conduct. These are the principles, in the authors’ words:

1. Simple monopoly pricing is legitimate because it spurs dynamic efficiency.
2. Extraction of surplus through means other than simple monopoly pricing is equally as “legitimate” as monopoly pricing, based principally on its impact on dynamic efficiency, all else equal.
3. Where scale economies matter, conduct that deprives rivals of scale may (but will not necessarily) harm competition.
4. Certain core components of competition—introducing better products and lowering production costs in particular—are in virtually all circumstances so likely to promote welfare and economic growth that they should be permitted by antitrust despite a theoretical possibility that protecting competitors from them will in rare circumstances enhance welfare. The costs of identifying and effectively remedying those rare but theoretically possible exceptions are too high to merit exposing such conduct to possible antitrust attack.
Although the authors concede that these principles are not all currently “susceptible to strong empirical verification,” they express the utopian dream that, in the future, empirical testing will make antitrust a “science based on facts and less a policy driven primarily by beliefs.”

Carlton and Heyer begin their analysis by justifying their first principle, which states that charging a single monopoly price should be per se lawful. They first observe that, even though single price monopoly is inefficient in a static comparison with competition, it provides a necessary incentive to innovation. They offer the example of a firm that makes a risky investment in developing new software that becomes extremely popular, gains monopoly power, and generates profits far above normal. To condemn the high prices as exploitative based on the ex post outcome would undermine incentives for the firm and others from contemplating similar high-risk investments in innovative products. Even if the firms’ profits in a particular case turn out to be higher than necessary to have induced the initial investment, any effort by antitrust regulators to cap prices would likely entail far more direct costs of regulation and indirect costs in diminished innovation than the transitory benefits to consumers from lower prices.

Carlton and Heyer then extend this safe harbor to practices that exploit monopoly power to extract surplus through (1) price discrimination, (2) commitments to limit ex post opportunistic behavior, and (3) simple refusals to deal. Perfect price discrimination, they note, is more efficient than simple monopoly pricing and thus should be lawful. But, the authors argue, even if discrimination is imperfect and less efficient than competition, courts should not condemn it. The same dynamic efficiency considerations that support single monopoly pricing also support price discrimination, because “efficient incentives for investment generally improve, the more surplus the firm is able to capture when its innovations create the surplus.” Particularly where entry entails high fixed costs, the authors argue, “[s]ophisticated pricing or other business strategies may be necessary for the firm to generate revenue greater than the total cost of economically desirable investment and production.” Thus, the authors propose that any use of tying to accomplish price discrimination, for example by metering intensity of buyers’ demand for the tying product, should be lawful “regardless of its effects on static efficiency.”

Similar reasoning, according to the authors, supports per se legality for restraints that allow a monopolist credibly to commit to its buyers not to engage in ex post opportunistic behavior. Vertical territorial restraints, for example, might allow a seller to persuade a dealer that the seller will not later offer more favorable terms to rivals. Although these commitments allow the seller more fully to exploit monopoly power, they constitute pure extraction and thus should be lawful.

Unconditional refusals to deal also should be lawful, Carlton and Heyer argue, because they allow the seller to protect its investment in assets that it has created. The authors suggest tentatively that where patent owners (as in Rambus) mislead standard-setting bodies about the existence of their patent claims, then later refuse to license the patents at “reasonable” prices, the appropriate remedy should be a breach of contract claim rather than an antitrust action.

In the last third of the paper, Carlton and Heyer argue that various forms of monopoly “extension” may “enhance[] the firm’s profitability by weakening the constraints imposed by competitors.” Examples include successful predatory pricing and tying arrangements that deny rivals the ability to achieve minimum efficient scale. This latter example leads the authors to propose that extension can only occur when “scale economies matter nontrivially” and therefore “marginal cost is declining.” If marginal cost is constant, then, unless rivals are entirely driven from the market, they continue to constrain the dominant firms’ pricing as before. Thus, the authors propose a safe harbor for conduct that does not “does not seriously raise rivals’ marginal costs or threaten their very survival.”
Even some conduct that denies rivals efficient scale, however, should be lawful if it is beneficial in other ways. Above-cost price-cutting, a cost-reducing merger, or even introducing a new product may “capture business that would otherwise go to price-constraining rivals” and thus (theoretically) reduce welfare. Nevertheless, U.S. courts have generally followed Carlton and Heyer’s fourth principle, which makes these kinds of practices lawful because of their tangible, present benefits, despite their theoretical future anticompetitive effects.

