A “Sound Basis” Exists For Revising the HSR Act’s Investment-Only Exemption

Only a small fraction of transactions reported under the Hart-Scott-Rodino Act receive in-depth review at the FTC or DOJ, and even fewer are challenged as violating the antitrust laws. In this article, Bilal Sayyed makes the case for replacing the current HSR “investment-only” exemption with an exemption for most investments of less than 15% interest in the target company.


Mark Popofsky and Michael Laufert analyze the concerns raised by the recent trend of firms outsourcing their patent enforcement to patent assertion entities and conclude that this practice may raise rivals’ costs and harm competition.

The Anti-Corruption and Antitrust Connection

Josh Goodman surveys the enforcement of the Foreign Corrupt Practices Act in relation to the enforcement of the antitrust laws. He explains why, despite abundant differences between the two bodies of law, the current trend appears to be one of convergence.

Book Review: Lessons from an Accidental Antitrust Lawyer

In Tom Leary’s memoir, The Education of an Accidental Lawyer: Told in True Stories, the former FTC Commissioner, in-house counsel to GM, and law firm attorney recounts his illustrious career in antitrust law. Steve Cernak finds that Leary’s tales of his life and legal practice are not only entertaining and well told, but that the stories also convey important lessons about the practice of law.

Paper Trail: A Collection of Reviews of Joshua D. Wright’s Papers

A distinguished panel of antitrust scholars and practitioners led by Editors John Woodbury and Bill Page, review newly installed FTC Commissioner Joshua Wright’s academic writings. Max Huffman, Serge Moresi, Danny Sokol, Jim Langenfeld, and Bill Page survey Wright’s papers on key antitrust and consumer protection issues, including the influence of the Chicago School on antitrust, the role of behavioral economics, and appropriate enforcement policies towards vertical restraints and high-tech industries.
A “Sound Basis” Exists for Revising the HSR Act’s Investment-Only Exemption

Bilal Sayyed

Whenever the Commission can determine that a class of transactions is unlikely to violate the antitrust laws, it has sought, with the concurrence of the Assistant Attorney General for Antitrust, to exempt such transactions from all notification obligations and the delay inherent in premerger review.¹

The Hart-Scott-Rodino Antitrust Improvements Act of 1976² (HSR Act) requires that acquisitions of voting securities, assets, or non-corporate entities be notified to the Federal Trade Commission and the Department of Justice (the Agencies).³ The Act’s notification and waiting period requirements have fundamentally changed the process and substance of merger review—the manner in which the government investigates, remedies, and challenges mergers and acquisitions—since coming into force in September 1978.⁴ While the Act has had a positive effect on the Agencies’ ability to identify, remedy, and, if necessary, to enjoin anticompetitive mergers, it has also imposed costs, some of which are unnecessary for accomplishing the Act’s purpose. The most easily measurable costs are the filing fees, which are $45,000, $125,000 or $280,000, depending on the size of the transaction. Other important costs are not easily quantified, but arise from the delay inherent in the Act’s reporting and waiting period requirements. The Act may also restrict or discourage shareholders from interacting with management. Because of the narrow reading of the investment-only exemption, such interaction may preclude reliance on the exemption. This disincentive runs counter to policies that encourage more communication between shareholders and management.

This article suggests, in accordance with President Obama’s call for regulatory reform, that the “investment-only” exemption should be replaced with a modest exemption for most acquisitions

³ The Act requires notification of acquisitions of voting securities valued in excess of (i) $200 million (as adjusted) or (ii) $50 million (as adjusted) where the parties to the acquisition meet certain annual net sales or total asset thresholds, unless an exemption applies. Prior to the 2000 Amendments to the Act, the Act required notification of all acquisitions of voting securities valued in excess of $15 million (where the parties to the transaction meet certain annual net sales or total asset thresholds) unless an exemption applied. The Act also reaches acquisitions of assets and the acquisition of control of a non-corporate entity. See Rules, Regulations, Statements and Interpretations Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 16 C.F.R. §§ 801–803 (2011) [hereinafter Rules]. There is a significant filing fee associated with notification under the Act. See Federal Trade Commission, Hart Scott Rodino, Premerger Notification Program, Filing Fee Information, http://www.ftc.gov/bc/hsr/filing2.shtm.
This article suggests, in accordance with President Obama’s call for regulatory reform, that the “investment-only” exemption should be replaced with a modest exemption for most acquisitions of a de minimis percentage of an issuer’s outstanding voting securities. Specifically, the investment-only exemption should be replaced with an alternative exemption for de minimis investments in issuers that are not competitors of the acquiring person, the acquiring person’s associates, or of entities in which the acquiring person or its associates have substantial holdings.

Such an exemption is not likely to exempt from the Act’s notification requirements a material number of transactions that might lead to a lessening of competition. Such transactions would continue to be subject to challenge under Section 7, but, because they do not raise the “unscrambling” concern that motivated passage of the Act, post-closing remedies are adequate to address the rare instance in which competitive concerns are identified. At the same time, it will eliminate the significant costs associated with compliance with the Act’s reporting and waiting period requirements for those firms whose acquisitions are not now exempt. The proposed exemption would not add meaningful complexity to the current determination of whether an acquisition is subject to the reporting requirements of the Act, and would eliminate the need to determine and document an investor’s intent in making an acquisition. The only additional compliance burden from this proposal is determining whether the persons involved qualify as “competitors,” but this can be minimized by defining competitors with reference to Section 8 of the Clayton Act. Finally, by making competitors ineligible, the proposed exemption addresses concerns expressed by the Commission, Congress, and affected parties in previous rulemaking efforts.

Few HSR Reported Transactions Are Investigated

The HSR Act is a procedural statute in the service of Section 7 of the Clayton Act. Section 7 prohibits mergers and acquisitions that “may . . . substantially . . . lessen competition” or “tend to create a monopoly.” As the Agencies have previously explained:

5 Improving Regulation and Regulatory Review, Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011) (directing each agency to “tailor its regulations to impose the least burden on society, consistent with regulatory objectives”). The FTC is not bound by this Order, but the Commission has indicated it fully supports the Order’s goals. See Fed. Trade Comm’n, The FTC’s Regulatory Reform Program: Twenty Years of Systematic Retrospective Rule Reviews & New Prospective Initiatives to Increase Public Participation and Reduce Burdens On Business 1 (2011) [hereinafter FTC’s Regulatory Reform Program], available at http://www.ftc.gov/os/testimony/110707regreview.pdf (prepared statement). The Department of Justice, as an executive agency, is bound by Executive Order 13,563.


The legislative history suggests several purposes underlying the [HSR] act. Congress wanted to ensure that certain acquisitions were subjected to meaningful scrutiny under the antitrust laws prior to consummation. To this end, Congress intended to eliminate the “midnight merger” that is negotiated in secret and announced just before, or sometimes only after, the closing takes place. Congress also provided an opportunity for the Commission or the Assistant Attorney General . . . to seek a court order enjoining the completion of those transactions that either agency has reason to believe would present significant antitrust problems. Finally, Congress sought to facilitate an effective remedy when a challenge by one of the enforcement agencies proved successful. Thus, the act requires that the antitrust agencies receive prior notification of certain acquisitions, provides tools to facilitate a prompt, thorough investigation of the competitive implications of these acquisitions, and assures the enforcement agencies an opportunity to seek a preliminary injunction before the parties to an acquisition are legally free to consummate it. The problem of unscrambling the assets after the transaction has taken place is thereby reduced.9

While the Act has helped provide the Agencies with notice of problematic transactions prior to their consummation, over the Act’s nearly thirty-five year history it has captured tens of thousands of transactions that neither Agency considered likely to violate Section 7. For the thirty-three year period FY 19799 (October 1978) through FY 2011 (September 2011), over 68,000 transactions were notified to the Agencies, representing an average of 2,065 per year.10 The number of notified transactions is substantially in excess of what the drafters of the Act predicted: they expected the Act would require notification of no more than a couple hundred transactions per year,11 and recognized that a notification regime requiring “thousands” of notifications per year would be burdensome, not only to business but to Agency staff.12 But, as the statistics summarized below (and provided in more detail in Tables A.1, A.2, and A.3 in the Appendix) indicate, opponents’ concerns that the Act would “overwhelm[] the [Agencies] with trivia”13 was prescient.

The Agencies investigate only a small percentage of transactions notified under the Act. Over the period encompassing nearly the entire history of the Act’s notification requirements (FY 1979 through FY 2011), the Agencies issued 2,258 Requests for Additional Information (“Second

---

11 In seeking support for the Act, Representative Rodino explained that the HSR notification requirements would “require[] advance notice . . . for the very largest corporate mergers—about the 150 largest out of the thousands that take place every year.” Report of the H. Comm. on the Judiciary, H.R. Rep. No. 94-1373, at 11 (1976), reprinted in 11 EARL W. KINTNER, THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 989, 993 (1985). The House Committee was commenting on H.R. 14580, requiring notification of all acquisitions where one corporation party to the acquisition had net sales or total assets of $10 million or more, and another had net sales or total assets of $100 million or more, and the acquiring corporation would hold voting securities representing 25% or more of the acquired corporations stock, assets or share capital, or an aggregate total amount of stock, share capital and assets valued in excess of $20 million. H.R. 14580, 94th Cong. (1975), reprinted in 11 KINTNER, supra, at 983–88. See also Report of the S. Comm. on the Judiciary, S. Rep. No. 94-803, at 66 (1976), reprinted in 10 EARL W. KINTNER, THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 210, 258 (1985) (“Title V’s dual requirement of (i) a $100 million acquiring company, and (ii) a $10 million acquired company would have required . . . notification, over the past five years, in less than 100 transactions per annum.”); S. 1284, 94th Cong. (1975), reprinted in 10 KINTNER, supra, at 190–209.
12 See H.R. Rep. No. 94-1373, at 11, reprinted in 11 KINTNER, supra note 11, at 989, 994 (“If these premerger reporting requirements were imposed on every merger, the resulting added reporting burdens might more than offset the decrease in burdensome divestiture trials. That is why [the bill] applies only to approximately the largest 150 mergers annually[,]”); see also S. Rep. No. 94-803, at 66, reprinted in 10 KINTNER, supra note 11, at 210, 258 (“To include the bulk of the approximately 3,000 mergers that have occurred annually in the course of the past several years would, however, in the Committee’s judgment, impose an undue and unnecessary burden on business.”).
Agencies received notification of 58,301 transactions and sought clearance in 7,559 matters to create an exemption for acquisitions of a de minimis percentage of voting securities, the (12.97%) and issued 1,710 second requests (2.93%). (See Table A.1)

One reason for the low rate of investigated transactions is that many notified transactions do not involve horizontal competitors. For the period FY 1990 through FY 2010, over 18,000 (representing almost 40 percent) transactions notified under the Act involved no SIC Code or NAICS code “overlap.” (See Table A.2.) Although acquisitions of an upstream or downstream firm can be anticompetitive under certain conditions (as can acquisitions of future horizontal competitors, under certain conditions), the great bulk of merger enforcement efforts focus on transactions that involve firms currently competing in the same relevant markets. Because of its breadth, the Act captures a high number and corresponding percentage of transactions that do not involve actual horizontal competitors.16

Similarly, as Table A.3 shows in more detail, the vast majority of the investigations involve acquisitions of assets or acquisitions of voting securities that confer control.17 For the twenty-five year period FY 1987 through FY 2011, only 9.5 percent of Agency clearance requests and only 7.4 percent of Second Requests involved acquisitions of voting securities for a less than controlling (but not necessarily de minimis) interest in the acquired person.

16 Both agencies focus their merger review efforts on transactions involving horizontal competitors. Although NAICS codes are not a strong proxy for relevant antitrust markets, they are an early, key screen for identifying potentially problematic transactions, and officials at both Agencies have indicated the relevance of NAICS code overlaps in determining which filings are given a more detailed look. See ANTITRUST MODERNIZATION COMM’N, PUBLIC HEARING ON MERGER ENFORCEMENT 189 (Nov. 17, 2005) (testimony of Susan Creighton, Dir., Fed. Trade Comm’n Bureau of Competition), available at http://www.ftc.gov/bcp/anncompreports.shtm (last visited Mar. 24, 2013).

17 See 16 C.F.R. 801.1(b)(1)(i) (“The term control . . . means . . . holding 50% or more of the outstanding voting securities of an issuer.”).
The Exemption for “Acquisitions Solely for the Purpose of Investment” Is Insufficient to Exempt De Minimis Acquisitions Unlikely to Raise Competitive Concerns

The Act exempts certain transactions unlikely to raise substantive concerns from its reporting obligations, e.g., transactions in the ordinary course; acquisitions of debt; acquisitions that do not change the percentage of voting securities held by the acquiring person; acquisitions where the acquiring person already holds 50 percent or more of the target’s voting securities; and acquisitions of non-voting instruments.18

The Act also includes an exemption for de minimis acquisitions—acquisitions of 10 percent or less of an issuer’s outstanding voting securities—but limits the exemption to acquisitions “solely for the purpose of investment.”19 While potentially a very broad exemption, in practice the Agencies’ interpretation of the scope of the exemption appears to preclude reliance on it by investors who wish to do more than hold and vote their shares, because the exemption is read very narrowly. It “may not be invoked merely because the acquirer’s ‘principal’ or ‘predominant’ intent is investment.”20 “[A]ny investor who anticipates seeking to influence management decisions is an ‘active investor’ and not entitled to rely on the ‘investment only’ exemption.”21 For purposes of the exemption, the FTC has suggested that investors are one of two types, “passive” or “active”:

A passive investor may vote or sell the securities it already holds. An investor may change from a passive to an active status, wherein the investor takes steps to influence the conduct of an issuer[.] . . . [O]nce the investor’s intent changes to an active status, the investor must file premerger notification and observe the waiting period prior to acquiring any additional voting securities of an issuer.22

Voting securities are held solely for purposes of investment if “the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.”23 Neither the Act nor the HSR rules define what is meant by “basic business decisions” or “management decisions.” But the Agencies have given guidance on activity that precludes, or is presumed to preclude, reliance on the exemption. For instance, having a representative on the board of directors of the issuer is inconsistent with the investment purpose required under the Act.24 The Agencies have also suggested that several
other activities may be inconsistent with an investment only purpose, including nominating a candidate for the board of directors of the issuer; proposing corporate action requiring shareholder approval; soliciting proxies; having a controlling shareholder, director, officer, or employee simultaneously serving as an officer or director of the issuer; being a competitor of the issuer; or doing any of the foregoing with respect to any entity directly or indirectly controlling the issuer.25

The leading treatise on the Act identifies the difficulty of the complying with the rule:

The FTC's narrow construction of the term "solely for the purpose of investment" and particularly the word "solely" creates a significant problem with respect to the nature and the sufficiency of the evidence required to establish the requisite investment intent . . . . It is unclear, however, what evidence is required to make this determination."26

This difficulty is compounded by the Agencies' reliance, at times, on post-acquisition activity to allege pre-acquisition intent.27 The difficulty is, in large part, due to the subjective nature of many indicia of a person's intent and the difficulty of identifying factors (and the weight that should be attached to those factors) that are sufficient to show when or whether a change in intent has occurred.

25 Statement of Basis and Purpose, supra note 16, at 33,465. The FTC Bureau of Competition has identified certain additional conduct as inconsistent with the exemption. See Bruno Remarks, supra note 20 ("[D]irect and indirect attempts . . . to persuade management to put the issuer up for sale . . . [are] inconsistent with the purely passive intent necessary to rely on the exemption."); John M. Sipple, Jr., Chief, Fed. Trade Comm'n Premerger Notification Office, Remarks Before the N.Y. State Bar Association, Antitrust Section 18 (Jan. 16, 1990) ("A passive investor can meet with management to gather information about its investment and it can vote the stock it holds," but "if a significant shareholder makes suggestions to the issuer's management that it undertake certain actions, whether or not they require shareholder approval, such conduct may be construed as evidencing an intent inconsistent with an investment only intent."). Also "[p]reparing to launch a takeover is obviously inconsistent with the assertion that a person has no intention to participate in the formulation, determination or direction of the basic business decisions of the issuer, " as is "harboring an intent to attempt a takeover." id. at 16, 17.

Although the exemption is read narrowly, some public statements have introduced some confusion into the Agencies' position. One former associate director of the FTC Bureau of Competition indicated that if a company is "seriously considering a takeover attempt . . . it is not buying stock solely for the purpose of investment." Mullenix, supra note 20, at 128 (emphasis added). The same official went on to say:

If an acquiring person expects to make changes in the way the acquired company does business, to induce the acquired company to sell off some assets, or to participate in the current operations of the acquired company, it is not buying stock solely for the purpose of investment. Id. (emphasis added). Neither qualification—"seriously considering" or "expects to"—is fully consistent with a view that there is no level of contemplation of activity within the exemption.

See also Malcolm R. Pfuner, Shareholder Activism and the Hart-Scott-Rodino Act Exemption for Acquisitions of Voting Securities Solely for the Purpose of Investment, ANTITRUST, Summer 2006, at 74, 76–77 (discussing "unresolved questions concerning shareholder activism").

26 STEPHEN M. AXINN ET. AL., ACQUISITIONS UNDER THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT § 6.11[3] n.6 (Third Ed.). It is important to distinguish between the ambiguity of the investment-only exemption, which may cause an acquiring person to inadvertently fail to comply with the Act, and intentional efforts to evade the Act's reporting requirements, either directly by ignoring them, or indirectly, by engaging in a transaction or device for avoidance that transfers beneficial ownership of voting securities prior to HSR clearance. See, e.g., Complaint ¶ 13–15, United States v. Equity Group Holdings, No. 91-cv-0153 (D.D.C. Jan. 25, 1991) (use of a partnership structure to avoid filing); Complaint ¶ 12–15, United States v. Trump, No. 88-cv-0929 (D.D.C. Apr. 5, 1988) (use of an agent to purchase voting securities); Complaint ¶ 12–15, United States v. First City Financial Corp., No. 86-cv-0895 (D.D.C. Apr. 1, 1988) (same); Complaint ¶ 12–15, United States v. Wickes Companies, Inc., No. 88-cv-0782 (D.D.C. Mar. 23, 1988) (same). See also 16 C.F.R. § 801.90 (addressing efforts to avoid the Act). See generally Malcolm R. Pfuner, Transactions or Devices for Avoidance of Premerger Notification Obligations: Toward an Administrable and Enforceable Interpretation of 16 C.F.R. § 801.90, 58 ANTITRUST L.J. 1031 (1989); Bruce J. Prager & Paul T. Denis, Regulatory, Legislative, and Administrative Changes Relating to the Hart-Scott-Rodino Premerger Notification, 56 ANTITRUST L.J. 817, 837–38 (1987) (quoting former FTC Commissioner Terry Calvani stating that "very creative lawyering to get around the regulations is, in our view, a violation of the law.").


28 See Plaintiff's Statement of Legal Theory, United States v. Farley, No. 92-cv-1071 (N.D. Ill. Jun. 8, 1994) ("subjective intent may be sufficient to take an acquirer outside the exemption").
A misunderstanding of the Act’s reach and the scope of the investment-only exemption underlies the majority of the HSR Act enforcement decisions of the past decade. In the ten-year period from 2003 to 2012, the Commission and the Department of Justice filed fifteen enforcement actions alleging violations of the Act.29 (Two additional enforcement actions related to an HSR violation were brought under the Act as criminal cases.30) Of these, ten involved allegations that the acquiring person failed to comply with the reporting requirements of the Act.

- In seven of these matters, the acquiring person held (by virtue of the acquisition) a small minority interest in the issuer.31
- In two of these seven matters, the acquiring person took a toehold position in a competitor.32
- In two of these matters, the acquiring person served as the Chairman and Chief Executive Officer of the issuer.33

A misunderstanding of the Act’s reach and the scope of the investment-only exemption underlies the majority of the HSR Act enforcement decisions of the past decade. In the ten-year period from 2003 to 2012, the Commission and the Department of Justice filed fifteen enforcement actions alleging violations of the Act.29 (Two additional enforcement actions related to an HSR violation were brought under the Act as criminal cases.30) Of these, ten involved allegations that the acquiring person failed to comply with the reporting requirements of the Act.

- In seven of these matters, the acquiring person held (by virtue of the acquisition) a small minority interest in the issuer.31
- In two of these seven matters, the acquiring person took a toehold position in a competitor.32
- In two of these matters, the acquiring person served as the Chairman and Chief Executive Officer of the issuer.33


32 See Complaint, United States v. Manulife Fin. Corp., No. 1:04-cv-0722 (D.D.C. May 3, 2004) (acquisition of approximately 1.5 percent of the voting securities of John Hancock Financial Services, Inc. did not qualify for the “investment-only” exemption because “[a]t the time it made those acquisitions . . . Manulife was considering a Manulife-John Hancock combination and its intent was not ‘solely’ for the purpose of investment[,]”); Complaint, United States v. Smithfield Foods, Inc., No. 1:03-cv-00434 (D.D.C. Feb. 28, 2003) (Smithfield Foods was not exempt from the filing and waiting period requirements of the Act because, at the time of its acquisition of IBP voting securities, the company was “considering and taking steps” towards a business combination with IBP, Inc., its competitor.).

33 See Complaint, United States v. Roberts, No. 1:11-cv-02240 (D.D.C. Dec. 16, 2011) (Chairman and Chief Executive Officer of Comcast Corporation violated the reporting requirements of the Act when he (i) acquired 400,000 shares of Discovery Series A voting securities on the open market and (ii) exercised options to acquire 6,667 shares of Discovery Series A voting securities and 60,000 shares of Discovery Series B voting securities. For an earlier case involving a Chairman and Chief Executive Officer’s failure to file for an acquisition of voting securities in the issuer, see Complaint, United States v. Figie Int’l, Inc., No. 1:97-cv-00302 (D.D.C. Feb. 13, 1997).
Rather than continuing to enforce the Act’s reporting requirements against transactions unlikely to raise substantive antitrust issues, a better response would be to eliminate the filing obligations for categories of transactions unlikely to violate Section 7.