That leaves monopoly extension without tangible present benefits. The authors consider and reject, based on our present knowledge, the possibility that this sort of conduct should be per se lawful because of its potential benefit to dynamic efficiency:

There seems no particular reason for believing that the prospect of greater profits through monopoly extension would itself foster, rather than perhaps even deter, innovation. The future beneficiaries of additional profits from monopoly extension will not obviously be those who have developed the best or most innovative products. And indeed, anticompetitive behavior by firms temporarily in the lead (or “dominant”) in particular markets may as well prevent and deter, rather than enhance, the chances of better products achieving success (and hence being developed and introduced in the first place).

While we are unaware of empirical studies showing that an added incentive to become a bigger and more impregnable monopolist through legalizing monopoly extension would lower welfare, we remain skeptical. Although we do not favor a change in the current system that would permit virtually all manner of unilateral conduct by firms, we remain open to further evidence.

In a brief final section, Carlton and Heyer argue that, while courts should not condemn monopoly extraction as a rule of liability, they may regulate extraction as a remedy, where a firm has acquired monopoly power by monopoly extension.

Although the authors disclaim any intent to speak for the Antitrust Division, their cautious approach is consistent with the Division’s Section 2 policy under the current administration. As the fall elections approach, it should contribute to the discussion of the proper place of Section 2 in public enforcement.

—WHP


Jonathan Baker (who has an affiliation with my employer) is one of the leading antitrust economists (we ignore his legal training purposely) with interesting and sometimes controversial insights into the application of economics to mergers and single-firm behavior. Not only is he a prolific writer, Baker is also one who can translate often abstruse and complicated economic analyses into lucid prose. That ability is illustrated in this paper on the role of market concentration in modern economic analysis of horizontal mergers. Baker explains why reliance on market concentration can be a sensible approach for merger analysis. But as I discuss in greater detail below, I do have to wonder if, at the end of the day, he is trying to fit a square peg into a round hole. Indeed, I wonder if he has actually proven the negative—that the role of market concentration in economic merger analysis is becoming irrelevant.

Baker begins by reviewing the modern legal history of the use of concentration in merger analysis beginning with the 1950 amended Section 7 of the Clayton Act. At that time, courts were prepared to condemn even the smallest of mergers in markets where concentration was increasing.
During the late 1960s through the 1970s in particular, the previously difficult-to-rebut presumption that a merger in a market with high and increasing concentration would result in consumer harm gave way to a more measured approach. In this antitrust evolution, the courts agreed that other factors could reasonably be used to rebut a government claim of competitive harm simply because the merger would lead to a significantly more concentrated market.

In terms of using market concentration in merger analysis, one needs first to define the market before one can calculate the requisite market shares. As critical as it is to the structural component of merger analysis, Baker doesn’t spend much time on market definition except to note that it is (currently) driven by demand-side substitutability, highlighting the importance of the role of own-price demand elasticity in determining whether this is a monopoly worth having. The almost passing reference to market definition may make sense because the focus of the paper is on the role of market concentration, assuming a market definition. But it would have been nice if Baker had provided the reader with some literature references on the methodology of defining markets other than his own recent paper in the Antitrust Law Journal (say, to take a random example, the Moresi-Salop-Woodbury paper on critical loss that recently appeared in the Antitrust Source).

Baker goes on to note that the four-firm concentration ratio—the sum of the shares of the largest four firms in the market—was used from the 1950s through the 1970s as a key component of the antitrust merger evaluation process. The 1982 Merger Guidelines then ushered in the widespread use of the Herfindahl-Hirschman Index (HHI)—the sum of squared shares of the players in the defined market. One reason for the use of the HHI was its conceptual underpinnings. In a classic paper, George Stigler demonstrated how the HHI could be used as an indicator of cartel stability.1 In particular, Stigler showed that the higher the HHI—reflecting a more skewed, more highly concentrated market—the greater the likelihood that a cartel would be able to detect any cheating on an agreement to maintain prices above competitive levels. The larger the firms are, the more difficult is it to cheat. Subsequent literature related the HHI to price levels in static non-cooperative oligopoly models. And there was also an empirical literature that demonstrated a positive correlation between higher concentration—sometimes the four-firm concentration ratio, sometimes the HHI—and higher profitability or higher price-cost margins or higher prices.

But contemporary antitrust analysis attaches far less significance to concentration than in the past, in assessing the potential both for adverse coordinated and particularly for adverse unilateral effects arising from a merger. Indeed, Baker notes that “concentration can be informative with respect to each type of competitive effects analysis, though in each case, with the right information, competitive effects can also be understood without reference to shares and concentration.” (p. 8)

Turning first to coordinated effects, Baker begins by highlighting the litany of conditions that may complicate coming to a price consensus among the firms in a market or conditions that make it difficult to maintain that consensus, such as cost and share asymmetries among the firms, excess capacity, product heterogeneity, and large buyers. Using a simple model, Baker explains clearly the modern approach to evaluating the effect of a merger on the likelihood of collusion.

But, you might ask, what about the HHI? What about concentration? Baker notes the role of concentration as a way of gauging the likelihood of collusion via the dinner scheduling analogy—it is easier to reach agreement on the date of the dinner when there are fewer parties involved. Then he goes on to note (p. 10) that reliance on concentration amounts to reliance on “a statistical prediction rather than an appeal to a mechanism to show why [any particular] merger matters.”

I've struggled a bit to try to understand whether that characterization understates the significance of market concentration. On the one hand, the concentration exercise is more arithmetic than analytic—one compares the current shares of the N firms to the shares of the N-1 firms when the shares of the merging parties are summed together. It doesn’t say anything about how the characteristics of the particular firms merging may affect that analysis, although a complete merger evaluation would encompass those merger-specific characteristics. On the other hand, there are analytic bases for drawing inferences from changes in concentration to changes in the likelihood of collusion, as in the previously mentioned Stigler paper.

Baker then turns to describing a different model of collusion that reflects the components of more contemporary thinking about the effect of a horizontal merger on increasing the likelihood of adverse coordinated effects. This model indicates how reliance on simple measures of concentration can generate “false positives.” Here, the paper is at Baker-best in illustrating that contemporary thinking. Briefly, he arrays firms beginning with the least likely to cheat on any tacit agreement and ending with the firm most likely to cheat. Firms that are less likely to cheat are those for which the profits from adhering to a coordinated agreement are high relative to the benefits of cheating. The firm-perceived benefits from cheating are higher the larger is its actual output relative to its potential output (i.e., when all excess capacity has been utilized) and the lower the extent to which firms discount payments received in the future. That is, other things equal, more patient firms are more likely to adhere to a price agreement rather than to take the money and run.

And other things equal, the higher the price, the greater the profits from undercutting the agreed-to price by just a shade and so the greater is the incentive to cheat. Thus, in choosing what the agreement price should be, the participating firms cannot set a price so high that the firm that is most likely to cheat will cheat—the firm that Baker identifies as the maverick firm. It is the maverick’s incentives to cheat that determine what the agreed-to price will be.

In this model, a merger between two non-maverick firms will have no effect on the agreed-to price (providing the merger itself does not induce a change in the maverick’s incentives). By contrast, a merger between a non-maverick and a maverick will increase the agreed-to price. The non-maverick already (by construction) had no incentive to cheat at the currently agreed-upon price, so combining the maverick with the non-maverick can be thought of as (roughly speaking) dulling the cheating incentives of the maverick firm and so permitting a price increase by the collusive firms.

In this model, then, concentration seemingly tells one nothing about whether a merger in this market will result in higher post-merger prices. If one of the merging firms is a maverick, then the merger would be price-increasing. If neither of the merging firms is the maverick, then price increases would not result from the merger. Indeed, in this model, the only incentive for merger between non-mavericks must be efficiencies, which in turn may result in the merged firm becoming the new “marginal” firm. Of course, the efficiencies generated by a merger between a maverick and non-maverick could increase rather then reduce the incentives to cheat, but in that merger, more analysis is necessary to determine whether the expected merger gains are positive.

The trick is to identify the maverick, which brings us back to concentration: “Greater concentration raises the odds that any particular merger involves a maverick.” (p. 16) When mergers occur in (correctly defined) markets where concentration is high, then Baker argues, there is a rebuttable presumption that the merger will have adverse coordinated effects. The odds that the merger involves a maverick firm are greater for higher concentration levels than for lower concentration levels. The presumption can be rebutted by other evidence suggesting the difficulties of coordination.
At first glance, this approach may seem reasonable and perhaps even obvious—mergers in more concentrated markets need to be examined more closely. On the “that’s obvious” point, it’s not where we end up but how get there that is the insight of contemporary thinking because it says something about how we should interpret high concentration and what we should look for in term of “plus” (or “minus”) factors in understanding the merger’s competitive effects.

But what seems to be left out is the question of how we deal with a merger between two very small share firms. Does the change in concentration indicate something about the likelihood that the merger involves a maverick? If the concentration change is small, should we interpret that change as suggesting that the likelihood that this merger involves a maverick is also small? That seems at least a bit wrong because normally, we think of the maverick as one of the smaller-share firms in the industry. And it seems wrong in light of Baker’s own model in which (other things equal) the lower-share firms have the most to benefit from cheating.