**Previous Agency Efforts to Exempt De Minimis Acquisitions from the Reporting Requirements of the Act**

The Act grants the Commission, with the concurrence of the Assistant Attorney General, the authority to “exempt . . . transactions which are not likely to violate the antitrust laws.”36 The Commission has used this authority to expand or introduce exemptions37 “designed to reduce the compliance burden on the business community by eliminating the application of the notification and waiting period requirements to . . . transactions that are unlikely to violate the antitrust laws.”38 Relying on this grant of authority, the Commission has twice proposed to exempt all acquisitions of 10 percent or less of an issuer’s outstanding voting securities.

**The Proposed Rulemaking of 1977.** In its revised proposed rulemaking to establish the reporting rules for compliance with the Act, the Commission sought comment on a proposed exemption for acquisitions of 10 percent or less of an issuer’s voting securities “[b]ecause of the difficulty in establishing criteria for determining when voting securities are held ‘solely for the purpose of investment[,]’”39 While there was some support for a 10 percent exemption that disregarded the investment intent of the acquiring person,40 the Commission did not adopt a blanket 10 percent exemption.

---

34 See Complaint, United States v. Sacane, No. 1:05-cv-01897 (D.D.C. Sept. 26, 2005) (Sacane failed to file for acquisition of Aksys, Ltd. voting securities valued in excess of $50 million filing threshold and for a later acquisition of 50 percent of Aksys’s voting securities; he also failed to file for the acquisition of voting securities of Esperion Therapeutics, Inc., valued in excess of $50 million, and a later acquisition of additional Esperion shares valued at or in excess of $100 million, resulting in Sacane’s possession of approximately 33 percent of Esperion’s outstanding stock.).


37 See, e.g., Premerger Notification; Reporting and Waiting Period Requirements, 61 Fed. Reg. 13,666, 13,666 (Mar. 28, 1996) (to be codified at 16 C.F.R. pts. 801–802) (amendments to the rules that provide “several new exemptions . . . for certain types of acquisitions of reality and carbon-based mineral reserves that are not likely to violate the antitrust laws.”); Premerger Notification; Reporting and Waiting Period Requirements, 44 Fed. Reg. 66,781, 66,782 (Nov. 21, 1979) (to be codified at 16 C.F.R. pt. 802) (extending Rule 802.20 to eliminate reporting and waiting period requirement for acquisitions of assets valued at less than $15 million, and the acquisition of voting securities conferring control of an issuer with net sales or total assets of less than $25 million.).

38 Premerger Notification; Reporting and Waiting Period Requirements, 61 Fed. Reg. 13,666, 13,666 (Mar. 28, 1996) (to be codified at 16 C.F.R. pts. 801–802). See also Premerger Notification; Reporting and Waiting Period Requirements, 44 Fed. Reg. 66,781, 66,781–82 (Nov. 21, 1979) (to be codified at 16 C.F.R. pt. 802) (Original Rule 802.20 exempted certain transactions that were clearly reportable under the Act because of the “Commission’s belief . . . that certain relatively small transactions . . . that might be reportable under the act are sufficiently unlikely to have a significant anticompetitive impact that imposition of the act’s requirements would not represent an appropriate use of public resources.”).


40 Statement of Basis and Purpose, supra note 16, at 33,490.
exemption, noting that “the language of Section 7A(c)(9) clearly makes the acquiring person’s intentions a relevant consideration.”41 In addition, “such an exemption would, when large corporations are involved, eliminate the $15 million reporting threshold of section 7(A)(a)(3)(B), contrary to congressional intent.”42

**The Proposed Rulemaking of 1988.** In a 1988 Notice of Proposed Rulemaking,43 the FTC, with the concurrence of the DOJ, proposed exempting from the Act’s notification and waiting period requirements all acquisitions that did not result in the acquiring person holding in excess of 10 percent of the issuer’s outstanding voting securities.44 The Notice indicated that the Commission’s experience suggested “that such acquisitions are unlikely to violate the antitrust laws.”45

The Agencies also proposed two alternatives to an absolute 10 percent exemption. One, the “escrow alternative,” would have required the acquiring person to comply with the Act, but allow the voting securities to be placed in escrow, pending termination or expiration of the waiting period.46 Under the second alternative proposal, the “optional notice alternative,” the acquired person would be relieved of its filing obligation, thus eliminating the requirement that the acquirings person provide notice to the target company.47 Thus, the acquisition, while still subject to antitrust agency review, would not become public because of the filing procedures. But the optional notice proposal placed an increased burden on the acquiring person by requiring that it provide information on the acquired person’s product offerings, geographic operations, and ownership of controlled subsidiaries, minority investments, and third-party ownership of the target company.48

The Commission, in proposing the rule changes

[R]ecognize[d] that premerger notification obligations can create delay even for acquisitions that do not raise competitive concerns, and that this delay can impose significant burdens on buyers and sellers. However, this interruption does not reflect a Congressional decision that the Commission should regulate generally the acquisition of voting securities or assets. It is, rather, the necessary conse-

---

41 Id.
42 Id.
44 Proposed Rule 802.24 read:

§ 802.24: De minimis acquisitions of voting securities. An acquisition of voting securities shall be exempt from the requirements of the act if as a result of the acquisition the acquiring person would hold 10% or less of the outstanding voting securities of the issuer, regardless of the dollar value of the voting securities so acquired or held.

*Id.* at 36,845.
45 Id. at 36,834.
46 Proposed Rule 801.34 read:

§ 801.34: De minimis acquisitions of voting securities. (a) An acquiring person shall not be considered to have consummated an acquisition of voting securities within the meaning of the act if: (1) The acquiring person: (i) Holds as a result of the acquisition 10% or less of the issuer’s outstanding voting securities; (ii) Immediately places into escrow any voting securities whose acquisition is subject to notification obligations of the act; and (iii) Requires the escrow agent to vote and withhold from voting all such voting securities placed into escrow in the same proportion that all other voting securities of the issuer are voted and withheld from voting; and (2) The acquisition is not the result of a tender offer. (b) The release of such voting securities from escrow shall be considered consummation of an acquisition of those voting securities.

*Id.* at 36,845.
47 See *Id.* at 36,846–46 (Proposed Rule § 802.25 (Optional Notification and Report Form exemption) and modifications to existing Rules 801.30, 803.1, 803.2, 803.3, 803.5, 803.6, and 803.20).
48 *Id.* at 36,843–46.
quence of preventing consummation while the antitrust agencies assess the likelihood that proposed transactions will violate the antitrust laws.49

The Commission’s primary and alternative proposals reflected (i) an understanding that the HSR Act was “never intended to generate public disclosure of stock acquisitions”50 but “solely” to “give the antitrust agencies an opportunity to determine whether a proposed acquisition might violate the antitrust laws,”51 and (ii) a concern that the differences between the Act’s reporting requirements and securities laws (which allowed for filings after consummation of an acquisition of 10 percent or less of an issuer’s voting securities) encouraged non-compliance with the Act.52

The Commission’s examination of its merger enforcement history suggested that acquisitions of 10 percent or less of an issuer’s voting securities were unlikely to violate the antitrust laws.53 The Commission also found very few instances of transactions that raised even modest substantive concerns—as measured by the number of clearance requests or second requests issued—for the five-year period 1981 to 1986. Table 1 reprints the Commission and DOJ’s investigation statistics for this period, updated to account for information not available when the 1988 Notice was published.54

Table 1

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td># of Transactions Reported (Adj)</td>
</tr>
<tr>
<td># of Transactions Reported/Acquisitions of 10% or Less</td>
</tr>
<tr>
<td>% of Filings, at 10% or Less</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investigation Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td># of Clearance Requests/Acquisitions of 10% or Less</td>
</tr>
<tr>
<td># of Clearance Requests as a % of # of Transactions Reported (Adj)</td>
</tr>
<tr>
<td># of Clearance Requests as a % of # of Transactions Reported (10% or less)</td>
</tr>
<tr>
<td># of Second Requests/Acquisitions of 10% or Less</td>
</tr>
<tr>
<td># of Second Requests as a % of Transactions Reported (Adj)</td>
</tr>
<tr>
<td># of Second Requests as a % of Transactions Reported (10% or less)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Agency Challenge to Acquisitions of &lt;,= 10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

49 Id. at 36,833.
50 Id. at 36,834.
51 Id. at 36,833.
52 Id. at 36,834. Revisions to the Rules simply because acquiring or acquired persons choose to avoid compliance with the Act do not seem justified or likely to encourage compliance with Act or the Rules. However, revising the Rules because they are complex and ambiguous is not only justifiable but also consistent with President Obama’s Executive Order. See Exec. Order No. 13,563, supra note 5.
54 The data is from the 1988 Notice, id., with the exception of data for 1985 and 1986 “adjusted transactions”; that data was collected from Fed. Trade Comm’n, Tenth Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, app. C (1987), available at http://www.ftc.gov/bc/hsr/annrpts/10annrpt1986-87.pdf. Data on the number of challenges (zero) to acquisitions of 10 percent or less of an issuer’s voting securities was collected by the author from a review of public
As identified in Table 1, for acquisitions of 10 percent or less of an issuer’s securities, the Agencies requested clearance at a 14.5 percent rate and a request for additional information at a 1.38 percent rate.\(^{55}\) Neither agency challenged any such acquisition as likely to violate the antitrust laws.

**Reaction to the 1988 Notice.** The Commission received sixteen substantive comments in response to the 1988 proposed rulemaking.\(^{56}\) A number of businesses supported the principal proposal (but not the alternative proposals) and agreed with the Commission’s conclusion that acquisitions of 10 percent or less of an issuer’s voting securities were unlikely to raise antitrust concerns; some also noted the difficulty of complying with the “intent” standard of the investment-only exemption.\(^{57}\) The major antitrust bar associations also supported the principal proposal, for similar reasons.\(^{58}\) One law firm, arguing in support of the principal proposal, noted that Commission’s investment-only exemption rules interfered with the efficient functioning of the capital markets for no good antitrust purpose and the principal proposal would correct for this interference without affecting antitrust enforcement, and would comply with Congress’s intent that the Act “not interfere unnecessarily with the operation of the market for corporate control.”\(^{59}\)

However, the proposal also received some resistance from the business and legal community. A joint comment of two law firms and an economic firm (collectively, Group) opposed the Commission’s proposal, believing it to be “an ill-advised, and probably unauthorized, effort by the Commission to repeal the Congressionally-enacted $15 million notification threshold.”\(^{60}\) The Group believed that the proposed rule, if adopted “would permit acquisitions that may raise substantial antitrust concerns to go forward without the Congressionally-required premerger review.”\(^{61}\) According to the Group’s comment, the Commission “ha[d] failed to show that the acquisitions it propose[d] to exempt . . . [were] inherently devoid of antitrust concern.”\(^{62}\) In fact, according to the Group, “minority stock acquisitions of this type may raise valid antitrust concerns when they

---

\(^{55}\) The 1.38 percent rate corresponds to just two transactions. In the 1988 Notice, the Commission explained that these two second requests were issued in conjunction with the acquired person’s receipt of voting securities of the acquiring person, where the acquiring person was purchasing 100 percent of the acquired person’s assets. “The concern that generated the second request was the merging of the two businesses, not the acquisition of a small amount of voting securities by what would become a shell corporation.” 1988 Notice, *supra* note 43, at 36,838.

\(^{56}\) All comments are on file with the author.

\(^{57}\) See Comments of Chase Manhattan Bank, N.A. (Nov. 18, 1988) (on file with author); Comments of Itel Corporation (Nov. 8, 1988) (on file with author); Comments of Reliance Group Holdings, Inc. (Nov. 21, 1988) (on file with author); Comments of Rothschild Inc. (Oct. 18, 1988) (on file with author).

\(^{58}\) Comments of the American Bar Association, Section of Antitrust Law (Nov. 21, 1988) (on file with author); Comments of the Association of the Bar of the City of New York, Committee on Antitrust and Trade Regulation (Dec. 19, 1988) (on file with author).

\(^{59}\) Comments of Wilmer, Cutler & Pickering at 7 (Nov. 21, 1988) (on file with author); see also Comments of Akin, Gump, Strauss, Hauer & Feld at 7 (Dec. 23, 1988) (on file with author) (arguing that it was Congress’s intent that the Act conform to the Williams Act’s principle of neutrality in regulating tender offers, and that this principle of neutrality was “threatened by the operation of the $15 million [HSR] filing threshold” which would be ameliorated by adopting the principle proposal); comments cited *supra* note 58.

\(^{60}\) Comments of Covington & Burling, Howrey & Simon, and Capital Economics at 3 (Dec. 19, 1988) (on file with author).

\(^{61}\) *Id.*

\(^{62}\) *Id.* at 4.
Congressional reaction to the FTC’s proposal, though limited, was negative, and may have been the determinative factor in the Commission’s failure to proceed with the proposed rule. Congressman James Florio, the Chairman of the House of Representatives Subcommittee on Commerce, Consumer Protection, and Competitiveness, stated that he was “extremely concerned with the [] proposal” as it would “make it harder . . . to monitor potential anticompetitive acquisitions[.]” He was “particularly concerned” that the proposal would “affirmatively facilitate hostile takeovers and takeover attempts, with negative consequences for companies, employees, communities, and [the] nation’s competitiveness.” Congressman Florio did not believe the FTC “should change its rules to affirmatively assist corporate raiders” and investors who “place undue emphasis on short-term results.” In conclusion, he “urge[d] the Commission not to adopt the[] proposed changes.”

Congressman Jack Brooks and Senator Jim Sasser were also opposed to the proposal. A year later, without responding to the Comments, the Commission indicated it “ha[d] no action pending or planned . . . regarding th[e] rulemaking.” Since then, the Commission has not publicly indicated an interest in revising the investment-only exemption.

Congressman Jack Brooks urged the Commission to “withdraw or delay [the] proposal until it can be reviewed by the appropriate Congressional committee” and expressed concern that the proposal would, for all practical purposes, repeal the $15 million reporting threshold. Comments of Rep. Jack Brooks (Dec. 9, 1988) (on file with author). Congressman Brooks did “not believe that Congress delegated authority to the Commission to repeal the statutory notification threshold.” Comments of Sen. Jim Sasser at 1 (Oct. 25, 1988) (on file with author). In a period of “speculative frenzy, excessive leverage, and potentially massive restructurings[,]” where “the hostile takeover craze” is “causing great worry to economists and to the employees of the firms involved[,]” Sen. Sasser “believe[d] that amendments to the premerger notification rules . . . should be deliberated and made only by Congress.” Comments of Sen. Jim Sasser at 1–2.

64 Id.
65 Id. at 2.
66 Id.
67 See Comments of American Society of Corporate Secretaries, Inc. (Dec. 19, 1988) (on file with author); Comments of CalFed Inc. (Oct. 25, 1988) (on file with author); Comments of The Williams Companies, Inc. (Nov. 18, 1988) (on file with author); Comments of Unocal Corp. (Nov. 7, 1988) (on file with author). The Unocal Corporation argued that the exemption if it were adopted, would “give the appearance that stock acquisitions, which may be in the hundreds of millions if not billions of dollars, do not raise antitrust concerns[,]” but “an asset acquisition of more than $15 million would raise such concerns.” Comments of Unocal Corp., id. at 2. There is a reasonable basis for distinguishing asset acquisitions from acquisitions of a de minimis percentage of voting securities, even where the value of those voting securities is substantial: an asset purchase gives the acquiring person direct control over the utilization of those assets, while a purchase of a de minimis percentage of an issuer’s voting securities gives no direct control (and probably no indirect control) of the issuer’s utilization of those assets.
68 Id.
69 Id.
71 However, in 2006, the Director of the FTC’s Bureau of Competition noted the FTC staff were “mak[ing] progress towards developing official agency initiatives that should lower the burdens imposed on investors in complying with the HSR Act.” See Letter of Jeffrey Schmidt, Dir., Fed. Trade Comm’n Bureau of Competition, to Robert Teitelman, Editor-in-Chief, The Daily Deal (June 29, 2006), available at http://www.ftc.gov/bc/hsr/060629deallettertoeditor.final1.pdf. These initiatives should be pursued and the Bureau’s analysis underlying its initiatives made public.
Experience Provides a Sound Basis for Exempting De Minimis Acquisitions

**Updating the Investigation and Enforcement Data (1987–2011).** Although the Agencies set forth a compelling argument (with supportive data) for a de minimis exemption in its 1977 and 1988 proposed rulemakings, the quarter century of experience with the Act since the proposed 1988 rule-making provides additional evidence of the “sound basis” for such an exemption.\(^{72}\) Table 2 updates the data the Commission released with its 1988 Notice, for the fourteen-and-a-third year period FY 1987 through Jan. 2001.\(^{73}\) Because data at the 10 percent level are not publicly available, the table instead summarizes data for acquisitions of less than 15 percent (acquisitions valued in excess of $15 million, but less than an acquisition of 15 percent or more of an issuer’s outstanding voting securities).

<table>
<thead>
<tr>
<th>Table 2(^{74})</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Filing Statistics</strong></td>
</tr>
<tr>
<td>OCT. 1986–JAN. 2001</td>
</tr>
<tr>
<td># of Transactions Reported (Adj)</td>
</tr>
<tr>
<td># of Transactions Reported (Acquisitions of &lt;15%)</td>
</tr>
<tr>
<td>% of Filings (Acquisitions of &lt;15%)</td>
</tr>
<tr>
<td><strong>Investigation Statistics (Clearance)</strong></td>
</tr>
<tr>
<td># of Clearance Requests (Total)</td>
</tr>
<tr>
<td># of Clearance Requests (Acquisitions of &lt;15%)</td>
</tr>
<tr>
<td># of Clearance Requests (Acquisitions of &lt;15%), as a % of Filings (Acquisitions of &lt; 15%)</td>
</tr>
<tr>
<td># of Clearance Requests (Acquisitions of &lt;15%), as a % of All Clearance Requests</td>
</tr>
<tr>
<td><strong>Investigation Statistics (Second Requests)</strong></td>
</tr>
<tr>
<td># of Second Requests (Total)</td>
</tr>
<tr>
<td># of Second Requests (Acquisitions of &lt;15%)</td>
</tr>
<tr>
<td># of Second Requests (Acquisitions of &lt;15%), as a % of Filings (Acquisitions of &lt; 15%)</td>
</tr>
<tr>
<td># of Second Requests (for Acquisitions of &lt;15%), as a % of All Second Requests</td>
</tr>
</tbody>
</table>

\(^{72}\) Baer, supra note 4, at 854 (“The agencies have . . . broadened exemptions to cover transactions that now have a sound basis for being excluded.”).

\(^{73}\) Revised filing thresholds took effect in Feb. 2001, as a consequence of the 2000 Amendments to the Act. Data for filings below the 15 percent level are no longer publicly available.

\(^{74}\) This data is collected from Table V of the Hart-Scott-Rodino Annual Reports to Congress for each year between 1986 and 2001. See Fed. Trade Comm’n & U.S. Dep’t of Justice, Hart-Scott-Rodino Annual Reports, available at [http://www.ftc.gov/bc/anncompreports.shtm](http://www.ftc.gov/bc/anncompreports.shtm) (last visited Mar. 24, 2013). More recent data is not publicly available, but is in the possession of the Commission. Because the Commission “rel[ies] on the public, including consumers, businesses, advocates, industry experts and others to help [it] decide whether it’s time to update a rule . . . leave it as is, or even rescind it,” such information should be made available to the public. Fed. Trade Comm’n, FTC Regulatory Review, [http://www.ftc.gov/ftc/regreview/index.shtml](http://www.ftc.gov/ftc/regreview/index.shtml) (last visited Mar. 24, 2013). This information can easily be incorporated into the HSR Annual Report. Historical information can be released in the Commission’s upcoming notice of its rule review schedule.
The data show that neither the Commission nor the Antitrust Division investigated a material number of acquisitions of less than 15 percent of an issuer's outstanding voting securities. Of 2,156 filings for acquisitions of less than 15 percent of an issuer's voting securities, the Agencies requested clearance in 155 matters (approximately 11 per year) and issued a second request in 17 matters (just over 1 per year).

Over this same period, the Agencies challenged only four acquisitions of a less than 15 percent equity investment; three of these four acquisitions were associated with a larger transaction that was also challenged.\(^7\) During the life of the Act, the Agencies have also challenged a small number of transactions where the acquiring person intended to acquire 20 percent to 30 percent of an issuer's outstanding voting securities.\(^6\)

In addition to these few challenges of a direct acquisition of a de minimis interest in another company, the Agencies have identified substantive concerns where, absent relief, the merged entity would acquire indirectly (or by reason of existing (pre-consummation) investments, hold), a
In practice, the Act has required the notification of tens of thousands of transactions that did not violate the antitrust laws, or even result in a preliminary investigation at either Agency. During the period the Act has been in force, there appears to be only one instance in which an Agency has challenged the direct acquisition of a minority interest in a firm that competed with another firm in which the acquiring person(s) already held a minority interest.80

A Proposed Rule to Eliminate Filings for Transactions Unlikely to Violate the Antitrust Laws

The Agencies’ three and a half decades of experience with the HSR Act show that it is significantly overbroad. In practice, the Act has required the notification of tens of thousands of transactions that did not violate the antitrust laws, or even result in a preliminary investigation at either Agency. Each such transaction was forced to observe a waiting period that imposed unnecessary costs on the parties and the reviewing Agency. Those costs include (i) the delayed implementation of efficiencies associated with an acquisition; (ii) interference with the market for corporate control, minority investment in a competitor to the merged entity. Most77 but not all78 of these concerns have arisen where the acquiring person would, post acquisition, hold a minority interest in a competitor in excess of 15 percent. (With the exception of the DOJ’s challenges to British Telecommunications plc’s acquisition of a 20 percent interest in MCI Communications Corp., and France Telecom’s and Deutsche Telekom’s investment in Sprint Corporation, discussed above,79 the challenged transactions involved horizontal competitors.) During the period the Act has been in force, there appears to be only one instance in which an Agency has challenged the direct acquisition of a minority interest in a firm that competed with another firm in which the acquiring person(s) already held a minority interest.80

77 See, e.g., CommScope, Inc., 72 Fed. Reg. 72,376 (U.S. Dep’t of Justice Dec. 20, 2007) (requiring divestiture of target’s 30 percent interest in a competitor in the market for drop cable); Univision Comm’n, Inc., 68 Fed. Reg. 27,851 (U.S. Dep’t of Justice May 21, 2003) (requiring Univision to divest the shares sufficient to hold no more than 15 percent (within 3 years) and 10 percent (within 6 years) of its 30 percent interest in a competitor to the target); Decision and Order, Conoco Inc., File No. 021-0040 (FTC Aug. 30, 2002), http://www.ftc.gov/os/2002/08/conocophillipsdso.pdf (divestiture of certain natural gas gathering systems where, absent divestiture, those assets would be a competitor to a firm 30 percent owned by the merged entity); Clear Channel Comm’ns, Inc. 66 Fed. Reg. 12,544 (U.S. Dep’t of Justice Feb. 27, 2001) (merging companies to divest acquired party’s 29 percent equity interest in advertising company that competed with acquiring party’s subsidiary); AT&T Corp., 65 Fed. Reg. 38,584 (U.S. Dep’t of Justice June 21, 2000) (divestiture of the acquired company’s 34 percent interest in a firm that competes with an entity controlled by the acquiring person); AT&T Corp., 64 Fed. Reg. 2,506 (U.S. Dep’t of Justice Jan. 14, 1999) (TCI must divest 23.5 percent ownership interest in Sprint, as a condition to its merger with AT&T); Lockheed Martin Co., 122 F.T.C. 161 (1996) (acquiring person required to cap, at 20 percent, its investment in firm that held 33 percent interest in a competitor of the acquiring person; investment also subject to conduct restrictions); Gillette Co., 55 Fed. Reg. 12,568 (U.S. Dep’t of Justice Apr. 4, 1990) (23 percent interest in a competitor must be held passively, and subject to conduct restrictions).