Baker then turns to assessing the role of concentration in what may be more familiar ground to antitrust counsel in particular—unilateral effects in differentiated product industries. To briefly reprise, the likelihood of adverse unilateral effects of a merger depends upon the substitutability of the goods sold by the two merging parties. Pre-merger, merging firm A loses sales when it increases prices and that loss constrains the extent to which pre-merger A can charge a high price. But some of the profit from those lost sales will be captured by its merger partner B. So post-merger, when A is setting its profit-maximizing price, it effectively loses less sales for any particular price increase because now some of those losses are recaptured by A via its merger with firm B. Thus, post-merger, A has an incentive to increase prices above its pre-merger level because one of its pre-merger competitive constraints—the goods sold by firm B—is no longer a constraint. This post-merger effect is also true for B’s price-setting calculus.

The magnitude of the post-merger price effect depends on a number of critical parameters, one of them being the extent to which consumers view the goods sold by A as a substitute for those sold by B and similarly for the goods sold by B. The greater the extent to which consumers view A and B as close (not necessarily the closest) substitutes, the greater will be the sales recapture rate by A and B and so the greater the incentive for post-merger price increases.

In the absence of any information on the recapture rate, one kluge is to assume that the second choices of (e.g.) firm A consumers are proportional to the shares of A’s rivals in the defined market. Focusing on the substitutability of B for A, suppose A had a 20 percent share and B had a 15 percent share. Using this proportionality assumption, of those lost sales by A that stay within the defined market upon an increase in A’s price, the likelihood of A losing sales to B is the share of B in total sales in the defined market, excluding A. In this example, the proportion of lost sales by A that are recaptured by B is simply \[\frac{15\%}{(100\% - 20\%)}\] or about 19%. The proportion of lost sales by B that are recaptured by A is simply \[\frac{20\%}{(100\% - 15\%)}\] or about 24%.

So what about the role of concentration in this analysis? Baker observes (p. 20) that there is “nothing in [the] intuition about unilateral competitive effects [that] obviously or necessarily requires market definition or relates the magnitude of unilateral effects to market concentration.” As the above example suggests, what counts is the extent to which the second choices of consumers of one of the merging parties are the goods sold by the other merging party. While Baker goes on to extend a model to show how concentration matters, it seems even within that model, all that really counts is the market share of each merging party from which a recapture rate can be inferred. And if there exist consumer surveys or demand econometrics that provide a “better” estimate of the recapture rates (i.e., rates that are estimated from consumer behavior, not assumed as with proportional recapture rates), the shares play an even more diminished role.
One point in the paper merits further thought. Suppose that use of a simulation model suggested a small post-merger price increase after accounting for efficiencies—Baker uses a 2 percent example. Should that be of concern to the antitrust authorities? Baker in effect notes that the magnitude of the predicted price increase must be weighed against the uncertainty of the share-estimated recapture rates and for smaller price increases in particular, more non-simulation evidence should be gathered before concluding that the merger will harm consumers.

But one’s confidence in the predicted price increase goes far beyond the degree of confidence one has in the recapture rate estimates. There is also uncertainty about the nature of demand (e.g., is it linear or is it constant elasticity?), about the margin estimates (have incremental costs been accurately measured?), about the calibration of the model to be consistent with current prices and shares at some inevitably arbitrary point in time (should you use the last six months or the last year or the last two years?), and about the underlying model itself (is it Cournot, Bertrand, or an auction model?), among other sources of uncertainty about the inputs into the model. These sources of uncertainty certainly caution against any blind reliance on the predicted price effects as the basis for a conclusion about the merger’s competitive effects. Indeed, this uncertainty suggests that even what might be regarded as relatively large predicted post-merger price increases (e.g., 5 percent) may not be held with much confidence.

In short, there is something of a “square-peg/round hole” flavor of attempting to fit concentration into the unilateral effects analysis. It certainly is easy to read the paper as concluding that in unilateral effects, reliance on concentration measures to infer competitive harm is misplaced. With regard to coordinated effects, Baker’s analysis is insightful, but perhaps incomplete. As noted above, I do think there are more reasons than those ultimately relied on by (but discussed by) Baker for attaching significance to concentration in coordinated effects analysis. For example, Baker too quickly dismisses the relevance of the apparent statistical regularity indicating that higher prices and higher concentration are correlated.

This paper is accessible to a wide audience of antitrust practitioners and all in all, makes for good summer reading.

—JRW

2 In this regard, it’s interesting that Baker begins by stating his purpose as evaluating “the extent to which modern economic analysis supports a role for concentration in the antitrust review of horizontal mergers.” (p. 1) Baker concludes that “there is a sensible basis for inferring harm to competition from market concentration or market shares.” (p. 26) (emphasis added.) While market shares are a structural measure, the reliance on specific market shares is not the same as reliance on concentration measures in the merger analysis.