78 See, e.g., Bell Atlantic Corp., 64 Fed. Reg. 32,523, 32,533 (U.S. Dep’t of Justice June 17, 1999) (requiring the merged company to obtain approval to continue to hold the acquired company’s minority interests, ranging from 2–40 percent, in competitors offering cell phone service in competition to the acquiring company; merged company must show the holdings were completely passive); Zeneica Grp. plc, 127 F.T.C. 874 (1999) (Zeneica required to divest various assets to, and 3 percent interest in, company that is an actual potential competitor to merger partner Astra); Medtronic, Inc., 126 F.T.C. 865 (1998) (order requiring and restructuring Medtronic’s less than 10 percent interest in a competitor to the merged entity to be passive); US West, Inc., 61 Fed. Reg. 58,703 (U.S. Dep’t of Justice Nov. 18, 1996) (divestiture of the target’s 11 percent interest in a competitor to the acquiring person required; a 34 percent passive investment in another competing entity was ordered divested by the FCC); see also Analysis of Agreement Containing Consent Order, Boston Scientific Corp., 71 Fed. Reg. 24,714, 24,717 (Fed. Trade Comm’n Apr. 26, 2006) (buyer of divested assets to divest “small equity position (under 5%)” in merged company so as to “limit any long term entanglements”).

79 See supra notes 75 & 76.

80 See Bain Capital, LLC, 73 Fed. Reg. 10,808 (U.S. Dep’t. of Justice Feb. 28, 2008). Concerns associated with holding minority interests in competing companies have arisen in the petroleum and natural gas industries, in markets for the pipeline transportation of product. See, e.g., Analysis to Aid Public Comment, Shell Oil Co., 62 Fed. Reg. 67,868 (FTC Dec. 30, 1997) (parties to a joint venture must divest either a 14 percent interest or a 24 percent interest in two competing pipelines). The FTC has challenged the acquisition of a minority interest in one firm, where associates of the acquiring person held a controlling interest in a competitor. TC Group LLC, 2007 WL 293866 (Fed. Trade Comm’n Jan. 24, 2007) (challenge to an acquisition of an 11 percent interest in Kinder Morgan, Inc., by each of two separately controlled funds of the TC Group, L.L.C., where a third separately controlled TC Group fund held a 50 percent interest in a competitor to Kinder Morgan; parties required to agree to restrictions sufficient to make the 50 percent investment a passive investment).
including changes in the financial terms of an acquisition, especially for acquisitions “in which voting securities . . . are to be acquired from a holder . . . other than the issuer”\(^{81}\); (iii) legal fees, opportunity costs, and the significant filing fees associated with the acquiring and acquired persons’ compliance with the Act; and (iv) the Agency resources devoted to ensuring compliance with the Act and to reviewing HSR filings unlikely to raise anticompetitive concerns.\(^{82}\)

Some of these costs may be unavoidable, but exempting from the HSR Act’s filing requirements those transactions that are very unlikely to raise competitive concerns—based on historical experience and economic theory—may eliminate a significant portion of such costs. Apparently recognizing these problems, the Agencies have twice considered imposing a flat 10 percent exemption for stock acquisitions. Although the Agencies did not finalize these proposals, the quarter-century of experience since then strongly supports the need for such an exemption.

The Commission should replace the existing exemption for acquisitions solely for the purpose of investment with a new Rule, as follows\(^{83}\):

An acquisition of voting securities shall be exempt from the requirements of the act if the acquisition does not result in the acquiring person holding in excess of 15% of the outstanding voting securities of the issuer, provided that the Associated Group is not a Competitor to the issuer nor holds in excess of 15% of the outstanding voting securities (or, in the case of a noncorporate entity, in excess of 15% of the economic interests) of any entity that is a Competitor of the issuer (or any entity controlled by the issuer) to be acquired.\(^{84}\)

Notwithstanding the proviso in the immediately preceding sentence, such acquisitions (of the type identified in the immediately preceding sentence) will be exempt from the requirements of the Act if (a) the competitive sales of either the Associated Group or the issuer are less than 2% of their respective total sales or (b) the competitive sales of each of the Associated Group and the issuer are less than 4% of their respective total sales.

---

\(^{81}\) 16 C.F.R. § 801.30(a)(5).

\(^{82}\) These opportunity costs were recognized by the sponsors of the 2000 amendments to the Act. See, e.g., Statement of Sen. Orrin Hatch, 145 CONG. REC. S13,973–74 (daily ed. Nov. 4, 1999) (“[C]ompanies frequently are required to notify the Antitrust Division and the FTC or proposed transactions that do not raise competitive issues. As a result, the agencies are required to expend valuable resources performing needless reviews of transactions . . . . In short, current law [] imposes . . . a sizeable drain on the resources of the agencies.”); Statement of Sen. Herbert Kohl, id. at S13,974–75 (supporting an increase in the size of transaction jurisdictional threshold from $15 million to $35 million because “[t]his will both lessen the agencies’ burden of reviewing small transactions unlikely to seriously affect competition and enable the agencies to allocate their resources to properly focus on those transactions most worthy of scrutiny.”).

\(^{83}\) Because the Commission, acting with the concurrence of the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, has the statutory authority to “except[] [from the Act] . . . transactions which are not likely to violate the antitrust laws[,]” 15 U.S.C. § 17a(d)(2)(B), this exemption can be incorporated into the Rules governing compliance with the Act and does not require an amendment to the Act.

\(^{84}\) Fifteen percent is chosen to be consistent with existing Rule 802.64 (Acquisitions of voting securities by certain institutional investors). 16 C.F.R. § 802.64. Assuming adoption of the proposed rule, Rule 802.64 should be amended by striking subparagraph (b)(3) (“made solely for the purpose of investment”). The aggregation requirement is consistent with the approach the agencies have used in acquisitions involving affiliated or associated investment funds. See Bain Capital, LLC, 73 Fed. Reg. 10808 (U.S. Dep’t. of Justice Feb. 28, 2008) (aggregating the minority ownership interests of various affiliated funds and co-investment vehicles of Bain Capital, LLC (Bain) and Thomas H. Lee Partners, L.P., (THL) in competitors to Clear Channel Communications, Inc. (Clear Channel), where each of Bain and THL (through affiliated funds and co-investors) would acquire at least 35 percent of Clear Channel’s outstanding voting rights. (Each of Bain and THL held, in the aggregate, 25 percent of the voting interests to a competitor of Clear Channel; THL also held, in the aggregate, 14 percent of a second competitor of Clear Channel. Id.) See also TC Group, LLC, supra note 80.
Definitions of Competitor and Associated Group would also need to be incorporated into the Rules.85 I propose the adoption of the following:

A person is a Competitor to another person, if, by virtue of their business and location of operations, the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.86

An Associated Group is (i) the acquiring person, plus (ii) all associates of the acquiring person.

The proposed rule would exempt a few classes of transactions—certain minority investments in an upstream or downstream firm or in a potential competitor (because of the narrow exemption for firms with de minimis competitive sales)—that might, under narrow circumstances, raise antitrust concerns. However, even if they did raise competitive concerns, the transactions would not raise the “unscrewing the assets” concern that motivated Congressional adoption of the Act. Concerns associated with such transactions can be, and have been, addressed through behavioral, as well as structural, relief. Such restrictions can be obtained post-consummation without limiting the likely effectiveness of the relief, and without imposing a substantial burden on either the agency or the parties. Such investments would also be subject to Section 1’s prohibition of agreements in restraint of trade.

The proposed rule would also exempt acquisitions of small minority investments in competing firms. While in theory such acquisitions could raise substantive antitrust concerns, history has demonstrated that in practice these concerns arise infrequently, if ever. In addition, Section 8’s prohibition on interlocking directorates and officers makes it difficult for an acquiring person to assert managerial control over both entities87 or to receive competitively sensitive information from both firms; the limited investment in either competitor makes it unlikely to give the acquiring person the ability (or strong incentive) to change the competitive behavior of one or both firms, and unlikely to receive any material benefit from a change in the competitive interaction between the firms. These transactions also do not raise the remedial problems that motivated passage of the Act: substantive concerns can be, and have been, addressed using conduct restrictions, such as a requirement that an investment be held passively.88

Alternatively, an exemption for all acquisitions of a de minimis amount without consideration of any competitive overlap could be considered. The Agencies’ historical record of merger investigations and enforcement actions would certainly justify such an approach. But because the

85 The term “acquiring person” is already defined in the Rules. See 16 C.F.R § 801.2(a). The term “associate” is also defined in the Rules, but the reach of the definition would need to be expanded to include the new rule. See 16 C.F.R. § 801.1(d)(2). Examples illustrating the application of the proposed rule are in the Appendix.

86 The definition of competitor is consistent with the definition in Section 8 of the Clayton Act. 15 U.S.C. § 19(a)(1)(B). See ABA SECTION OF ANTITRUST LAW, INTERLOCKING DIRECTORATES: HANDBOOK ON SECTION 8 OF THE CLAYTON ACT 49–56 (2011) (discussing the term competitor, as applied in Section 8 case law). “Competitive sales” is defined in Section 8. 15 U.S.C. § 19(a)(2)(C) (“competitive sales means the gross revenues for all products and services sold by one corporation in competition with the other”). Robert Schlossberg identifies practical questions an acquiring person can use to identify whether the Associated Group is a competitor to the issuer (or entities held by the issuer). See Schlossberg, supra note 16. These questions can be incorporated into a Statement of Basis and Purpose accompanying adoption of the proposed rule to provide additional guidance in support of compliance with the rule.


88 See cases discussed supra notes 75–80.
Commission has twice declined to adopt an exemption for acquisitions of no greater than 10 percent of an issuer’s outstanding voting securities, an exemption that considers whether the parties are competitors may be more palatable to enforcers and legislators. However an exemption—without any additional qualifiers—for all acquisitions of no more than 15 percent of the outstanding voting securities of an issuer is very unlikely to impact the Agencies’ ability to enforce the substantive restrictions of Section 7 and to prevent or remedy acquisitions that “may . . . substantially lessen competition” or “tend to create a monopoly.”

Conclusion

Twenty-five years ago, James Mullenix, an associate director of the FTC Bureau of Competition stated that “premerger notification is not an end in itself. Its value lies in its demonstrated ability to improve our substantive review of mergers under the Clayton Act.” While the Act’s ability to improve the substantive review of mergers is largely unquestioned, it is wildly overbroad in its notification requirements. Over the life of the Act, only about 3 percent of all transactions notified under the Act receive a request for additional information. Over the last decade, the period after the 2000 Amendments to the Act, fewer than 20 percent of all filings even triggered a clearance request. Nearly thirty-five years of experience with the Act make clear that it requires notification of too many transactions that do not raise competitive concerns.

Although the FTC has procedures in place to consider new filing exemptions or to revise existing exemptions such as those proposed here, the Agency need not follow its usual timeframe, particularly where existing data demonstrate the need for revision. The FTC “conduct[s] a regular, systematic review of all its rules and guides on a rotating basis[,]” to ensure that they enhance consumer welfare without imposing undue burdens on business.” Such rules “need to be reviewed periodically to ensure they are up-to-date, effective, and not overly burdensome.” Although the Commission had previously intended to review the Rules exempting transactions from the Act in 2013, they are now scheduled for a review in 2020. However, the Commission also indicated that it would “accelerate these reviews if necessary.” Over nearly thirty-five years—having been notified of over 60,000 acquisitions—the antitrust agencies have not sought relief for more than a handful of acquisitions of 15 percent or less of an issuer’s voting securities. An accelerated review leading to the replacement of the existing investment-only exemption rule is called for.

90 Mullenix, supra note 20, at 130–31.
92 See FTC’S REGULATORY REFORM PROGRAM, supra note 5.
94 Notice of Intent to Request Public Comments, 77 Fed. Reg. 22,234, 22,235 (Apr. 13, 2012). The Commission also stated that the review of the exemption rules would be consolidated with the review of the Act’s coverage and transmittal rules. In announcing the revised schedule, the Commission indicated that delay was appropriate because it had recently engaged in changes to each section of the rules: (i) overhauling the notification form (Transmittal Rules); (ii) amending the definition of “associates” in the Coverage Rules; and, (iii) making minor amendments to several of the Exemption Rules.
95 Id. at 22,235 n.4.
Table A.2

<table>
<thead>
<tr>
<th>FY OF TRANSACTION</th>
<th>(ADJUSTED) FILINGS (98)</th>
<th>NUMBER OF (ADJUSTED) FILINGS WITH ECONOMIC OVERLAP</th>
<th>PERCENTAGE OF (ADJUSTED) FILINGS WITH ECONOMIC OVERLAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1955</td>
<td>786</td>
<td>40.2%</td>
</tr>
<tr>
<td>1991</td>
<td>1376</td>
<td>801</td>
<td>58.2%</td>
</tr>
<tr>
<td>1992</td>
<td>1451</td>
<td>941</td>
<td>64.9%</td>
</tr>
<tr>
<td>1993</td>
<td>1745</td>
<td>1102</td>
<td>63.2%</td>
</tr>
<tr>
<td>1994</td>
<td>2128</td>
<td>1467</td>
<td>68.9%</td>
</tr>
<tr>
<td>1995</td>
<td>2612</td>
<td>1733</td>
<td>66.3%</td>
</tr>
<tr>
<td>1996</td>
<td>2864</td>
<td>2015</td>
<td>70.4%</td>
</tr>
<tr>
<td>1997</td>
<td>3438</td>
<td>2326</td>
<td>67.7%</td>
</tr>
<tr>
<td>1998</td>
<td>4575</td>
<td>2975</td>
<td>65.0%</td>
</tr>
<tr>
<td>1999</td>
<td>4340</td>
<td>2752</td>
<td>63.4%</td>
</tr>
<tr>
<td>2000</td>
<td>4749</td>
<td>2638</td>
<td>55.5%</td>
</tr>
<tr>
<td>2001</td>
<td>2234</td>
<td>1319</td>
<td>59.0%</td>
</tr>
<tr>
<td>2002</td>
<td>1142</td>
<td>713</td>
<td>62.4%</td>
</tr>
<tr>
<td>2003</td>
<td>968</td>
<td>600</td>
<td>62.0%</td>
</tr>
<tr>
<td>2004</td>
<td>1377</td>
<td>783</td>
<td>56.9%</td>
</tr>
<tr>
<td>2005</td>
<td>1610</td>
<td>894</td>
<td>55.5%</td>
</tr>
<tr>
<td>2006</td>
<td>1746</td>
<td>941</td>
<td>53.9%</td>
</tr>
<tr>
<td>2007</td>
<td>2108</td>
<td>1037</td>
<td>49.2%</td>
</tr>
<tr>
<td>2008</td>
<td>1656</td>
<td>869</td>
<td>52.5%</td>
</tr>
<tr>
<td>2009</td>
<td>684</td>
<td>398</td>
<td>58.2%</td>
</tr>
<tr>
<td>2010</td>
<td>1128</td>
<td>645</td>
<td>57.2%</td>
</tr>
</tbody>
</table>

\(97\) Received from the FTC pursuant to a Freedom of Information Act request. Original document on file with author.

Table A.3

<table>
<thead>
<tr>
<th>Filing Statistics</th>
<th>FY 1987–FY 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td># of HSR Filings (Adjusted) (Total)</td>
<td>54,399</td>
</tr>
<tr>
<td># of Filings (Asset Acquisitions)</td>
<td>18,990</td>
</tr>
<tr>
<td># of Filings (Voting Securities, =,&gt; 50%)</td>
<td>27,250</td>
</tr>
<tr>
<td># of Filings (Voting Securities, &lt;50%)</td>
<td>8,159</td>
</tr>
<tr>
<td># of Clearance Requests (Total)</td>
<td>7,559</td>
</tr>
<tr>
<td># of Clearance Requests (Assets)</td>
<td>2,539</td>
</tr>
<tr>
<td># of Clearance Requests (Voting Securities, =, &gt; 50%)</td>
<td>4,302</td>
</tr>
<tr>
<td># of Clearance Requests (Voting Securities, &lt;50%)</td>
<td>718</td>
</tr>
<tr>
<td># of Clearance Requests (Assets), as % of Total Clearance Requests</td>
<td>33.6%</td>
</tr>
<tr>
<td># of Clearance Requests (Voting Securities, =, &gt; 50%), as % of Total Clearance Requests</td>
<td>56.9%</td>
</tr>
<tr>
<td># of Clearance Requests (Voting Securities, &lt; 50%), as % of Total Clearance Requests</td>
<td>9.5%</td>
</tr>
<tr>
<td># of Second Requests (Total)</td>
<td>1,710</td>
</tr>
<tr>
<td># of Second Requests (Assets)</td>
<td>561</td>
</tr>
<tr>
<td># of Second Requests (Voting Securities, =, &gt; 50%)</td>
<td>1,023</td>
</tr>
<tr>
<td># of Second Requests (Voting Securities, &lt; 50%)</td>
<td>126</td>
</tr>
<tr>
<td># of Second Requests (Assets), as % of Total Second Requests</td>
<td>32.8%</td>
</tr>
<tr>
<td># of Second Requests (Voting Securities, =, &gt; 50%), as % of Total Second Requests</td>
<td>59.8%</td>
</tr>
<tr>
<td># of Second Requests (Voting Securities, &lt; 50%), as % of Total Second Requests</td>
<td>7.4%</td>
</tr>
</tbody>
</table>

Examples of the Application of the Proposed Rule

1. Investment Fund A, which is its own ultimate parent entity, intends to acquire voting securities of Corporation 1 representing 5 percent of the corporation’s outstanding voting securities and valued at $500 million. Neither Fund A, nor its associates, holds voting securities or economic interests in any person who is a competitor to Corporation 1. Investment Fund A’s acquisition is exempt from the reporting requirements of the Act.

2. Same facts as 1. Investment Fund B, which is its own ultimate parent entity, is an associate of Investment Fund A. Investment Fund B intends to acquire voting securities of Corporation 1 representing 2.5 percent of the company’s outstanding voting securities and valued at $250 million. Neither Investment Fund B, nor its associates, holds voting securities or an economic interest in a competitor to Corporation 1, but Investment Fund A holds 5 percent of Corporation 1. Investment Fund B’s acquisition of 2.5 percent of the voting securities of Corporation 1 is exempt from the reporting requirements of the Act because Investment Fund B is not acquiring in excess of 15 percent of the voting securities of Corporation 1, and the Associated Group does not hold voting securities or economic interests in a Competitor to Corporation 1.

3. Assume the transactions identified in Examples 1 and 2 have been consummated. Investment Fund A intends to acquire 10 percent of the outstanding voting securities of Corporation 2; the securities are valued at $100 million. Corporation 2 is a competitor of Corporation 1. Investment Fund A’s acquisition is exempt from the reporting requirements of the Act because the Associated Group does not hold in excess of 15 percent of the voting securities or economic interests of a Competitor to Corporation 2.

4. Assume the transactions identified in Examples 1 through 3 have been consummated. Investment Fund A intends to acquire an additional 6 percent of the voting securities of Corporation 2; the dollar value of the voting securities to be acquired exceeds $50 million, as adjusted, and the size-of-person test is met. Investment Fund A’s acquisition is not exempt from the reporting requirements of the Act, because upon consummation Investment Fund A will hold in excess of 15 percent of the voting securities of Corporation 2.

5. Assume the transactions identified in Examples 1 through 4 have been consummated. Investment Fund B intends to acquire an additional 1 percent of the voting securities of Corporation 1. Investment Fund B’s acquisition is not exempt from the reporting requirements of the Act by reason of this rule, because Investment Fund B and its Associated Group hold in excess of 15 percent of the voting securities of Corporation 2, a Competitor to Corporation 1.

6. Assume the transactions identified in Examples 1 through 5 have been consummated. Corporation 1 issues a stock dividend, pro-rata to all shareholders, including Investment Fund A and Investment Fund B. For purposes of this rule, the exemption for “pro-rata” stock dividends and splits (16 C.F.R. § 802.10) will apply to the calculation of the holdings of the Associated Group for Investment Funds A and B.

7. Assume the transactions identified in Examples 1 through 5 have been consummated. Corporation 1 issues a special dividend to shareholders that hold in excess of 3 percent of its voting securities. Because the dividend is not issued to all shareholders on a pro-rata basis,
the exemption at 16 C.F.R. § 802.10 will not apply. Investment Fund A's and Investment Fund B's acquisition of voting securities of Corporation 1 will not be exempt from the reporting requirements of Act by reason of this rule, because Investment Fund A, in conjunction with its Associated Group, and Investment Fund B, in conjunction with its Associated Group, hold in excess of 15 percent of the voting securities of Corporation 2, a Competitor to Corporation 1.

8. Corporation 1, a competitor of Corporation 3, intends to acquire voting securities of Corporation 3, valued at $300 million and representing 3 percent of Corporation 3's outstanding voting securities. This rule does not exempt Corporation 1’s acquisition of voting securities of Corporation 3 from the Act.

9. Corporation 1, a publicly controlled company, intends to acquire voting securities of Corporation 4. Corporation 1 directly acquires 10 percent of the voting securities of Corporation 4; two directors, a corporate officer, and two individual shareholders of Corporation 1 form a separately controlled partnership to purchase an additional 10 percent of the voting securities of Corporation 4; the two shareholders manage the investment of the partnership. Directors, officers and shareholders of Corporation 1 do not, in the ordinary course of business, form partnerships to invest in the same entity that Corporation 1 does. The formation of the partnership may be a viewed as a device to avoid the reporting requirements of the HSR Act. 16 C.F.R. § 801.90. See United States v. Equity Group Holdings, No. 91-cv-0153 (D.D.C. Jan. 25, 1991) (use of a partnership structure to avoid filing); United States v. Tengelmass-Warenhandelsgesellschaft, No. 89-1621 (D.D.C. June 5, 1989) (use of partnership to avoid filing). If the use of the partnership is a device to avoid the reporting requirements of the Act, the structure of the transactions will be disregarded, and Corporation 1’s acquisition of 20 percent of the voting securities of Corporation 4 will not be exempt by reason of this rule.

Mark S. Popofsky and Michael D. Laufert

The power of a patent can depend on its holder. In one set of hands, a patent might play a defensive role, warding off suits by similarly armed competitors. But when placed in another’s, the same patent can serve as a weapon for extracting royalties from inadvertent infringers or for raising rivals’ costs. In short, much like the theory of relativity, the ability and incentive to assert a patent can turn on the positions rights holders and enforcement targets occupy.

The ease with which patents change hands, and the eruption of new business models focused on patent monetization, amplify the importance of understanding the consequences of this Einsteinian patent/antitrust twist. Today, a vibrant market exists for patent rights.1 Buyers of patents frequently include “patent trolls,” which, like the Federal Trade Commission, we call Patent Assertion Entities or “PAEs.” PAEs typically do not make or sell products. Rather, their business model is to make money from monetizing patent rights, typically by licensing or suing Operating Companies (firms that practice patents).

In this article, we survey certain antitrust issues presented by an emerging trend: the outsourcing by Operating Companies of patents to PAEs, a phenomenon some commentators describe as “privateering.”2 Operating Company transfers of patents to PAE proxies can raise competitive concerns. Through transfers that evade constraints on their own ability to enforce patents, Operating Companies can harness PAEs to raise rivals’ costs. PAE proxies can enable Operating Companies to evade F/RAND3 commitments and thereby engage in patent hold-up. Operating Companies can retain the ability, through contract or otherwise, to influence a PAE’s choice of enforcement targets or intensity of monetization efforts. Operating Companies can combine these elements to hinder rivals, for example by parceling out pieces of a portfolio of standard-essential patents to PAEs through contracts that create incentives for PAE transferees to aggressively target competitors.

Such arrangements can harm not only rivals, but also competition, consumers, and innovation. Moreover, well-established antitrust principles govern Operating Company/PAE patent outsourcing arrangements. Whether any particular Operating Company/PAE transfer implicates the antitrust laws depends on the arrangement’s particular facts. Firms contemplating such arrangements accordingly must consider the antitrust risks such arrangements can entail, including potential agency scrutiny. And firms subject to PAE enforcement actions might consider appropriate antitrust and related counterclaims.

3 Following typical conventions, in this article we use “F/RAND” to refer to obligations to license on terms that are either FRAND (fair, reasonable, and non-discriminatory) or RAND (reasonable and non-discriminatory).
Background: PAEs, Privateering, and Recent Antitrust Attention

PAEs typically neither generate nor practice patents. Rather, they acquire and assert patents for profit. As the FTC has explained: “The business model of PAEs focuses on purchasing and asserting patents against manufacturers already using the technology, rather than developing and transferring technology.”

PAEs thus are usefully distinguished from Operating Companies—firms that practice patents. PAEs monetize patents, by and large, through licensing Operating Companies or by bringing patent infringement suits against them.

PAE activity has exploded. Sales to PAEs and other non-practicing entities represent 75 percent of all patent transactions. PAEs in 2012 accounted for 62 percent of all patent suits. The proliferation of PAEs has spawned concerns that PAEs contribute little to innovation, but rather impose what some characterize as a patent “tax” on productive activity. According to this view, PAE’s ever-increasing enforcement activities—which typically occur following commercialization of an invention—produce no value to society. When, for example, a PAE asserts a patent obtained from a third party against an Operating Company, “[a] manufacturer’s royalty payment may raise costs to consumers, but it obtains only the avoidance of infringement litigation, not the benefit of the technology itself.”

Put differently, a PAE’s ex post assertion imposes a tax that may reflect not the ex ante value of the technology, but rather the “hold-up” value of asserting the patent after technology-specific or other costs have been sunk.

Accordingly, although some argue that PAEs help fund independent inventors and those otherwise incapable of obtaining a reasonable return on their inventive efforts, many contend that PAEs impose a significant drain on America’s most innovative industries. Some scholars conclude that less than 25 percent of PAE revenues flow to innovation and that “less than two percent of losses in wealth caused by PAEs passed through to independent inventors.” Moreover, according to recent research, the direct costs of PAE patent assertion activities are staggering: some $29 billion in 2011, a figure that has increased by 400 percent since 2005. Against this backdrop, the FTC judged PAEs’ benefits “uncertain” and warned that PAEs “can distort competition in technology markets, raise prices and decrease incentives to innovate.”

These aspects of the modern patent landscape—the rise of the PAE model; the ease with which PAEs can obtain patents; and the differences between PAEs’ and Operating Companies’ incen-

---

4 Fed. Trade Comm’n, The Evolving IP Marketplace Aligning Patent Notice and Remedies with Competition 8 (2011) [hereinafter Evolving IP Marketplace], available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf. The FTC described numerous other models, including PAEs that also function as Operating Companies. Id. at 62–67. In this article, we focus solely on PAEs.

5 Kelley, supra note 1, at 118.


7 Evolving IP Marketplace, supra note 4, at 53.

8 Id. at 52.


11 Id. at 2.

12 Id. at 8.

13 Bessen & Meurer, supra note 9, at 2, 18–19.

14 Evolving IP Marketplace, supra note 4, at 71.
tives—fuel an emerging practice that can raise antitrust concerns: the transfer of patents (or portfolios) from Operating Companies to PAE enforcement proxies. The transfer of patents from Operating Companies to PAEs is not new. PAEs have frequently mined Operating Companies for patents to fuel their patent monetization programs. What is new is that Operating Companies appear increasingly willing to deputize PAE “privateers”\(^\text{15}\) to enforce their patents against rivals. To give some recent examples:

- Microsoft and Nokia in 2011 collaborated in transferring 2,000 patents, many of which were standards-essential patents (SEPs), to Canadian PAE MOSAID.\(^\text{16}\) Nokia subsequently transferred additional patents to PAEs Sisvel and Vringo.\(^\text{17}\)
- In 2012, British Telecom (BT) sued Google for patent infringement relating to Android, claiming that several of Google’s services violate BT patents.\(^\text{18}\) BT then transferred at least one patent to IPValue, a PAE, which in turn transferred that patent to a subsidiary, Suffolk Technologies, which brought suit against Google and AOL.\(^\text{19}\)
- In January 2013, Ericsson sold more than 2,000 patents to PAE Unwired Planet, which previously had sued Ericsson’s mobile device competitors, Apple, Google and RIM.\(^\text{20}\)

Recently, the DOJ and the FTC held a joint workshop on PAE activities, which explored how the antitrust laws might apply to certain PAE activities.\(^\text{21}\) Among other topics, panelists debated the outsourcing by Operating Companies of patent portfolios (or parts of portfolios) to PAE enforcement proxies. According to the research of one panelist, “operating companies [can] use or ‘sponsor’ PAEs as a means of imposing costs on rivals and achieving other anticompetitive ends.”\(^\text{22}\)

To unpack how Operating Company transfers to PAEs can achieve “anticompetitive ends,” it is first necessary to explain why Operating Companies may find it attractive to transfer patents to PAEs—the very entities that inflict on Operating Companies millions of dollars in costs each year.

### Why Do Operating Companies Transfer Patents to PAEs?

Operating Companies may transfer patents to PAEs for several reasons. Some appear competitively benign: Where patent holders are under-capitalized, PAE agents willing to fund litigation can help generate cash flows from investments in innovation that a resource-starved innovator cannot.\(^\text{23}\) PAE advocates have posited similar justifications for transfers by large, sophisticated, and

---


\(^{17}\) See infra notes 60 and 61 (citing sources describing transfers).


\(^{22}\) Yeh, supra note 10, at 2.

well-funded Operating Companies. PAEs can help firms manage sprawling patent holdings. Outsourcing part of a vast patent portfolio to a PAE (for example, in exchange for a future royalty stream) might achieve efficiencies. An Operating Company also might exit a business line and no longer need certain patents. Transferring patents to a PAE might enable a firm to recoup its investment, and thereby fuel future innovations.

By contrast, others contend that Operating Companies may at times transfer patents to PAEs for reasons that, depending on the facts, can raise competition-related concerns. We outline three such scenarios below. These by no means exhaust the competition-related concerns that transfers by Operating Companies to PAEs can present.

1. **Evade MAD or reputational constraints to raise rivals’ costs.** Operating Companies often patent defensively—to prevent others from patenting an invention or to dissuade competitors from initiating patent suits. Defensive patenting thereby can secure a firm’s “freedom to operate.” At times, defensive patenting can lead to what is termed “patent peace”: Because rivals each possess patents that implicate one another’s products, they enter into cross licenses or (similarly) abstain from suing one another. Some have rightly termed this dynamic the patent equivalent of the mutual assured destruction (MAD) logic of the nuclear arms race.

   Transfers by Operating Companies to PAEs can defeat MAD by disrupting this “risk symmetry.” Because a PAE—which makes nothing—does not need licenses from an Operating Company’s rival, a PAE transferee lacks the same disincentive to launch a patent suit as the Operating Company transferor. Moreover, PAEs do not fear reputational costs associated with patent assertions. They do not face “customers exerting pressure to settle litigation or shareholders skeptical of patent enforcement,” and they are infrequently repeat players in standard-setting organizations, where a reputation as a non-aggressor can increase the likelihood that a firm’s technology is included in standards. In short, transferring a patent to a PAE can radically alter—indeed increase—incentives to enforce it.

   Operating Companies might seek to sidestep MAD (or reputational constraints) through transfers to PAE proxies to raise rivals’ costs. Depending on the facts, the Operating Company transferor may thereby acquire greater market power in a downstream market than it possessed before the transfer. Moreover, evading “patent peace” or undoing incentives to cross license can

---

24 Other theories, on which we do not focus, can involve collusion. For example, suppose an Operating Company that possesses patents that are substitutes for those already held by a PAE transfers its patents to a PAE and retains a stake in their enforcement. If the transfer increases the PAE’s market power in a technology market, the conduct may present a traditional horizontal antitrust concern (and, depending on the facts, may also present the exclusion concerns discussed below). Parallel transfers by firms that own substitute patents to the same PAE could present similar issues. We also do not discuss here how aggregating a large number of patents, whether or not substitutes, might anticompetitively shield weak patents through a mechanism that might be termed “strength in numbers”: The more patents a PAE brings under common ownership, the greater the incentive to enforce weak patents.


27 Id. at 333–34 (“In a ‘cold war’ environment in which players patent and practice related inventions . . . a company’s patent portfolio protects it from attacks.”).


impose a deadweight loss on the economy. “[C]ross licenses can solve the complements problem, at least among two firms, and thus be highly procompetitive.”\(^{30}\) If an Operating Company elects instead to arm a PAE to attack its rival, society will lose the benefits cross licensing can create.

Of course, if a rival could easily determine that its competitor has elected to forgo patent peace and instead has initiated patent war through a proxy, the rival could retaliate in kind by outsourcing some of its patents to its own PAE deputy. This prospect, in theory, might preserve MAD. But the veil behind which PAEs operate can make tracing the links between Operating Companies and PAE proxies difficult.\(^{31}\) PAEs often operate through holding companies that can mask their IP portfolios.\(^{32}\) PAEs may also assert patents to which they hold exclusive licenses, where “the effect would be similar to owning the patent outright, but the parties would not necessarily record a change of patent ownership with the USPTO.”\(^{33}\) In sum, Operating Companies can hinder rivals by arming PAE agents that are invulnerable to patent countersuits.

2. Evade F/RAND and other licensing commitments. In the standard-setting context, some firms make promises to license patents on F/RAND terms if their patents are included in—and become essential to the implementation of—a standard (so-called Standard Essential Patents, or SEPs). Outside of the standard-setting context, firms may make F/RAND commitments to induce adoption of proprietary technology as a de facto standard.\(^{34}\) Firms may also make pledges to avoid royalty stacking or to cap the royalties they seek for patents essential to a particular standard. These commitments all are designed to avoid ex post opportunism. As Rambus\(^{35}\) and N-Data\(^{36}\) teach, when firms renege on these commitments, depending on the facts, the conduct can transgress Sherman Act Section 2 or FTC Act Section 5.

An Operating Company can evade a “no stacking” (or similar) pledge by transferring some, but not all, of its SEPs that pertain to a particular standard to a PAE in exchange for a portion of the PAE’s proceeds from monetizing the patents. Even if the PAE agrees to honor the Operating Company’s commitments, the disaggregation of the previously unified SEP portfolio can enable the Operating Company and its PAE enforcement agents together to raise total royalties above the level the Operating Company promised. That is, where, before disaggregation of the portfolio, one entity agreed to charge no more than the cap regardless of the number of patents an implementer needed, after the transfer multiple entities each may seek to charge that amount.


\(^{31}\) Secrecy is not responsible for all unravelings of MAD. An Operating Company might retain some patents to ward off a rival’s suit while outsourcing others to a PAE. Some Operating Companies, however, might be more willing to sacrifice long-term reputational benefits than others, which also can lead to a breakdown of MAD.


\(^{33}\) Id. ¶ 21.


This problem is exacerbated when an Operating Company divides an SEP portfolio among multiple PAEs. Each may seek royalties up to the cap promised by the Operating Company, along with the Operating Company itself.\textsuperscript{37} The adverse consequences of employing PAE enforcement proxies to evade a F/RAND commitment or royalty cap include those of ex post patent hold-up generally. By employing PAE privateers, the Operating Company and the PAE collectively can extract greater royalties than the Operating Company’s pledge permitted. Moreover, atomizing a previously unified SEP portfolio splits complementary patents (a Cournot Complements problem), which may impair efficiency.\textsuperscript{38}

3. \textit{Strategic outsourcing to PAEs to hinder rivals.} Yet another strategy involves an Operating Company outsourcing patents to a PAE over which it maintains some influence. Among other mechanisms that create a “Hybrid PAE,”\textsuperscript{39} Operating Companies and PAEs can enter into contracts that align incentives. For example, an Operating Company might induce a PAE to target the Operating Company’s rivals by retaining or securing a broad license to the transferred patents that protects the Operating Company and its customers while sharing a carefully selected list of unlicensed firms (viz. rivals) with the PAE transferee.

An Operating Company can combine mechanisms that align incentives with other elements outlined above to hinder rivals. For example, an Operating Company that made a “no stacking” pledge to implementers of its technology might parcel out pieces of a previously-unified SEP portfolio to multiple PAEs subject to contractual commitments that encourage PAEs to target a particular rival, thereby inflicting the very harms that the “no stacking” pledge was designed to avoid.

One commentator has suggested that PAE transfers where Operating Companies assert some control over the PAE’s “ability and incentive to exercise market power” should be scrutinized seriously, “particularly when it aligns with the interests of downstream manufacturers that could use the transfer to target rivals.”\textsuperscript{40} The Department of Justice’s current Assistant Chief for Competition Policy similarly has contended that a transfer “that align[es] [a] PAE’s incentives with those of [the] seller” is a possible factor that indicates the PAE transfer deserves antitrust scrutiny.\textsuperscript{41}

\textbf{Potentially Troubling Transfer: MOSAID}

A recent example of a transfer of patents form an Operating Company to a PAE that raises antitrust concerns is the three-way arrangement between Microsoft, Nokia, and PAE MOSAID.

\textsuperscript{37} Enforcement targets may assert estoppel and other defenses against efforts to sidestep a no stacking or F/RAND commitment. An Operating Company and its transferee nonetheless might take the position that it comports with their commitments for each to charge up to the previously specified cap (or F/RAND level).

\textsuperscript{38} See, e.g., Mark A. Lemley & Carl Shapiro, Patent Holdup and Royalty Stacking, 85 Tex. L. Rev. 1991, 2014 (2007) (explaining that “as usual with Cournot complements” when “three patents” are “held by separate firms, downstream output is half as much as it would be if a single company owned all three patents”).


\textsuperscript{40} See Carrier, supra note 28, at 8.

whereby Nokia transferred a significant patent portfolio, including over 1,200 wireless SEPs, to MOSAID.42

Microsoft and Nokia made unlikely bedfellows. In the 1990s, Nokia spearheaded the open source Symbian mobile operating system as a competitor to Microsoft’s Windows Mobile operating system and supported open source software through F/RAND commitments.43 But when Symbian languished, Nokia joined its former adversary by agreeing in 2011 to form an alliance with Microsoft and deploy Windows Phone 7 (WP7) as Nokia’s primary operating system.44 Nokia acknowledged that the Microsoft alliance “changed its role in the market.”45 In particular, joining the Windows ecosystem gave Nokia an incentive to induce firms to “abandon Android in favor of WP7” and, indeed, Nokia’s CEO declared “war” on Google and Android.46 Inducing Nokia to declare “war” on Google benefits Microsoft, according to some, because “Google, with Android, is the biggest threat to Microsoft” and its enduring dominance in desktop-based operating systems.47

Acting on their newly aligned incentives, Microsoft and Nokia later in 2011 entered into an agreement with Canadian PAE MOSAID.48 Under this arrangement:

- MOSAID obtained some 2,000 Nokia patents, including 1,200 standard-essential wireless patents from Nokia’s Core Wireless subsidiary49;
- Nokia transferred the patents for a nominal price ($19,975.00)50;
- MOSAID agreed to pay Microsoft and Nokia two-thirds of the royalties it collects from enforcing Nokia’s patents, and it agreed “to monetize the Assigned Patents and to maximize the Royalty”51;

46 Id.; Sarah Reedy, Nokia Boss Declares War on Android, LIGHT READING MOBILE (June 2, 2011), http://www.lightreading.com/mobile-operating-systems/nokia-boss-declares-war-on-android/240129422 (“Fundamentally, we believe that what has happened in the past couple of years was a shift from a battle of devices to a war of ecosystems.”).
49 Press Release, supra note 48.
50 Share Purchase Agreement, supra note 48, § 2.02.
MOSAID agreed to a detailed set of confidential royalty protection provisions and milestone payments calculated to maximize the revenue MOSAID obtains from enforcement of these patents; In the event of a change in control of MOSAID or if MOSAID fails to meet its royalty obligations, Microsoft and Nokia may jointly compel MOSAID to transfer these patents to another party for a mere $10,000.00; and Microsoft retained a license that prevents MOSAID from asserting certain patents against third parties implementing certain Microsoft software in their mobile devices.54

In short, Microsoft and Nokia jointly outsourced to a PAE several hundred SEPs assertedly essential to mobile operating system competitors under terms that (i) create significant incentives for PAE MOSAID to act in Microsoft’s and Nokia’s strategic interests (because Microsoft and Nokia can direct transfer of the patents elsewhere); and (ii) enable Microsoft and Nokia to benefit from the PAE’s monetization of the patents. MOSAID, moreover, expects to collect billions from the transferred patents, including from Android licensees. MOSAID predicted that “over the next five years,” “companies unlicensed to its portfolio will generate US$500 billion in mobile device[ ] revenues.”55 According to Phil Shaer, MOSAID’s Senior VP and General Counsel: “Owning these patents opens up a market for MOSAID that could reach 1 trillion dollars” and MOSAID expects to “be monetizing them for at least a decade.”56

The Microsoft/Nokia/MOSAID transfer implicates each of the potential harms from Operating Company to PAE transfers sketched above.

1. The MOSAID transfer alters enforcement incentives. If Nokia alone had asserted the transferred patents against Android implementers (and other enforcement targets), Nokia could face patent counter-suits. The threat of such counter-suits might have limited Nokia’s ability to enforce the Core Wireless patents. Outsourcing enforcement of part of its SEP portfolio to MOSAID while retaining an interest in the resulting royalty stream enabled Nokia to sidestep this constraint on enforcement and share in the royalties MOSAID anticipates it will extract. Moreover, as further discussed below, the arrangement threatens to raise rivals’ costs in circumstances that might hinder competition.

2. The transfer threatens royalty stacking and hold-up. Nokia’s SEPs, like many SEPs, are subject to F/RAND commitments made to standard-setting organizations (SSOs). Indeed, Nokia’s SEPs are covered by a specific commitment to charge no more than a particular royalty (2 percent) no matter how many Nokia SEPs a licensee needs to implement wireless standards for a par-
ticular end device. Nokia appears to have made this 2 percent “no stacking” pledge to induce firms to adopt its proprietary wireless technology over alternatives.

The MOSAID transfer enables Nokia and its PAE transferees to evade this 2 percent cap and thereby may cause the very royalty stacking Nokia promised to avoid. When in Nokia’s hands, the transferred SEPs formed part of a unified wireless patent portfolio. Abiding by its commitment, Nokia could charge no more than 2 percent for a license to the entire portfolio. The transfer to MOSAID, however, divided the portfolio. And once Nokia split the portfolio, even if both Nokia and MOSAID each committed to abide by Nokia’s 2 percent royalty cap, both may be free to seek royalties up to that level. Thus, where before the MOSAID transfer Nokia could seek only 2 percent on the portfolio, the transfer may enable Nokia to seek 2 percent and MOSAID to seek 2 percent (which it splits with Nokia and Microsoft). There is no indication that Nokia and MOSAID agreed collectively to honor the 2 percent royalty cap; on the contrary, Nokia’s public statements stressing its lack of control over MOSAID’s enforcement activities are inconsistent with such constraint.

The MOSAID transfer, therefore, may enable abrogation of the “no stacking” pledge that induced firms to adopt a standard incorporating Nokia’s patents. Subsequent transfers of yet other portions of Nokia’s SEP portfolio to PAEs Sisvel and Vringo threaten to exacerbate the concern by increasing the total royalties that Nokia and PAE transferees can collect on the same portfolio even if Nokia never itself enforces the patents it retains. Nokia’s conduct, therefore, could implicate the patent hold-up concerns that animated N-Data and Rambus. Moreover, the facts suggest that, had now locked-in firms known ex ante that Nokia would break its promise, they might have implemented a different technology.

3. Microsoft and Nokia appear to be employing a PAE to raise rivals’ costs. As discussed, publicly available facts disclose that Microsoft and Nokia exert significant influence over MOSAID’s enforcement of the transferred Nokia patents. MOSAID cannot assert certain patents against devices running mobile versions of Microsoft’s Windows operating system. Of equal significance,
Microsoft and Nokia can ship the patents to a third party if MOSAID fails to meet revenue expectations, a lever Microsoft and Nokia would lack had Nokia sold MOSAID the patents outright or obtained a lump sum royalty. Because, presumably, Microsoft and Nokia can waive this provision, MOSAID has an incentive to act in Microsoft’s and Nokia’s interests. Those interests, as explained, include seeking to raise the costs of Android licensees, which threaten both Microsoft’s monopoly power and sales of Nokia’s Windows Mobile phones. Indeed, because Microsoft and Nokia retain certain licenses to the transferred patents, Android licensees comprise MOSAID’s most obvious enforcement targets (along with Apple).

Put differently, Microsoft and Nokia armed a PAE with 1,200 SEPs under circumstances where (i) contractual provisions align the PAE’s incentives with Microsoft’s and Nokia’s; (ii) those incentives include raising the costs of implementing Android, because Android threatens both Microsoft’s and Nokia’s interests; (iii) the PAE lacks the same constraints on enforcement (e.g., the 2 percent cap; counterclaim risk) as Nokia confronted, and thereby is better positioned than Nokia to inflict higher costs on Android OEMs; and (iv) such PAE enforcement threatens royalty stacking that not only raises costs but also impedes efficiency.

It is little wonder that a senior Microsoft executive candidly remarked that the MOSAID transfer marked “an effective way” “to unlock the considerable value of [Nokia’s] IP portfolio.”62 The “value” to Microsoft appears to include the strategic benefit of impeding Android by raising the costs of its implementation. Indeed, low-cost Android devices are particularly concerning to Microsoft, because consumers may be abandoning PCs for low-cost tablets and other Android-run devices.63 Put otherwise, through the tri-partite MOSAID transfer, Microsoft might raise the costs of implementing Android and thereby maintain its PC operating system dominance.

How Antitrust Might Constrain Operating Company Transfers to PAEs

The above discussion of the mechanisms by which PAE transfers can threaten to hinder competitors and consumers suggest several potential antitrust theories that might constrain Operating Company transfers to PAEs:

1. A PAE transfer may comprise exclusionary conduct under Section 2. In some circumstances, outsourcing patent enforcement to PAEs might form part of a scheme to maintain or obtain monopoly power. The above examples suggest two distinct Section 2 theories.

First, when a transfer to a PAE evades a F/RAND or no stacking commitment made to an SSO (or others), and the commitment the transfer evades induced adoption of the transferor’s technology over alternatives, the transfer can implicate the “patent hold-up” concerns articulated in Broadcom64 and Rambus. Put differently, the transfer enables the defendant wrongly to obtain monopoly power in a technology market. Such claims, of course, face a number of hurdles including, among others: (i) demonstrating (as Rambus requires) that the SSO (or others) would have selected different technology in the “but for” world; and (ii) showing that the conduct facilitates evasion of the original commitment. The MOSAID transfer is striking because the facts might suggest that both obstacles could be overcome. Nokia made a “no stacking” pledge to prevail in a

62 Foley, supra note 42.


64 Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297 (3d Cir. 2007).
battle against an alternative standard; and circumstances suggest that Nokia and its PAE transferees have not agreed collectively to honor the 2 percent royalty cap.

Second, a PAE may assist a monopolist in hindering a product market rival and thereby maintain or obtain monopoly power in violation of Section 2. The MOSAID transfer illustrates a putative multi-faceted exclusionary strategy. One element includes the above-described potential of the transfer to MOSAID to evade Nokia’s F/RAND commitments and thereby increase the effective costs of licensing Nokia’s SEPs. Contractual provisions that appear to give MOSAID an incentive to act in Microsoft’s and Nokia’s strategic interests by aggressively targeting Android OEMs comprise another element. Yet another is that MOSAID does not face the threat of counterclaims Nokia confronted and, therefore, has a greater ability to seek royalties that raise the costs of implementing Android than did Nokia.

Of course, these facts alone would not make out a violation of Section 2. A coherent theory would need to link the transfer’s raising of rivals’ costs to the maintenance of monopoly power. The threat Android poses to Microsoft’s PC Operating System dominance, and how raising Android’s costs may delay erosion of that power, could supply such a link. Moreover, a Section 2 violation requires showing exclusionary conduct that is not fully justified by procompetitive efficiencies. It is difficult to see the benefit to consumers of the MOSAID transfer. Evading the “no stacking” pledge produces inefficiency by separating complements (a Cournot Complements problem65), and MOSAID’s greater ability to monetize Nokia’s patents might impair a rare serious rival to Microsoft’s continued dominance in PC Operating Systems. Giving Nokia (and Microsoft) a higher return on the Nokia patents may benefit Nokia, but it is not clear that the net effect is to encourage innovation. On the contrary, because Nokia’s conduct arguably betrays its F/RAND commitment, the conduct may deter innovation.66

2. PAE transfers may be challenged under Section 7 of the Clayton Act. Perhaps the most natural mechanism by which to challenge Operating Company transfers to PAEs is Clayton Act Section 7. A non-PAE example provides a template for applying Section 7 to police Operating Company/PAE transfers. In 2010, the Antitrust Division blocked Microsoft from acquiring Novell’s patents to which Microsoft already had a license. According to the DOJ, the only reason for Microsoft to acquire the patents was for offensive enforcement against open source software, including Linux (on which Android is based). The Division restricted Microsoft’s rights to the patents “to protect competition and innovation in the open source software community.”67

The key to understanding the Division’s action against Microsoft lies in how the transfer from Novell changed enforcement incentives. Novell possessed incentives to support the open source community. Microsoft, as explained, had quite different incentives: to protect Windows (and Office) from emerging open source threats. Which firm held the patent, in other words, had antitrust significance. The transfer accordingly raised competitive concerns because it placed the patents in

65 See Lemley & Shapiro, supra note 38, at 2013–15 (“The theory of Cournot complement teaches us that the royalty stacking problem is likely to be worse the greater the number of independent owners of patents that read on a product.”).
66 The MOSAID arrangement could present a rare instance when Section 2’s prohibition of conspiracies to monopolize has independent significance. Only Microsoft likely could be held liable under Section 2 on a theory of monopoly maintenance in PC operating systems. However, Nokia—as a new stakeholder in the Windows ecosystem—might share Microsoft’s incentive to hinder Android. Cf. Perington Wholesale, Inc. v. Burger King Corp., 631 F.2d 1369 (10th Cir.1979) (sustaining complaint for conspiracy to monopolize claim where supplier assertedly shared downstream firm’s incentive to maintain its monopoly).
the hands of a firm with incentives to raise open source costs to protect its market power, an incentive the transferring firm lacked. This implements in the patent context the well-settled principle (typically applied in a vertical setting) that antitrust analysis must consider changes in the ability or incentive to exclude rivals.68

An Operating Company’s transfer of patents to a PAE similarly can change enforcement incentives in a manner that might harm competition in an adjacent product market. The transfer can, depending on market structure and the degree to which costs are raised, enhance the Operating Company’s ability through its PAE proxy to wield a patent to hinder or exclude rivals and thereby gain incremental market power. In the language of the DOJ/FTC Merger Guidelines, the transfer may unlawfully “facilitate [the] exercise” of “market power.”69 The MOSAID transfer might implicate Section 7 for the same reasons that it implicates Section 2.

3. Section 1 unreasonable restraint of trade. Transfers unlawful under Section 7 can also be recast as violations of Sherman Act Section 1. Differences in the claims include that both parties might be liable (sellers can violate Section 1 but not Section 7), as well as the facts required to make out a prima facie liability case. Some have also suggested that certain PAE transfers may run afoul of Section 1’s per se rule. According to one commentator, that “Nokia and Microsoft pooled their patents and enlisted [MOSAID] to use the patents to sue competitors” could present a Section 1 concern similar to a pooling arrangement the Supreme Court declared per se illegal in Singer Manufacturing Co.70

4. The FTC might challenge certain transfers to PAEs under Section 5 of the FTC Act. The FTC has recently aggressively deployed FTC Act Section 5 to combat conduct perceived to breach or evade F/RAND commitments. In N-Data, the Commission concluded that a patent transferee violated Section 5 of the FTC Act when it failed to honor its transferor’s licensing commitment to license at low, set royalty rates and the likely consequence was to increase prices to consumers and impair standard setting.71 Applying (or depending on one’s view, expanding) N-Data’s underlying rationale, the FTC might condemn Operating Company transfers to PAEs that evade “no stacking” or similar commitments when, as in N-Data, the result is to raise licensing fees and impair the standard-setting process. Once again, Nokia’s atomizing of its SEP portfolio to multiple PAEs—where it appears there is no mechanism for the firms collectively to honor the 2 percent royalty cap—represents the type of scenario that might warrant the FTC’s scrutiny.

Conclusion

Operating Company transfers to PAEs can present antitrust concerns. Operating Companies can raise rivals’ costs by transferring patents to PAE agents who face fewer enforcement constraints. Transfers to PAEs can threaten patent hold-up by facilitating evasion of F/RAND or no stacking commitments.

68 See, e.g., U.S. DEP’T OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES 5 (2011) (explaining that “vertical mergers can create changed incentives and enhanced ability of the merged firm to impair the competitive process”).


70 Carrier, supra note 28, at 10 (citing United States v. Singer Manufacturing Co., 374 U.S. 174 (1963)). Carrier likened the MOSAID case to Singer, where “the Supreme Court struck down an arrangement in which three companies pursued a ‘common purpose’ to suppress competition ‘through the use of [a] patent.’” Id. (quoting Singer, 374 U.S. at 194–95). The analogy to Singer would be more compelling if, absent the alliance, Nokia and Microsoft would have continued to compete in mobile operating systems. The MOSAID agreement, then, would arguably reflect competitors agreeing to transfer Nokia’s patents to a party better situated to enforce them against a common rival.

commitments. Contractual mechanisms that align a PAE’s incentives with those of an Operating Company or its allies can form part of an exclusionary stratagem. As ever in antitrust, separating anticompetitive from benign patent transfers turns on a fact-driven analysis.

Not every (or perhaps not even the majority of) Operating Company transfer to a PAE raises significant antitrust concerns. But not every such transfer is competitively benign. Operating Companies transferring patents to PAEs, therefore, must consider the potential antitrust constraints on their activities.
The Anti-Corruption and Antitrust Connection

Josh Goodman

Three major U.S. aerospace companies stand accused of bribing foreign government officials to secure jet aircraft sales. The defendant companies settle the charges by entering into consent orders that require them to adopt new compliance policies for documenting their foreign payments. No—these are not the details of the latest Foreign Corrupt Practices Act (FCPA) case. These are the facts behind a trio of 1978 consent orders resolving antitrust law complaints brought by the Federal Trade Commission against Lockheed, Boeing, and McDonnell Douglas.1 As these cases illustrate, antitrust law and foreign corruption law in the United States have a long, yet often overlooked, shared history.

The past decade has witnessed a resurgence in U.S. anti-corruption enforcement, and several cases in that time period serve to illustrate the parallel trends and convergences between the FCPA and the antitrust laws. Three such trends are particularly striking: (1) the rise of a compliance-focused enforcement model, (2) cases that combine antitrust and anti-corruption claims, and (3) an increase in international enforcement coordination and harmonization.

The FCPA, the FTC Aircraft Cases, and Their Antecedents

The FTC’s 1978 aircraft industry bribery cases grew out of post-Watergate Securities and Exchange Commission (SEC) and Congressional investigations that revealed widespread corporate bribery of foreign government officials by many American corporations.2 In the mid-1970s, the bribery charges against Lockheed Corporation, in particular, became headline news and a focal point for public perceptions of declining corporate integrity in that era, although hundreds of other companies ultimately disclosed similar foreign conduct.3 Following public revelations of Lockheed’s questionable payments, an investigation commissioned by a special committee of Lockheed outside directors found that Lockheed had paid more than $30 million in bribes from 1970 to 1975 to influential figures in the governments of Japan, Germany, the Netherlands, Italy, and other countries.4

The Lockheed scandal’s impact reverberated widely, leading to the arrest of former Japanese Prime Minister Kakuei Tanaka and other Japanese politicians, the impeachment of two former Italian

---


defense ministers, and other international political fallout. \(^5\) Domestically, Lockheed and other aircraft firms faced investigations from the SEC, FTC, and the Department of Justice. \(^6\)

These scandals also spurred U.S. policymakers to debate whether new anti-corruption legislation was necessary or whether existing laws, including antitrust laws, were sufficient to combat the problem of American corporations bribing foreign governments. \(^7\) Policymakers recognized that the antitrust laws, as well as the securities laws and other statutes, could apply to certain instances of bribery by U.S. corporations overseas. \(^8\) On the other hand, many experts concluded that it would be more efficient simply to legislate against this type of foreign bribery directly. In testimony before Congress in 1975, Donald Baker, the Deputy Assistant Attorney General for the Antitrust Division of the DOJ, explained that, while foreign bribery would violate the antitrust laws in certain circumstances, antitrust would not be “the most cost effective enforcement tool” for combating it due to the need to show the bribery scheme caused harm to competition under the antitrust framework. \(^9\)

Ultimately, the Congressional consensus favored new legislation. In late 1977, Congress enacted the FCPA, making it a crime to bribe foreign government officials to win a business advantage. \(^10\) Because the FCPA had not been in effect when Lockheed and other companies had made the payments that gave rise to the public scandal, federal agencies pursued charges under other laws, including civil antitrust laws. Thus, in the 1978 FTC Aircraft Cases, the FTC alleged that Lockheed, Boeing, and McDonnell Douglas had violated Section 2(c) of the Robinson-Patman Act (RPA) and Section 5 of the Federal Trade Commission Act (FTC Act) by paying bribes to win contracts abroad during the early 1970s. \(^11\)

The use of the antitrust laws, including the FTC Act, to challenge bribery, though uncommon, was not unprecedented. In its early years, the FTC made pursuing and exposing bribery within the United States a significant focus of its enforcement activities. \(^12\) Combating domestic bribery had waned as an FTC priority many decades earlier, however. The FTC’s renewed attention to bribery proved short-lived because, with the FCPA’s enactment in 1977, the perceived need for antitrust to serve as an enforcement gap-filler for foreign corrupt payments diminished.

Antitrust and foreign corruption law thus largely diverged over the following three decades. During the 1980s, the FCPA fell into disuse, with prosecutors bringing few cases for the next two

---

\(^5\) Id. at 152.

\(^6\) Id. at 145–46.


\(^9\) Baker Testimony, supra note 8, at 96.


\(^11\) FTC Aircraft Cases, supra note 1. The SEC and DOJ also brought enforcement actions arising out of the same general conduct.

\(^12\) See Note, Bribery in Commercial Relationships, 45 HARV. L. REV. 1248, 1251 (1932); Franklin A. Gevurtz, Using the Antitrust Laws to Combat Overseas Bribery by Foreign Companies: A Step to Even the Odds in International Trade, 27 VA. J. INT’L L. 211, 222–23 (1987).
decades. Beginning in the mid-2000s, however, a massive expansion of FCPA enforcement occurred, and has continued unabated.

The reasons for the waning and waxing of FCPA enforcement over time are open to debate. Explanations for the growth in FCPA prosecutions during the past decade include increased awareness of violations due to the corporate accounting requirements of the Sarbanes-Oxley Act of 2002, a push for international anti-corruption enforcement following a 1997 anti-bribery treaty among OECD member states (discussed below), and the embrace of new prosecutorial tools in the form of deferred prosecution agreements and non-prosecution agreements (also discussed below).\(^\text{13}\) Former Attorney-General John Ashcroft has also suggested that the anti-terrorist financial tracking efforts following the September 11, 2001 attacks contributed to an increase in FCPA enforcement.\(^\text{14}\) Whatever the correct explanation may be, in the years since the recent FCPA expansion, several similarities between the worlds of the FCPA and antitrust have emerged.

### The Treatment of Foreign Bribery Under the FCPA and the Antitrust Laws

The antitrust laws prohibit bribery in ways that are simultaneously broader and narrower than the FCPA. In terms of jurisdiction, both the FCPA and the antitrust laws apply to certain categories of extraterritorial activity, but they have a different focus:

- **Broader and narrower** than the FCPA.

With antitrust, jurisdiction hinges on any bribe payment’s *effect* on U.S. competition and commerce, while FCPA jurisdiction turns on the identity of the bribe payer or the location of the corrupt activity. The FCPA applies broadly to any bribe paid to a foreign government official anywhere in the world by a U.S. person, business, or securities issuer.\(^\text{15}\) In addition, the FCPA creates jurisdiction over non-U.S. persons who, “while in the territory of the United States,” corruptly “make use of the mails or any means or instrumentality of interstate commerce” or commit any act “in furtherance of” a bribe of a foreign government official.\(^\text{16}\) By contrast, the Sherman Act and Section 5 of the FTC Act, as amended by the Foreign Trade Antitrust Improvements Act of 1982, could only cover foreign bribery with a direct, substantial, and reasonably foreseeable effect on U.S. domestic commerce or U.S. export businesses.\(^\text{17}\) The broader overseas reach of the FCPA makes sense since regulating the foreign conduct of U.S. businesses and securities issuers is fundamental to the law’s purpose.

The types of bribes covered by each area of law differ as well. For example, the FCPA bans bribery of foreign government officials, but does not reach general commercial bribery. Section 5 of the FTC Act, which broadly prohibits “[u]nfair methods of competition in or affecting commerce,” contains no such limitation and can thus apply regardless of a bribe’s recipient.\(^\text{18}\) The FCPA’s limitation to bribery of foreign government officials only has sparked lively debate over who qualifies


\(^\text{17}\) *See* 15 U.S.C. § 6a; 15 U.S.C. § 45(a)(3); *see also* F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004). This limitation, added in 1982, would not have changed the 1978 charges in the *FTC Aircraft Cases*, since the FTC alleged that Lockheed, Boeing, and McDonnell Douglas made payments “to procure aircraft sales for [themselves] and deny such sales to domestic competitors.”

\(^\text{18}\) 15 U.S.C § 45(a)(1).
as a government official in foreign countries where state-owned businesses are common, a definitional conundrum that is not relevant to antitrust cases. Section 1 of the Sherman Act, for its part, does not prohibit commercial bribery per se, but could apply where a bribery scheme qualifies as, or is paid in furtherance of, any “contract, combination . . . or conspiracy, in restraint of trade.”

The Robinson-Patman Act has its own unique possibilities and limitations for combating bribery. Section 2(c) of the RPA—one of the provisions invoked in the FTC Aircraft Cases—prohibits the payment of commissions, brokerage fees, or other compensation in connection with the sale of goods except payments made for services rendered. This provision arose to combat the practice of “large stores using their economic dominance to force sellers to pay a fee for doing business.” Several federal appeals courts have held that Section 2(c) more generally encompasses a ban on commercial bribery connected to the sale of goods. But the range of bribery proscribed by the RPA has its own idiosyncratic limitations. By its terms, Section 2(c) of the RPA only relates to payments connected to the sale of “goods, wares, or merchandise,” thus excluding bribes paid for services or other types of contracts.

One significant difference between the RPA or the Sherman Act and the FCPA or FTC Act is that persons injured by RPA or Sherman Act violations may bring an action for treble damages and counsel fees pursuant to Section 4 of the Clayton Act, while the FCPA and FTC Act contain no similar private rights of action. Some litigants have attempted to argue that the FCPA contains an implied private right of action, but courts thus far have unanimously rejected that view. In part, courts have premised their rejection of an implied private right of action under the FCPA on the availability, in appropriate cases, of a remedy under the antitrust laws for persons who suffer competitive harm resulting from the bribery of foreign government officials. In the 1990 case of Lamb v. Phillip Morris, Inc., the Sixth Circuit became the first federal appeals court to consider whether to recognize an implied private right of action under the FCPA. The Sixth Circuit

---

19 See, e.g., Br. for Appellant, United States v. Joel Esquenazi (11th Cir. 2012) (No. 11-15331-C) (appealing a conviction for FCPA violations on the grounds that certain employees of a Haitian telecommunications company were not “foreign officials” under the FCPA); Samuel Rubenfeld, Justice Department Attacks ‘Foreign Official’ Challenge in Appellate Brief, WALL ST. J. (Aug. 21, 2012), http://blogs.wsj.com/corruption-currents/2012/08/21/justice-department-attacks-foreign-official-challenge-in-appellate-brief; see also CRIMINAL DIV. OF THE U.S. DEP’T OF JUSTICE & ENFORCEMENT DIV. OF THE U.S. SEC. & EXCH. COMM’N, A RESOURCE GUIDE TO THE FOREIGN CORRUPT PRACTICES ACT 19–21 (2012) [hereinafter FCPA Resource Guide] (explaining that “Foreign officials under the FCPA include officers or employees of a department, agency, or instrumentality of a foreign government” and “[t]he term ‘instrumentality’ is broad and can include state-owned or state-controlled entities.”).

20 See Williams Electronics Games, Inc. v. Garrity, 366 F.3d 569, 578 (7th Cir. 2004) (“Commercial bribery that does not involve any collusion between competitors does not violate the Sherman Act’s prohibition against price-fixing.”); Morning Star Packing Co. v. SK Foods, L.P., 754 F. Supp. 2d 1230, 1236 (E.D. Cal. 2010) (allegation of defendants’ payment of bribes to win bids and obtain bid information did state cause of action under the Sherman Act).


23 2660 Woodley Road Joint Venture v. ITT Sheraton Corp., 369 F.3d 732, 737 (3d Cir. 2004).

24 Id. at 738 n.6 (collecting cases).


28 See id. at 456–57; see also Lamb v. Phillip Morris, Inc., 915 F.2d 1024, 1030 (6th Cir. 1990).

29 Lamb, 915 F.2d at 1027.
observed, citing Sherman Act cases, that “the international reach of federal antitrust laws dilutes the plaintiffs’ assertion that a private cause of action under the FCPA constitutes the only viable mechanism for redressing anticompetitive behavior on a global scale.” The *Lamb* court further noted that “the potential for recovery under federal antitrust laws . . . belies the plaintiffs’ contention that an implied private right of action under the FCPA is imperative.”

Due to recent court decisions, however, the extent to which bribery occurring outside the United States may give rise to an RPA claim is an unsettled question. In one recent case featuring allegations of foreign bribery, a federal district court held that Section 2(c) of the RPA does not apply extraterritorially. In 2010, a chemical maker, Innospec, pleaded guilty to FCPA violations, which arose from bribes paid to Iraqi officials to secure fuel additive contracts. Under the plea, Innospec agreed to pay multimillion-dollar fines to various enforcement agencies. Subsequently, NewMarket Corporation, a competitor of Innospec, filed suit under the Sherman Act, Section 2(c) of the RPA, and Virginia state antitrust laws, alleging competitive harm resulting from Innospec’s foreign bribery. Innospec moved to dismiss NewMarket’s RPA and Virginia state law claims. Following the reasoning set forth in *Morrison v. National Australia Bank Ltd.*, a 2010 U.S. Supreme Court case involving the securities laws, the district court held that there is a presumption against applying any statute to conduct overseas absent a clear legislative intent to the contrary. Finding no clear intent for extraterritorial application of Section 2(c) of the RPA, the court dismissed NewMarket’s RPA claim, leaving the Sherman Act and state law claims intact. Innospec ultimately paid $45 million to settle the remaining claims.

The *NewMarket* court’s ruling that Section 2(c) does not apply extraterritorially may not be the last word on the issue. First, the *NewMarket* court did not directly address the existing precedents that sanction such claims. For example, in *Environmental Tectonics v. W.S. Kirkpatrick, Inc.*, a Pennsylvania supplier of aircraft medical equipment sued under the RPA and other laws following the loss of a foreign contract to a competitor who admitted violating the FCPA and bribing foreign officials to obtain the contract. In a 1988 ruling, the Third Circuit held that “[a]s far as
plaintiff’s] antitrust standing is concerned, the allegations . . . make out an actionable violation of section 2(c) of the Robinson-Patman Act.”

Further, the Morrison ruling may actually have left open more possibilities for extraterritorial application than it might seem. In Morrison, the Supreme Court stated that the presumption against extraterritoriality often “is not self-evidently dispositive, but its application requires further analysis.” The Australian plaintiffs in that case had filed a U.S. securities fraud lawsuit against an Australian securities issuer over securities purchased in Australia, but the plaintiffs alleged that the underlying fraud had been committed by executives at the firm’s U.S. subsidiary. Since, as the Court in Morrison observed, “it is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States,” the real question the Supreme Court answered was whether the defendants’ alleged conduct fell within the regulatory ambit of the statute at issue.

The Court in Morrison concluded that “the focus of the [Securities] Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States.” Arguably, then, Morrison requires a similar analysis of the “focus” of Section 2(c) of the RPA to determine whether suits like NewMarket’s claim should be dismissed on extraterritoriality grounds. If a court finds the “focus” of the RPA to be protection of competition in the United States, that would not necessarily require the dismissal of all RPA claims based on bribery overseas, if the purpose or effect is to harm U.S. businesses.

Trends of Convergence
The NewMarket case illustrates the first area of convergence for antitrust and anti-corruption law: litigants asserting claims that relate to both areas of law in the same proceeding. Since the dawn of a robust FCPA enforcement program in the past decade, there have been a number of cases in which FCPA and competition law claims coincide. This trend is likely a result of the increased exposure of foreign bribery and the realization that such bribery may cause competitive harm or occur in tandem with other corporate misconduct, like price fixing. The competition law claims may be brought by private plaintiffs following public revelations of an FCPA investigation, as in NewMarket.

In at least one notable recent DOJ case, both antitrust and FCPA allegations appeared together. In 2011, Bridgestone Corporation entered into a plea agreement with the DOJ that simultaneously settled charges for conspiracy to violate both the FCPA and the Sherman Act. The Sherman Act charge stemmed from the company’s involvement in a price-fixing cartel among manufacturers of marine hose, a type of rubber hose used to transfer oil, while the related FCPA charge arose from bribes that Bridgestone’s sales agents paid to officials at state-owned customers in Latin America to secure marine hose contracts and other business. Unlike the FTC’s Aircraft Case settlements, the bribery itself did not serve as the predicate for the antitrust charge.

42 Id. at 1066. The defendants subsequently appealed the case to the Supreme Court on the ground that the suit was barred by the act of state doctrine. The Supreme Court affirmed the Third Circuit. W.S. Kirkpatrick & Co. v. Envtl. Tectonics Corp., 493 U.S. 400, 401–02, 409–10 (1990).
43 Morrison, 130 S. Ct. at 2884.
44 Id. at 2875–76.
45 Id. at 2884.
46 Id.
in the *Bridgestone* case, but this case still illustrates how antitrust violations and foreign bribery can occur—and be prosecuted—together.48

The second point of convergence is the rise of a compliance-focused enforcement model for both FCPA and antitrust enforcers. For the past few decades, the antitrust enforcement agencies have strived to publicize extensive guidelines and policy statements designed to aid businesses in understanding and complying with the antitrust laws. Among other steps, the FTC and the Antitrust Division of the DOJ have published joint guidelines covering horizontal mergers, non-horizontal mergers, collaborations among competitors, the licensing of intellectual property, and other antitrust topics.49 The appetite for antitrust guidelines publications was fueled in part by a shift away from an enforcement model based more heavily on courtroom litigation. For example, prior to the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976, which introduced mandatory pre-merger waiting periods for antitrust review, the antitrust agencies typically would sue to challenge a merger after the merger had already been consummated.50 A lengthy litigation might then have ensued, but effective post-merger remedies proved difficult to obtain even in cases the government won.51 The HSR Act created a new, proactive model of merger review that shifted much of the action away from the courtroom to the pre-merger investigations conducted by the FTC and DOJ. This change, in turn, necessitated well-publicized guidelines to inform businesses about the agencies’ mode of legal analysis.

More recent developments signal a parallel trend in the FCPA context. Throughout the boom in FCPA enforcement in the past decade, the DOJ has resolved most cases without litigation—and thus typically without judicial commentary and guidance.52 In the early 2000s, federal prosecutors began settling FCPA cases via deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs).53 These settlement agreements allow defendants to settle criminal allegations without either a public trial or a guilty plea, while also enabling prosecutors to obtain fines and commitments about future behavior.

With so many FCPA cases resolved out of court, businesses and their lawyers have clamored for the enforcement agencies to provide detailed FCPA guidance documents.54 In November

---

48 See Brass, Chan & Lipshutz, supra note 35. This article provides a good discussion of both the *Bridgestone* and *Innospec* cases, discussed above.


51 Id.


2012, the DOJ and the SEC published a comprehensive, 120-page FCPA Resource Guide, which serves a function similar to the antitrust agencies’ guidelines by explaining the views of the DOJ and SEC on how to interpret the FCPA, including by way of hypothetical examples.

After the past several years in which the DOJ Criminal Division has relied heavily on deferred prosecution and non-prosecution agreements to resolve FCPA cases, the same types of agreements have begun to show up in the DOJ Antitrust Division’s resolution of price-fixing cases as well, though less frequently. In 2010 and 2011, the Antitrust Division entered into five non-prosecution agreements with major financial firms to settle charges arising from a municipal bond bid-rigging conspiracy, a substantial increase in the Antitrust Division’s usage of NPAs. In addition, in 2012 and to date in 2013, the DOJ entered into non-prosecution or deferred prosecution agreements with three banks to settle LIBOR rate rigging allegations in cases jointly investigated by the Antitrust Division and the Criminal Division. Even so, the Antitrust Division’s use of this tool remains very sparing in comparison with the Criminal Division’s FCPA prosecutions, and the recent increase may not signal a new trend, but rather may merely reflect the circumstances of the particular cases involved.

Some commentators have hypothesized that the Antitrust Division may be more hesitant to use NPAs and DPAs because of the perception that these settlements create tension with the Division’s Corporate Leniency Program. The Corporate Leniency Program relies on a carrot-and-stick approach to encourage cartel members to stop their illegal conduct and report it to the Division. Under the program, the first corporation to report its involvement in a cartel can potentially avoid criminal conviction, fines, and prison sentences for its employees. Corporations later found to be involved in the cartel typically must either plead guilty or go to trial. This policy creates a strong incentive to be the first party to report involvement in a cartel. The possibility that a corporation could still avoid criminal conviction by negotiating an NPA or DPA, without being the first cartel member to report the cartel, might reduce the incentive for cartel participants to come forward in the first place. In contrast to a cartel situation, in an FCPA case, typically, the bribing company and its employees may be the only parties with knowledge (apart from the foreign official who received the payoff). In those circumstances, absent multiple conspirators, the possibility of

61 Antitrust Alert, supra note 59.
avoiding prosecution via NPA or DPA may be the best way to encourage an offending company to report the bribery, rather than to try to hide it.

The third significant developing convergence between FCPA and antitrust enforcement involves frequent, high-level international coordination among enforcement agencies and harmonization of legal regimes for anti-corruption and antitrust. The Innospec case, discussed above, provides a good example here, too: The investigation and settlement in that case was coordinated among U.S. authorities and the UK Serious Fraud Office, and the plea agreement included the joint appointment of an independent monitor acceptable to both U.S. and UK authorities. The 2008 FCPA case against German multinational Siemens, in which U.S. and German authorities collaborated, provides another notable instance of cross-border enforcement coordination. Anti-bribery laws and enforcement techniques are also crossing borders; the 2010 UK Bribery Act contains provisions similar to the FCPA, and legislation that would bring DPAs to the UK was introduced in the British Parliament in 2012.

Antitrust authorities from different countries also frequently collaborate on major international investigations. The International Competition Network, founded in 2001 to bring together antitrust authorities from different nations, promotes harmonization of international antitrust legal regimes and coordination among global competition agencies. The OECD and other forums serve a similar function in harmonizing national anti-corruption enforcement regimes. For example, the OECD Working Group on Bribery in International Business Transactions monitors the implementation and enforcement of a 1997 treaty initiated to combat bribery in international business deals. This treaty, which has been adopted by forty countries and which establishes legal standards for criminalizing bribery of foreign public officials in business transactions, helped lay the foundation for the expansion of effective FCPA enforcement in the 2000s. Some observers have called for improved coordination among international anti-bribery enforcement agencies, and the work of the International Competition Network in the antitrust arena might serve as a valuable model.

Conclusion
Abundant differences exist between the legal treatment of foreign bribery and more typical antitrust concerns. Even so, the current trend appears to be one of convergence between anti-corruption and antitrust in certain respects. The continuing globalization of international business cre-

62 See DOJ Innospec Press Release, supra note 34; Plea Agreement as to Innospec, Inc., supra note 33, ¶ 13.
67 See Philip Urofsky et al., supra note 3, at 1179.
ates an environment in which claims of corrupt foreign payments and claims of antitrust violations are likely to arise in the same case. Businesses’ desire for predictable and familiar legal rules likely will continue to support a compliance-focused enforcement model, with corporate compliance personnel playing a role in both FCPA and antitrust compliance. Cross-border legal harmonization and enforcement coordination will continue to be driven both by governmental interests in thorough, effective, and efficient enforcement, and by businesses’ needs for cost-effective resolution of investigations and clarification of the legal environments in which they operate.

In this environment, antitrust and FCPA practitioners may be able to benefit greatly from each other’s knowledge and experiences. For, while not obvious at first, the common threads between antitrust law and anti-corruption law should not be too surprising in light of their shared and overlapping history and development.
Book Review
Lessons from an Accidental Antitrust Lawyer

Thomas B. Leary
The Education of an Accidental Antitrust Lawyer: Told in True Stories
CreateSpace Independent Publishing Platform 2013

Reviewed by Steven J. Cernak

Tom Leary can tell a good story. Actually, that statement is too limiting—Tom Leary can tell many good stories, often one right after another. And that is exactly what Leary has done in his memoir, The Education of an Accidental Antitrust Lawyer: Told in True Stories. Leary draws on his decades of experience as outside counsel in New York and Washington law firms, inside counsel at General Motors, and Federal Trade Commissioner to spin stories that illustrate lessons applicable to antitrust lawyers of all ages.

The reference to “lessons” should not mislead you. This book is not an inflated self-help book or a series of lectures on how things were better in the good old days. Instead, Leary sets out to entertainingly recount his life's adventures—and he succeeds.

Some of these adventures provide profound lessons. Other stories, however, are included not for any universal lesson but just because they are too much fun not to tell again. So we are treated to a description of how Leary's life-long love of chocolate once led him to confuse bath soap for an after dinner treat while dining with some new partners. We also are told of Justice William Douglas’s wandering eye during argument in United States v. Grinnell Corp. All the stories are told in a lightly edited version of Leary’s usual speaking style. If you have had the pleasure of hearing him tell a story, you will fondly recognize some of the catch-phrases.

The basics of Leary’s resume should be familiar to most antitrust lawyers. He graduated from Princeton, served in the Navy during the Korean War, and then received his law degree from Harvard. He practiced at White & Case’s New York office before joining the GM Legal Staff at the age of forty in 1971. He later joined what was then the law firm Hogan & Hartson before serving as an FTC Commissioner for six years during the Clinton and G.W. Bush years. Along the way, he had occasion to interact with (and pick up stories about) interesting people ranging from several U.S. Presidents and Supreme Court Justices to Albert Einstein and Walt Disney.

The book spends only a short time on Leary’s early life, emphasizing that his career both as a lawyer and an antitrust specialist was not pre-ordained but was instead the result of a series of seeming accidents—hence, the book’s title. The majority of the stories focus on his professional career, starting in 1958 at White & Case in New York. There, Leary picked up several lessons that

1 Leary’s sweet tooth—and the ability to feed it seemingly without any effect on weight—was a trait passed on to subsequent generations of GM antitrust lawyers.
served him well at other career stops along the way. First, he recounts his work defending Panagra, a joint venture between Pan Am and W.R. Grace, against a Justice Department complaint. Once the judge had the case under advisement, Leary continued to fret over the case until a White & Case partner, Tom Kiernan, reminded him that “there isn’t one more thing that we can do that will affect the result . . . . Don’t torture yourself with worry about the outcome.” These words echoed advice given Leary earlier by his grandmother and later by a GM General Counsel.

Next, Leary represented B.F. Goodrich in the FTC’s investigation of the use of basing point pricing by all the major tire manufacturers. This case gave him his first opportunity to interact with the FTC and compare his approach to those of the counsel representing the other companies. His mentor, Ed Barton, pointed out the risk other counsel took by arguing all the unimportant points with the agency lawyers. That strategy, Barton said, was unlikely to wear down the government lawyers and certain to harm the lawyer’s own credibility. Leary continued to apply that lesson while defending mergers at Hogan and appreciated when others applied it while he was an FTC Commissioner.

The Tire Case also taught Leary an early lesson in civility. After difficult negotiations, the case settled. Despite earlier differences, counsel for the FTC and all the parties gathered for a small celebration. At the party, Joe Sheehy, chief negotiator for the FTC team, “brought down the house” with this quip:

I want to express my appreciation to respondents’ counsel for the graciousness with which they received all the major concessions that I made in the course of these discussions, and I want to assure you that—had you made any concessions at all—I would have received them with equal grace.

Finally, Leary’s involvement in the private litigation that came after several criminal price-fixing pleas in the electrical component industry allowed him to “[eat] more meals and [drink] more whiskey with confessed price fixers than anyone other than another price fixer.” When asked for a lesson from serving time, one price fixer told Leary: “Never talk prices with more than one other guy in the room”—explaining Leary’s later skepticism for 3 to 2 mergers. The experience also helped him in counseling as he learned how powerful the incentive to fix prices and the bond between co-conspirators can be. Given the hundreds of millions of dollars in fines that continue to be levied on conspirators every year, it seems those incentives and bonds remain strong and that lesson must still be learned today.

When Leary moved to the GM Legal Staff in 1971, he had to learn the lessons all inside counsel must (and more outside counselors should) learn: Understand the client’s business well enough to give effective, efficient—and, usually, quick—advice. Leary’s boast to the Antitrust Division head that he faced more potential antitrust issues before breakfast every day than the latter saw in a week might not have been much of an exaggeration, given the era’s antitrust principles and GM’s 40+ percent market share. After all, Leary had to deal with both a dedicated GM Section of the Antitrust Division as well as periodic FTC investigations into the industry. Leary tells the story of convincing GM management to send the corporation’s first written antitrust compliance manual to any GM employee who could cause the corporation to violate the antitrust laws—and 40,000 copies were printed.

His GM experience also gave Leary opportunities for active, creative lawyering. He worked with Bob Nitschke, Bob Weinbaum, and others on the GM Legal Staff to support, financially and otherwise, “new economic thinkers,” such as Robert Bork, Harold Demsetz, and Henry Manne. So, yes, the Chicago School does have some roots in Detroit. Leary helped ghost-write many speeches and op-ed pieces for top GM management as they tried to influence industrial policy gener-
ally and antitrust policy specifically. He also worked on issues of immediate importance to GM. For instance, he tells the story of negotiating a deal, complete with controversial resale restraints, for certain metals necessary for GM’s new emission equipment which were available at the time only in South Africa and the Soviet Union.

Leary learned the lessons of leadership both from GM General Counsel Otis Smith and, after moving to Hogan & Hartson in 1982, from Warren Gorrell, now co-head of Hogan Lovells. In addition to their obvious intelligence and energy, Leary sees in them the trait that management guru Peter Drucker calls the ability to “demonstrate . . . full confidence in his subordinates’ ability to carry out whatever responsibilities are assigned to them.” As Leary sees it, supposed leaders lacking that trait will constantly second-guess their subordinates and smother their creativity.3

Leary’s move to the Hogan firm allowed him to share his talents with—and learn lessons from—even more clients. He continued his association with The Business Roundtable, begun while at GM, and added major clients such as General Dynamics. Those clients allowed Leary to develop an active merger practice and apply his views of how best to shepherd a difficult transaction through the Hart-Scott-Rodino merger review process. He explains his success as resulting partly from not picking fights with agency staff and quickly providing them the information necessary to do their job.

Leary also participated in key antitrust cases in the sports world. He represented Cornell in the Antitrust Division suit challenging an agreement with other Ivy League schools on athletic scholarships and helped establish the system now known as the Bowl Championship Series.

Leary has also written ten briefs filed in the Supreme Court, all as amicus, and many for the Roundtable. He supported the winning side in Brooke Group.4 Khan,5 and Leegin.6 He has one more notable Supreme Court connection. Leary spends several pages describing “the Fulbright Table,” an area of the Hogan firm cafeteria where Leary and other firm lawyers met to exchange stories on just about any topic other than firm business. The table was named for William Fulbright, the former Arkansas Senator and Hogan lawyer. One of the younger regulars was a Hogan lawyer named John Roberts, who has since enjoyed some Supreme Court jurisprudence success.

Then, at an age when other lawyers might have wound down an illustrious career, Leary was appointed an FTC Commissioner. His description of the long confirmation process is another frustrating tale of Washington dysfunction, but at least colorfully told. Suffice it to say that there is an implied comparison between the Senators who held up his nomination and the pre-school children on the playground just outside his FTC office. As Commissioner, Leary was involved in many of the key merger and other antitrust matters of the era. He describes his thinking as the deciding vote to challenge the merger of the baby food business of Heinz and Beech Nut (remember the skepticism about 3 to 2 mergers?) and his later thoughts when, after that challenge was upheld in court, Heinz sold the business to Del Monte. He also has an “extended discussion of the [bleeping]” Schering-Plough case, where he wrote the opinion for a unanimous Commission challenging a “reverse payment” in a patent dispute. The challenge was vacated by the Eleventh Circuit.7 Leary continues to try to understand what he and the Commission could have done dif-

3 Drucker’s opinion echoed early advice from Leary’s father: “Tom, why don’t you just let someone else be wrong?”
7 Schering-Plough Corp. v. FTC, 402 F.3d 1056 (11th Cir. 2005).
ferently. One suspects that he will be very interested in the Supreme Court’s pronouncements on
the subject later this year in the Actavis case now before it.

Leary offers his thoughts on convergence among regimes in competition laws and enforcement
now and during his time at the Commission. Perhaps not surprisingly, Leary suggests a humble
approach, emphasizing that we in the U.S. might be able to learn lessons from other jurisdictions
that, while new to antitrust, have governed themselves for centuries longer than have we. Also, our
own system might not be perfect for other jurisdictions: it can be difficult to preach the benefits of
convergence when our own system has two federal and fifty state enforcement agencies.

Leary freely admits that this book “is a December song.” In fact, he even spends a few pages
discussing his thoughts on what lies beyond. So the question arises: How should we celebrate a
man who has spent decades advancing this corner of the profession that many of us call home?
Yet again, Leary himself provides us with the lesson. Appendix B of the book is the only place to
find the text of a speech Leary gave in November 2001. The speech, at a Pepperdine business
school program, had been delayed by the events of September 11. When rescheduled, the pro-
gram had turned into an awards presentation, including a tribute to a Pepperdine graduate who
had helped overpower the terrorists on Flight 93 that crashed in Pennsylvania. Leary discovered
this fact shortly before the event and changed his speech to one that attempted to answer the
question of how we should honor our heroes. His eloquent admonition to cheerfully defend the
freedoms we have is itself worth the price of the book. In direct answer to the question, however,
Leary begins as you would expect any master storyteller to begin: We honor our heroes by
“remember[ing] them on occasions like this. Telling stories about them.” So consider this review
a suggestion to all who have known Tom Leary in any one of his many roles—outside counsel,
inside counsel, Commissioner, colleague, friend—to keep telling stories about this “accidental
lawyer” so that his life continues to be one “Told in True Stories.”


The Paper Trail: Working Papers and Recent Scholarship
A Collection of Reviews of Joshua D. Wright’s Papers

Editors’ Note: On January 11, 2013, Joshua Wright, Professor of Law at George Mason University School of Law, became Commissioner Wright as he took his (Republican) seat at the Federal Trade Commission, a seat vacated by former Commissioner J. Thomas Rosch. Commissioner Wright is also one of those rare animals who has both a Ph.D. in Economics as well as a JD. And his facility with both is evident in his scholarship—more than sixty papers in journals and books. Wright has also been a frequent contributor to the antitrust blog, Truth on the Market.

Given his background as both economist and lawyer, antitrust practitioners may be well served by understanding how Commissioner Wright thinks about antitrust issues and antitrust methodologies as they consider how to develop and present arguments that would resonate with him. To that end and instead of the usual Paper Trail format, we have asked a distinguished panel of five antitrust scholars and practitioners to describe and assess some of his key papers. This panel reviews Wright's papers that span his key research interests: The influence of the Chicago School on antitrust, the role of behavioral economics in fashioning antitrust and consumer protection policies, appropriate antitrust policy towards vertical restraints and in technologically dynamic industries, and whether the increasing complexity of the economics underlying antitrust policy has affected the quality of adjudicated antitrust claims.

Notwithstanding these varied interests, a dominant and common theme is Wright's focus on the evidence required to pursue appropriate, welfare-maximizing antitrust or consumer protection policies. And there is no doubt that Wright believes the evidence supports his strongly held views.

Paper Trail co-editor Bill Page considers three Wright papers that review Wright's views of the influence of the Chicago School on antitrust. In considering the differences across schools of thought—Chicago v. Post-Chicago in particular, Wright argues that the Chicago School “wins” because it “provides a more robust theoretical and empirical account of the business practices we observe in the real world along with their competitive effects.” Indeed, he is emphatic about the empirical bases for the Chicago School in discussing RPM and vertical restraints generally:

A scientific, Bayesian approach to the design of optimal antitrust policy requires that we update our prior beliefs based on the available empirical evidence . . . In the context of RPM and vertical restraints, it is impossible to evaluate the existing empirical literature without reaching the conclusion that these practices are nearly always efficient.

In a similar vein, Wright takes pains to dispel the notion that the Chicago School is the product of a conservative ideology. As Page observes in his discussion, Wright “insists that it is scientifically based in price theory, empirical verification, and error cost analysis.”

Still, in a subsequent paper considered by Page, Wright argues for jettisoning the Chicago School label—or attaching “School” to any set of views—so as to avoid what he regards as oversimplified and misleading characterizations of the Chicago School, in particular. Instead, he
argues, courts and agencies should focus on the evidence, “choos[ing] theories and models based on their ‘predictive power’ determined by the ‘best available empirical evidence’ and use decision theory to pick rules that minimize social and administrative costs of error.”

While Wright eschews labels, he nonetheless shows substantial skepticism of the “behavioral” school, as highlighted by Max Huffman in a discussion of a number of Wright papers on this still-controversial approach to economic issues. Huffman wastes no time in getting to the heart of the matter: “Wright’s bottom-line conclusion is that behavioral antitrust is not worthy of consideration until a comprehensive new theory is announced that encompasses all of antitrust law within its boundaries,” a standard Huffman regards as extreme compared to “any example of the law’s reliance on social science evidence.” Wright also suggests that relying on behavioral economics in antitrust and consumer protection would likely lead agencies to adopt an aggressive policy of “paternalistic intervention.”

Despite Wright’s focus on the need for evidence, Huffman takes him to task for not fully considering the evidence to assess the predictions of behavioral economics. As one example, Wright suggests that the evidence indicates that consumers’ credit card choices can best be explained by rational decision-making, not any “cognitive biases” that are posited by the behavioralists. Huffman points out that in reaching this conclusion, Wright relies on one study that seemingly demonstrates that 60 percent of consumers choose the “optimal credit card contract” when offered a number of choices. Huffman responds by noting that “a conclusion that 40 percent of consumers choose sub-optimally . . . is hardly a ringing endorsement for hands-off regulatory policy.”

Huffman also notes that Wright’s view is that “there is an onus on those conducting behavioral economics scholarship to ‘map the conditions under which specific errors are more or less likely to affect decisions and then to generate estimates of the social costs imposed by those errors.’” Huffman argues that this is a particularly “confounding position for an antitrust scholar” because “the common-law, evidence-based process by which antitrust develops is ideally suited to adjusting rules incrementally as new learning emerges.”

Serge Moresi discusses two Wright papers on a particular intellectual focus for Wright: the pro-and anticompetitive theories girding vertical restraints, including slotting contracts, loyalty discounts, and exclusive dealing. Moresi then considers a third paper on how to better evaluate any claims of anticompetitive harm resulting from vertical restraints. As Moresi highlights, once again Wright’s focus is on the evidence, but when it comes to vertical restraints, Wright concludes that there is a “lack of empirical evidence capable of guiding sensible antitrust policy.” Indeed, in one of the papers discussed by Moresi, Wright himself provides empirical evidence on the benign character of slotting contracts, concluding that the evidence demonstrates “that such agreements are likely procompetitive.”

By contrast, Wright views the models that instead focus on anticompetitive exclusion that can result from these kinds of vertical restraints as demonstrating that exclusionary effects can only be harmful when the associated contracts are relatively long and the production of the good or service is subject to substantial scale or scope economies. But, Wright argues, in most cases these conditions are not fulfilled. Indeed, Wright notes that the fact that firms without any significant market power adopt these kinds of vertical restraints underscores the substantial evidence of their pro-efficiency benefits and undermines any view that these practices lead to anticompetitive outcomes.

To be sure, as Moresi notes, “Wright acknowledges that the empirical evidence does not conclusively show that exclusive dealing is always pro-competitive.” Still, as Moresi further notes,
Wright concludes that “exclusive dealing, market share discounts, and loyalty discounts generally are efficient and not associated with anticompetitive outcomes.” In the final paper considered by Moresi, Wright proposes an empirical measure of foreclosure that would indicate the likelihood that the vertical restraint is anticompetitive.

Danny Sokol considers two papers that follow a related evidentiary theme: assessing “whether or not antitrust is too complex for effective adjudication.” Observing that antitrust has become increasingly driven by economics, Wright uses statistical techniques to assess the role of what Sokol calls “econ-friendly judges” in fashioning opinions that can withstand judicial appeal. In a follow-up article, Wright assesses whether Administrative Law Judges affiliated with an expert antitrust agency (the FTC) do “better” than generalist district court judges in producing higher quality decisions that are more likely to withstand appeal, concluding that decisions by generalist judges are far less likely to be reversed than is the case for ALJs.

A third Wright paper discussed by Sokol focuses on the “right” level of antitrust sanctions, reviewing the empirical studies on cartels and deterrence. Wright's reliance on evidence comes through here as well. While many Chicago thinkers suggest that monetary penalties can optimally deter antitrust violations, Wright argues that, based on the evidence, penal sanctions for corporate crime may well be more efficient than monetary penalties alone.

Jim Langenfeld considers two Wright papers addressing the controversial issue of antitrust policy in industries that are technologically dynamic. Not surprisingly, Wright counsels caution in reaching findings of consumer harm in innovative markets and industries. Langenfeld discusses Wright’s view that (in Langenfeld’s words) “economic theory does not provide an analytically coherent method for evaluating the trade-offs across competition, efficiency, and consumer welfare, and there is a corresponding lack of an empirical basis for estimating these trade-offs.” Wright suggests that that “humility regarding the current state of knowledge implies that deference to the competitive process is an appropriate guiding principle in the absence of clear and convincing evidence of substantial consumer harm.”

Like other authors of the present survey, Langenfeld highlights Wright’s advocacy for legal and economic research to “develop better analytic approaches and empirical bases for evaluating” the various trade-offs. Langenfeld notes that in one paper, Wright advocates relying on analyses like “industry-specific studies of the history and conditions of innovation that are similar to those found in business and economic history journals.”

Langenfeld also considers an alleged “patent-holdup” matter—N-Data—which was decided by the FTC under Section 5 in the context of a standard-setting procedure. Wright argues that the Commission treated the case as an “unfair method of competition,” when it should have seen it as simply patent infringement. Using Section 5 in such a case, he argues, might chill innovation by deterring licensors from changing the terms of a royalty related to a standard.

In spite of the wide variety of interests of Commissioner Wright as evidenced in these discussions, his scholarship reflects a long-held commitment to a belief in the centrality of empirical evidence in fashioning and implementing antitrust (and consumer protection) policies. And based on one of his recent speeches he has already delivered in his short time at the Commission, that commitment will not likely change. To be sure, his view of the evidence to date results in conclusions that are largely consistent with what many will still call the Chicago School. But knowing of his

---

emphasis on empirical evidence means that those practitioners presenting their arguments to the Commissioner or the Commission have a path forward in efforts to persuade Wright of the validity of their arguments: Show Wright the evidence.

Send comments or suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—William H. Page and John R. Woodbury
Josh Wright’s “Chicago School Papers”: An Overview

By William H. Page
Marshall M. Criser Eminent Scholar, University of Florida Levin College of Law.

In what follows, I consider three of Commissioner Wright's “Chicago School Papers.” In these papers, Commissioner Wright considers the past, present, and future role of the Chicago School of antitrust analysis in the shaping of law and policy, offering along the way some interesting insights into what his priorities at the FTC are likely to be. The papers discussed have common themes: the mischaracterization of the “Chicago School,” the scientific advantage of dispensing altogether with “School” labels, and a focus on empirical findings in shaping antitrust analysis.


The first paper challenges essays collected by a former FTC Chairman, Robert Pitofsky, How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust. The essays argue, in various contexts, that the Chicago School has won over the courts to a conservative, minimalist antitrust agenda that ignores evidence of consumer harm, and that the Post-Chicago school literature provides a better basis for antitrust policy. Wright argues that the choice between theories should be based on which theory has the best empirical support. On that standard, he argues, the Chicago School wins, because it “provides a more robust theoretical and empirical account of the business practices we observe in the real world along with their competitive effects.” The standard also refutes the simple characterization of the Chicago School as conservative in the pejorative sense of skewing inquiry away from demonstrable consumer harm.

Wright begins with a useful history of the Chicago School of industrial organization economics, which refuted the dominant structure-conduct-performance paradigm in the 1970s, and the Chicago School of antitrust analysis, initiated by Aaron Director, developed more fully by Richard Posner, Robert Bork, Frank Easterbrook, and Benjamin Klein (and his many co-authors, including Wright). These analyses have transformed antitrust by eliminating or eroding per se illegality of vertical restraints and placing merger analysis on a sounder economic footing.

He compares this body of work to Post-Chicago antitrust, which has shown that some vertical restraints can reduce efficiency by raising rivals’ costs in certain defined circumstances. These

---

results are the basis for the suggestion that the Chicago School “overshot the mark” in excusing certain practices. Although Post-Chicago analysis has had wide influence in economics departments and in European competitive law, it has relatively little influence on American antitrust, apart from *Image Technical*.9

Wright is at pains to refute the characterization of the Chicago School as a branch of conservative ideology. Instead, he insists that it is scientifically based in price theory, empirical verification, and error cost analysis. In the heart of the paper, he offers evidence to support Chicago-inspired reforms of recent years. For example, some Post-Chicagoans have criticized the abandonment of the per se illegality of resale price maintenance, arguing that the need to control free riding by discount retailers does not explain many if not most of the uses of the practice. Wright responds by pointing to studies showing that, even in the absence of free riding, dealers may not provide the optimal level of promotional services, (1) because their profit margin on promotional expenditures is typically less than the manufacturer’s margin, and (2) because those expenditures will increase sale of the manufacturer’s product at the expense of its rivals’ products, even when the expenditures do not increase the retailers’ overall sales.10 In these circumstances, the manufacturer will have a procompetitive reason for using RPM (or some other practice, like slotting fees) to compensate dealers for providing additional (albeit unspecified) promotional services.

Although there are anticompetitive theories of RPM, Wright suggests that the justification for a per se rule depends on the relative frequency of the anticompetitive uses. He points to two surveys of the empirical literature that conclude that RPM usually benefits consumers. In a passage that may shed light on his approach to his new job, Wright concludes:

> A scientific, Bayesian approach to the design of optimal antitrust policy requires that we update our prior beliefs based on the available empirical evidence. In order to select the best performing economic models from those available, antitrust decision-makers must rigorously examine the existing evidence. In the context of RPM and vertical restraints, it is impossible to evaluate the existing empirical literature without reaching the conclusion that these practices are nearly always efficient.

In another section, Wright reviews Post-Chicago theories showing that exclusive dealing arrangements can inefficiently exclude rivals, particularly when it is hard for dealers to coordinate a rejection of the exclusionary proposal or when manufacturers can compensate dealers for their participation in exclusion.11 He then reviews the literature showing efficiency justifications for exclusive dealing, including by promoting dealer loyalty.12 Although the empirical literature is thinner, Wright suggests that it favors the efficiency explanations rather than the Post-Chicago “possibility theorems.”

In a final section, he rejects the argument that the conservative ideology in Chicago School analysis has misled the Supreme Court in cases like *Brooke Group*,13 *Leegin*,14 and *California Dental*,15 to adopt unduly sweeping rules favoring legality. In response, Wright points to the vot-

---

15 California Dental Ass’n v. FTC, 526 U.S. 756 (1999).
ing record on the Court, particularly in recent years, when essentially of the Court’s decisions other than *Leegin* were decided by supermajorities that included the Court’s more liberal justices.


In the second article under consideration here, Wright covers some of the same ground, but focuses on the relationship between the Chicago School and both Transaction Cost Economics (TCE) and New Institutional Economics (NIE), which takes account of transaction costs in comparing institutions. The Chicago School, although based on price theory, has taken account of transaction costs, particularly in Benjamin Klein’s many studies of vertical restraints. Non-Chicago scholars in the NIE tradition (e.g., Oliver Williamson) and TCE (Paul Joskow) have also influenced antitrust, but Wright argues that there has been a Chicago School/TCE revolution in antitrust reflected in Roberts Court decisions.

The ensuing discussion of *Leegin*, *Twombly*, and *Weyerhaeuser*, has surprisingly little to say about the role of transaction costs specifically, apart from highlighting *Twombly’s* reference to the high costs of discovery in antitrust cases as one reason for tightening pleading standards. At the end of the paper, however, Wright indicates that he finds an awareness of the role of transaction costs implicit in the Court’s “institutional modesty”:

Each of the three decisions is motivated, at least in part, by the possibility of chilling procompetitive conduct by erroneously assigning liability to efficient conduct. A corollary is that the Court, again in each of the cases but especially *Leegin*, is sensitive to what is known and unknown about the competitive effects of RPM and other contractual arrangements. The combined affinity for price theory and TCE, emphasis on empiricism and knowledge, and institutional modesty in light of the potential for significant error costs follow directly from Chicago School/TCE analytical principles.


In the last paper under consideration, Wright continues his support of the substance of Chicago School analysis, but argues for abandoning that label in favor of an approach that bypasses the current multiplication of antitrust schools. He sets three goals for the paper: to describe the increasingly difficult problem of “model selection” for antitrust decision making in a time when scores of models in the economics literature compete to guide our understanding of alleged restraints; to show how the proliferation of schools in antitrust worsens the model-selection problem; and to argue instead for a program of empirical testing to identify the most appropriate model.

Wright begins by defending the Chicago School against oversimplified and misleading characterizations, much as he did in the first two papers. He identifies the essence of the Chicago School in its reliance on price theory with empirical testing (what Stigler called “microeconomics with evidence”) and its focus (following Easterbrook) on the costs of judicial error—particularly false positives. He contrasts this approach, once again, with the multiplication of “possibility the-

orems’ of anticompetitive effect of vertical restraints. He rejects the recent announcements of a “Neo-Chicago” school\textsuperscript{18} as a repackaging of Chicago insights and methodologies with a more accommodating rhetoric, even though the Chicago School (properly understood) has never been doctrinaire or limited in ways that required updating.

He also rejects proposals for a “behavioral” school of antitrust, which claims to offer a more realistic picture of the economic motivations and conduct of producers and consumers than the tradition economic assumption of rationality would admit. Wright suggests that the behavioral approach is unsuited to antitrust both because of its inconsistency with the evidence and its logical failings. First, the evidence does not show that firms are “predictably irrational.” Second, if they were, it would seem to follow that everyone is irrational, including regulators, so there would be no reason to think antitrust intervention could improve matters.

Wright then turns to the model selection problem. Among the Chicago School’s greatest achievements was the formulation of the consumer welfare standard, which virtually all antitrust scholars have now adopted in one form or another. Discussions of antitrust policy and briefing of antitrust cases are guided on all sides by economics. Moreover, both the Chicago School and its critics endorse empirical testing and updating of theories. Thus, the substance of the Chicago School approach has gained wide acceptance on some of the most important cornerstones of a sensible antitrust policy. The question remains, however, whether the Chicago School name (and the prevalence of a variety of schools) has outlived its usefulness.

The adoption of the consumer welfare standard opened the door for a proliferation of demonstrations, under various assumptions, of the possibility that virtually any restraint could reduce welfare. Generalist judges now must decide which model is most appropriate for decision of the case. This is the model selection problem. Wright argues that the association of models with schools is an impediment to model selection in part because of the tendency of scholars to cast rival schools in pejorative terms. For example, according to Wright, some critics (including Thomas Rosch, the FTC Commissioner Wright has now replaced) portray the Chicago School as resistant to any departure from the standard (and politically conservative) assumptions of price theory. These mischaracterizations “come at the expense of serious scientific analysis of the right question and communicate to courts and agencies abroad that the relationship between economics and domestic antitrust policy is superficial.” Thus, he argues, the Chicago School label with a set of policy positions and methodologies carries too much baggage to be useful.

In place of schools, Wright suggests that all should agree on evidence-based antitrust, which would choose theories and models based on their “predictive power” determined by the “best available empirical evidence,” and use decision theory to pick rules that minimize social and administrative costs of error. In a key passage, he writes:

Evidence-based antitrust policies should derive theoretical insights from the Chicago School, the Post-Chicago School, and elsewhere—as long as such insights have empirical support. For example, there would be no principled objection to such a program recommending a Post-Chicago School approach to predatory pricing and a Chicago School approach to exclusive dealing—provided each approach best fit the available evidence. Neither one size nor one school need fit all. The determina-

tive criteria would be to select the theoretical foundation with the greatest predictive power, as determined by credible and reliable empirical evidence. Such a program allows for change over time as new evidence may lead to an updating of prior beliefs concerning either the likelihood that any given business practice is anticompetitive or the net magnitude of social benefits and harms arising out of a practice.

This approach favors a special role for the agencies in conducting research, taking care not to become embroiled in policy disputes that undermine the process. As a cautionary tale, he points the failure of the FTC’s Section 2 Hearings. Those hearings resulted in a valuable positive summary of the state of knowledge of the law and economics of monopolization, but disagreements over the normative recommendations led the Commission to abandon the report entirely. The evidence-based approach also argues for greater collaboration by the FTC with antitrust academics, and greater involvement of economists and economically sophisticated managers in the formulation of commission policy.

Evidence-based antitrust also has implications for the courts. Judges should receive more economic training in order to make the right choices among theories. The law more generally should use the best available theory and evidence to establish appropriate filters to improve antitrust outcomes. These include legal standards, like the monopoly power requirement for Section 2 offenses. They also include reliance on procedural settings like Daubert hearings and motions to dismiss under Twombly for failure to state a plausible claim. Both of these settings provide an opportunity to consider the economic validity of antitrust claims in specific cases.

Commissioner Wright and Behavioral Antitrust

By Max Huffman
Associate Professor, Indiana University Robert H. McKinney School of Law

Commissioner Wright might be said to be the newest occupant of a “scholar’s seat” on the FTC. The Commission boasts an impressive list of the nation’s leading antitrust scholars as its members. Reaching back only a few years one finds Robert Pitofsky, Timothy Muris, William Kovacic, and now Josh Wright. As an extremely prolific economist-lawyer, Commissioner Wright thinks deeply and broadly about antitrust and consumer law topics and should be credited for his sincere efforts toward achieving the right answer. Wright’s work also qualifies him well, even uniquely, for his new role.

Wright has produced an impressive body of scholarship on behavioral law and economics as it applies to consumer law and to antitrust. He is a scholar’s scholar: others of us writing on these topics have benefitted not just from his work but from his generosity in offering insights and editorial improvements on our own work. In light of his productivity, Wright has produced an extensive body of work to analyze and to sift for clues as to his likely direction as a Commissioner.

Wright filled the seat vacated by Tom Rosch, who was during his tenure the leading proponent of behavioral economics ideas on the five-member Commission. Rosch spoke frequently about behavioral antitrust, relying on the work of leading scholars whose work favors analyzing antitrust law through a behavioral economics lens.21 Wright, by contrast, does not seem to be open to behavioral antitrust or to the use of behavioral economics insights in the FTC’s work. Wright recently has asserted that “behavioral antitrust is not ready for prime time” and that research in behavioral economics has not taken the steps required to be policy relevant.22

A careful reading of his extensive body of work on this topic suggests Wright’s bottom-line conclusion is that behavioral antitrust is not worthy of consideration until a comprehensive new theory is announced that encompasses all of antitrust law within its boundaries. Such an extreme demand, which one strains to find satisfied in any example of the law’s reliance on social science evidence, would have the effect of preventing behavioral antitrust from ever achieving recognition in the interpretation and enforcement of antitrust law. Behavioral law and economics advocates will need to look elsewhere for policy-makers who might be receptive to their research.

Commissioner Wright is an early commentator on behavioral antitrust. His first article on behavioral law and economics, and its application in the general sphere of consumer law, was published

---


in 2007. Over the following years, he produced a deep body of scholarship on behavioral law and economics generally and behavioral antitrust specifically, for the most part canvassing the literature derived from empirical studies of consumer behavior. A review of these articles shows that Wright has been a consistent critic and a dissenter from the beginning.


In this article, Wright announces an early skeptical take on behavioral law and economics in the area of consumer protection. He tips his hand in the abstract, referring to the results of behavioral law and economics analysis as “proposals for paternalistic regulation.” Such apparent skepticism about the enterprise remains throughout his work in the field. Wright’s analysis of literature on behavioral law and economics is that it “overwhelmingly” calls for “paternalistic intervention.”

In this article, Wright criticizes behavioral law and economics analyses of credit and consumer contracting markets, summarizing empirical studies that he argues undermine the proposition that behavioral economics theories offer greater predictive power than does rational choice economic theory. Contrary to Wright’s conclusions, however, the studies do not undermine the fundamental proposition that substantial consumer harm exists from the exploitation of consumer cognitive biases. Wright relies on one study purporting to show that 60 percent of consumers chose the “optimal credit contract” when presented with a menu of choices. A conclusion that 40 percent of consumers chose sub-optimally when presented with a menu of credit contract terms is hardly a ringing endorsement for hands-off regulatory policy.

Wright also notes that “learning may mitigate the relevant biases.” This is a frequent observation that favors a deregulatory approach if regulation can be expected to defeat learning behavior. However, learning is less likely to lead to improved outcomes in markets characterized by one-time or rare transactions, such as those for durable goods or consumer real property transactions.

Wright’s conclusion in this paper, with regard to his study of the literature on consumer lending transactions, is ultimately quite lukewarm: “the frequency and magnitude of sub-optimal credit transactions...
card contract decisions appear to be less severe than is assumed . . . .”31 His conclusion does not undermine the proposition that behaviorally informed regulation can improve consumer credit outcomes.


In a recent paper, Wright is joined by Judd Stone in arguing broadly against behavioral antitrust.32 According to Wright and Stone, “behavioral economics does not yet offer an antitrust-relevant theory of competition.”33 They name this proposition the “irrelevance theorem.”34

Wright and Stone might be criticized for knocking down straw men in this paper. Wright and Stone over-describe the arguments of behavioral antitrust scholars, including Avishalom Tor, Maurice Stucke, and Amanda Reeves, incorrectly arguing, among other things, that “behavioral antitrust advocates . . . uniformly favor greater intervention.”35 In fact, in the article by Reeves and Stucke, which is one of the papers that Wright and Stone address head-on, the authors flatly assert that “[b]ehavioral economics does not necessarily call for less or more antitrust regulation.”36

Wright and Stone go further and argue that “behavioral economics . . . fails to offer any clear policy implications for antitrust law.”37 First, even that is a diluted claim. Much about antitrust law and economics is murky. Neo-classicists have been accused of “rambl[ing] through the wilds of economic theory” themselves.38 To assert that behavioral antitrust is not black and white is not a serious indictment.

Second, Wright and Stone’s expectation is in any case unfairly high for any social science when it is imported into a legal framework. If a full and “clear” theory that was also not subject to reasonable cavil was available, Congress might be expected to enact it and to be done. Instead, through the common-law process, courts and commentators work with new information as it becomes available and slowly improve antitrust outcomes.

Certainly the institutionalization of neo-classical economic theory as the dominant mode of antitrust analysis over the decades beginning in the 1960s was accomplished more by drip than by torrent. As Wright himself argues in another paper (discussed below), “the evolution of the Sherman Antitrust Act has been a tale of measured integration of neoclassical microeconomic analysis into the vague contours of the Sherman Act.”39 A leader in that process, Richard Posner,
has described the incremental adoption of modern antitrust economics into the law in terms that are strikingly similar to Wright and Stone’s objections to behavioral antitrust.40

Behavioral economics should inform antitrust thought in just the same way. Nobody has ever advanced the claim to which Wright and Stone apparently object—behavioral economics is prepared to replace neoclassical economics in antitrust decision-making—and neither should a scholar, advocate, policymaker, or court ever be required to do so.41

A final criticism of Wright and Stone’s irrelevance theorem is that it fails to recognize the important application of an analysis of consumer contracting behavior in the antitrust framework. Wright and Stone limit their analysis of consumer contracting behavior to the question of market definition, arguing that biases affecting consumer decisions are incorporated into a revealed preference analysis.42 One lesson we should take from behavioral economics understandings is the increased opportunity for exploitation vis-à-vis the circumstance of unbiased consumers. That provides for a new theory of antitrust liability based on behavioral exploitation, which supports the result in cases relying on deception or lock-in effects to find antitrust harm.43


Also in 2012, Wright discussed perceived conflicts between antitrust and consumer protection, using the new Consumer Financial Protection Bureau (CFPB) as the stage for his analysis.44 He describes these conflicts as presenting “a battle” over “[t]he intellectual soul of American consumer law.”45 The CFPB’s regulatory powers, directed toward curbing unfair, deceptive, and abusive practices in consumer financial services, are seen to herald the “arrival of behavioral law and economics as the intellectual centerpiece of the current administration’s approach” to consumer protection.46

Wright argues that Dodd-Frank consolidates consumer financial protection in a new agency, seeks to insulate the business of consumer financial protection from political interference, and opens the door to experimentation with lessons drawn from decades of behavioral economics research.47 That recognition is not new.48 Wright also foretells “significant implications for antitrust law.”49 He proposes under a comparative institutional analysis that consumer protection law, which advances primarily by legislation, rule-making, and interpretations of statutes and rules, may be more amenable to importing new economic ideas than is antitrust. Antitrust law develops primarily through the common-law process, favoring “a set of economic tools that narrows the pos-

41 See Wright & Stone, supra note 22, at 1549 (“[B]ehavioral economics cannot supplant the existing body of theoretical knowledge underlying the core of antitrust . . . .”).
42 Id. at 1523.
43 See generally Max Huffman, Marrying Neo-Chicago with Behavioral Antitrust, 76 ANTITRUST L.J. 105, 130–35 (2012); Huffman & Heidtke, supra note 30, at 81–83, 93–95.
44 Wright (2012), supra note 39.
45 Id. at 2218.
46 Id. at 2220.
47 Id. at 2219–20.
49 Wright (2012), supra note 39, at 2224.
sible set of outcomes, reduces uncertainty, and improves the quality of decisions."\(^\text{50}\) And because an “important feature of behavioral economics” is that “it broadens rather than reduces uncertainty,” it is a misfit with antitrust adjudication.\(^\text{51}\)

Wright’s syllogism, detailed above, shows his continued hostility to the practice of revisiting neo-classical theory with lessons from new empirical studies of individual behavior. I am aware of no commentator on behavioral economics or behavioral antitrust who claims a “feature” of the enterprise as being “broadened uncertainty.” Claims do abound about the possibility of increased accuracy of predictions of individual behavior. According to a leading article in the field of behavioral law and economics, the enterprise promises “a higher R-squared.”\(^\text{52}\) Wright is correct to observe that this increased accuracy creates the possibility of greater complexity in analysis.\(^\text{53}\) Wright’s concern logically reduces to a fear that antitrust law will perform poorly under more textured descriptions of consumer behavior. To one who is inclined to favor the importing of behavioral economics insights into antitrust decision-making, Wright’s concern sounds more like a confession that under the leading theories, antitrust economics is something of a blunt instrument.


Finally, in a recent paper co-written with Judge Douglas Ginsburg, Wright discusses what he perceived to be the “fatal flaws” of behavioral law and economics.\(^\text{54}\) First recognizing that “[b]ehavioral economics is one of the most significant developments in economics over the past thirty-six years,” Wright and Ginsburg contend that a course of policy-making informed by behavioral economics “will fail to achieve its goal of increasing welfare without reducing liberty and will pose a significant risk of reducing both.”\(^\text{55}\)

Liberty reduction is Wright’s and Ginsburg’s core concern in this article. They conclude that “it is inevitable” that lost liberty from regulatory interventions “will sometimes—perhaps often—defeat the case for intervention.”\(^\text{56}\) Part of their argument is a slippery slope of paternalism, although their lead example for this slippery slope—seatbelt laws—is flawed, because even under their description of the regulatory progression, public backlash checked efforts at more invasive safety regulation. Wright and Ginsburg note that proof that seatbelts saved lives led to mandatory installation of seatbelts in automobiles, which in turn led to mandated active restraint systems, which then led to a cooperative federalist regime in which highway funding was contingent on state seatbelt laws, though efforts at more substantial safety requirements failed due to public backlash.\(^\text{57}\) Thus, evidence of a slippery slope of paternalism reduces to evidence that we have nationwide seatbelt laws.

\(^{50}\) Id. at 2225.

\(^{51}\) Id. at 2256–57. Wright’s argument in this paper relies heavily on a paper by Judge Douglas Ginsburg and Derek Moore, arguing that behavioral law and economics was unlikely to be helpful to judges in deciding antitrust cases. See Douglas H. Ginsburg & Derek W. Moore, The Future of Behavioral Economics in Antitrust Jurisprudence, COMPETITION POL’Y INT’L, Spring 2010, at 89.


\(^{55}\) Id. at 1034, 1036.

\(^{56}\) Id. at 1068.

\(^{57}\) Id. at 1075–76.
Coming from a scholar specializing in consumer policy, which Wright is, the concern for a slippery slope of paternalism rings particularly hollow. In the consumer law arena, the opposite would seem to be true. Wright is well versed in the story of perceived Federal Trade Commission overreach in the 1960s and 1970s leading to a deregulatory backlash in the 1980s, which even nearly four terms of Democratic presidents have not come close to reversing.\(^58\)

In this paper Wright returns to his initial criticism of behavioral law and economics generally (rather than as applied in the specific context of antitrust). He and Ginsburg restate the common criticism that behavioral law and economics lacks its own unifying theory—instead, it is “a comprehensive theory of errors” that shows where the simplifying assumption of individual rationality fails accurately to describe instances of individual behavior.\(^59\) But to Wright and Ginsburg, there is an onus on those conducting behavioral economics scholarship to “map the conditions under which specific errors are more or less likely to affect decisions and then to generate estimates of the social costs imposed by those errors.”\(^60\)

Placing the burden of proof on any who proposes limitations in neo-classical economic theory is a confounding refrain in Wright’s scholarship. A reader is left with the impression that improvements in legal policy may not begin until one has exhausted all questions through a course of double-blind clinical trials that would make the FDA blush. This is particularly a confounding position for an antitrust scholar. After all, the common-law, evidence-based process by which antitrust develops is ideally suited to adjusting rules incrementally as new learning emerges.

For example, one can imagine two approaches to a behavioral economics insight that undermines a belief about the likelihood of successful entry competing away monopoly profits. If evidence shows persistent monopoly profits in a market despite observed entry, one might rely on Avishalom Tor’s demonstration that cognitive biases exhibited by individual decision-makers within firms undermine the rational choice theory’s expectations that new entrants are likely to be successful. Such a conclusion should increase a court’s willingness to accept evidence that recoupment is likely even in the presence of entry, which Tor shows frequently is small scale and fails to accomplish real penetration into the market.\(^61\)

The alternative approach would be to conclude that the evidence of long-term monopoly profits must somehow be inaccurate, because successful entry is a necessary corollary to sustained monopoly profits. Thus, the entry that is known to be occurring must necessarily be competing those profits away. As Christopher Leslie has shown,\(^62\) holdings in cases like \textit{Matsushita} and \textit{Brooke Group} rely on beliefs in the implausibility of conduct that evidence demonstrated was occurring.\(^63\)

The preceding example strikes at the heart of a pattern of inhospitality to ideas built on recent economic learning. In his writing, Wright appears concerned that a move is afoot to replace centuries of development of economic thought with a hodge-podge of interesting ideas built on


\(^{59}\) Wright & Ginsburg, \textit{supra} note 54, at 1040.

\(^{60}\) Id.


experiments conducted on undergraduate economics students. In reality, the clearest immediate benefit from behavioral economics to antitrust thought is the development of intuitions about individual conduct that may increase hospitality to evidentiary demonstrations of real-world marketplace events. Rather than concluding that a successful predator cannot recoup profits lost during the course of predation (so evidence of recoupment must be flawed—or the evidence needs to be “more persuasive”), a court might conclude the evidence deserves equal billing with any contrary evidentiary proffer. Rather than to suggest there could be no market power in the sale of durable goods like business copiers, behavioralist insights might support evidence of lock-in effects and the functional incapacity to engage in life-cycle pricing that permit just such a monopoly to arise.

Commissioner Wright is a scholar with impeccable credentials and a long and increasing list of accomplishments and accolades, well situated by study, experience, and temperament to serve in his current role. Commissioner Wright is also a leading commentator on topics relating to behavioral antitrust. Careful consideration of his work admits only one conclusion: Commissioner Wright does not believe antitrust or consumer protection outcomes will be improved with lessons drawn from behavioral economics generally or behavioral antitrust specifically.

64 A common, if dated, complaint about behavioral economics is that many of the interesting lessons are drawn from classroom experiments that involve, for example, the buying and selling of coffee mugs. See, e.g., Steven D. Levitt & John A. List, What Do Laboratory Experiments Tell Us About the Real World? 2–3, 34, 42 (U. Chicago & NBER Working Paper, 2006), available at http://pricetheory.uchicago.edu/levitt/Papers/jep%20revision%20Levitt%20&%20List.pdf (noting restrictive features of laboratory experiments that may render them imperfect indicators of real-world conduct). Wright’s writing does not specifically rely on that criticism.

65 Matsushita, 475 U.S. at 587.

Commissioner Joshua Wright on Foreclosure Analysis As Applied to Exclusive Dealing, Slotting Contracts, and Other Vertical Restraints

By Serge Moresi
Vice President and Director of Competition Modeling, Charles River Associates

Joshua Wright has written several articles in which he discusses foreclosure analysis and explains his position on a number of antitrust policy issues related to exclusive dealing, slotting contracts and other vertical restraints. To get insight into his views on these issues, I will review three articles. These articles consistently argue that antitrust policy should be based on empirical evidence. Wright states:

At least one cause of the doctrinal uncertainty surrounding vertical distribution arrangements more generally is the lack of empirical evidence capable of guiding sensible antitrust policy.67

In general, these articles state that (1) a necessary condition for exclusive dealing and other vertical restraints to be anticompetitive is that they prevent rivals from achieving minimum efficiency scale, (2) there are several procompetitive justifications for these practices, (3) these practices are observed in many competitive markets and adopted by firms without significant market power, and (4) these practices are more likely to be procompetitive than anticompetitive. These statements suggest that Wright, in his role as FTC Commissioner, likely will not favor any policy initiative that calls for more enforcement in the areas of distribution contracts and vertical mergers.


Wright is a leading expert on the economics of slotting contracts involving manufacturers paying retailers for shelf space.68 He views slotting contracts as an important component of the competitive process in many consumer product industries. This article discusses the fact that slotting contracts have been the subject of many debates (congressional hearings, agency investigations and workshops, antitrust litigation, and academic articles) and yet there is very little evidence about their competitive effects.69 The article thus seeks to provide some empirical evidence on the competitive consequences of slotting contracts by analyzing a natural experiment in which military commissaries ceased to accept slotting payments. Wright’s analysis of that natural experiment provides support to his views that slotting contracts mainly result in brand-shifting of sales within a product category, but do not lead to an increase in category prices or a reduction in category output or variety. Wright concludes that this type of evidence is “inconsistent with anticompetitive theories [of slotting contracts] and, in practice, demonstrate that such agreements are likely procompetitive . . .”70

68 Slotting contracts often involve payments for stocking the product on premium shelf locations, such as an end-aisle display or “eye-level” shelf space. The payments may take the form of either a discount from the wholesale price or an upfront, lump-sum amount.
70 Id. at 442.
This article also describes his views on the economics of slotting contracts. The role of empirical evidence is very prominent here as well. Wright states:

While there have been a number of theoretical attempts to explain slotting contracts as either efficiency-enhancing or anticompetitive, many of the existing explanations are fundamentally inconsistent with the evidence concerning the incidence of slotting contracts across product markets and over time, making further empirical study of these contracts particularly useful.

Wright first discusses several theoretical models that have shown how slotting contracts could be used by manufacturers or retailers to exclude rivals. He criticizes these models by arguing that the exclusionary effects often hinge on the assumption that capital markets are imperfect. In addition, Wright argues that the exclusionary effects are harmful, provided that two necessary conditions are satisfied: the duration of the slotting contracts must be relatively long and the products involved must exhibit significant economies of scale. Wright claims that, for many slotting contracts, none of these conditions is satisfied. He thus views the anticompetitive theories of slotting contracts as fundamentally inconsistent with the evidence.

Wright then discusses several existing procompetitive theories of slotting contracts. He claims that none of these theories can explain slotting contracts in light of the available empirical evidence. Wright thus points to the “promotional services theory” of slotting contracts that he developed with Ben Klein. That theory is based on empirical findings and explains why slotting contracts are a consequence of the normal competitive process when shelf space is promotional. Wright states:

Because retailer shelf space is a form of promotion that consumers are not willing to pay for but that generates profitable incremental sales for the manufacturer, manufacturers will generally want more promotional shelf space than retailers are willing to provide independent of a separate contract compensating retailers for the additional promotion.

Wright argues that his theory is consistent with the available data. He also claims that slotting payments are passed on to consumers in the form of lower store-wide prices and the provision of non-price amenities. Wright thus concludes that slotting contracts are unlikely to be anticompetitive and may generate significant benefits for consumers.

71 See also Benjamin Klein & Joshua D. Wright, The Economics of Slotting Contracts, 50 J.L. & Econ. 421 (2007).
72 Wright (2007), supra note 67, at 443.
73 Id. at 443–44; see also Klein & Wright, supra note 71, at 423 (“What remains is the claim that slotting arrangements make it more difficult for rivals to compete because shelf space payments raise the cost of obtaining retail distribution. However, slotting fees are a payment that must be borne by all manufacturers. Competition for shelf space that leads to slotting may raise the cost of obtaining retail distribution, but it does so for everyone. An artificial barrier to entry is created only if one assumes that the increased cost necessary to distribute a product imposes a higher cost on new entrants relative to incumbents, for example, because of imperfections in the capital market. However, competition between incumbents and entrants for retail distribution generally occurs on a level playing field in the sense that all manufacturers can openly compete for shelf space and it is the manufacturer willing to pay the most for a particular space that obtains it.”) (footnote omitted).
74 See Klein & Wright, supra note 71, at 426.
75 Wright (2007), supra note 67, at 448.
2. Joshua D. Wright, An Evidence-Based Approach to Exclusive Dealing and Loyalty Discounts, 
GLOBAL COMPETITION POL’Y, July 2009

This second article extends his analysis of slotting contracts to the case of exclusive dealing and other distribution contracts, such as market-share discounts and loyalty discounts. Wright states:

These contracts, including market-share discounts and “loyalty discounts,” can harm competition when they deprive rivals of an entrenched firm from accessing distribution sufficient to achieve a minimum efficient scale.

In other words, Wright’s position seems to be that exclusive dealing and other related practices could be anticompetitive provided that the products under consideration exhibit significant efficiencies of scale.

Wright discusses several procompetitive theories of exclusive dealing. These theories suggest several ways in which exclusive dealing can prevent free riding and facilitate relationship-specific investments by manufacturers or retailers. He describes these theories as “a set of sensible and economically rigorous procompetitive justifications for the practice” and, at the same time, describes the anticompetitive theories as “a set of possibility theorems which indicate that exclusive dealing and de facto exclusive contracts can lead to anticompetitive outcomes under some specified conditions, including substantial economies of scale or scope.” However, one probably could argue that all these theories are equally “sensible,” equally “economically rigorous,” and equally merely “possibility theorems” that apply under specific conditions only. Indeed, Wright states:

The question is not one of the logical validity of any of the competing theories: the possibility of anticompetitive effect from exclusive dealing arrangements is well established as a matter of economic theory. The question, rather, is whether these theories describe an empirical phenomenon of relevance in forming antitrust policy.

Wright then points to the fact that we observe exclusive dealing contracts in many competitive markets, and that exclusive dealing and other related practices often are adopted by firms without any significant market power. Based on this and other empirical evidence, Wright concludes that exclusive dealing, market-share discounts and loyalty discounts generally are efficient and not associated with anticompetitive outcomes.

---

76 Market-share discounts are wholesale price reductions given by the manufacturer to the retailer provided that the retailer procures a minimum share of its total category purchases from the manufacturer. They are a variant of exclusive dealing arrangements in the sense that the minimum share requirement is less than 100 percent. Loyalty discounts are wholesale price reductions given by the manufacturer to the retailer provided that the retailer also stocks other products of the manufacturer.

77 Joshua D. Wright, An Evidence-Based Approach to Exclusive Dealing and Loyalty Discounts, GLOBAL COMPETITION POL’Y, July 2009, at 2 [Wright (2009)].

78 Wright does not discuss or mention a second anticompetitive theory of market-share discounts that is based on alleged “tax” effects. See, e.g., Reply Brief in Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000), available at http://www.appellate.net/briefs/concordreply.pdf; see also Joseph Farrell, Janis Papppalardo & Howard Shelanski, Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior, 37 REV. INDUS. ORG. 263 (2010). In addition, there is also a third anticompetitive theory based on alleged “coordinated effects” (i.e., market-share discounts can be used to soften competition from rival firms even when there are no economies of scale and the rivals are not foreclosed). See Roman Inderst & Greg Shaffer, Market-Share Contracts as Facilitating Practices, 41 RAND J. ECON. 709 (2010); see also Einer Elhauge & Abraham Wickelgren, Anti-Competitive Exclusion and Market Division Through Loyalty Discounts, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1937658.

79 See Wright (2009), supra note 77, at 3.

80 Id. at 3.
While in his opinion empirical evidence is a key factor for guiding antitrust policy, Wright finds it important to emphasize the limits of what the empirical evidence demonstrates. In particular, Wright acknowledges that the empirical evidence does not conclusively show that exclusive dealing is always procompetitive. Wright then argues that payments for exclusivity at the retail level are likely to be passed on to consumers (in competitive retail markets) and thus there is little risk of consumer harm.

Wright claims that his analysis leads to two clear policy recommendations. First, there should be a safe harbor for foreclosure levels of less than 40 percent of the relevant market. Second, there also should be a safe harbor for exclusive dealing contracts that are terminable in less than one year. Wright does not provide a complete explanation why his analysis implies a 40 percent threshold for foreclosure and a one-year threshold for contract duration, as opposed to different threshold levels. It is also unclear how to define the foreclosure rate in cases involving market-share discounts instead of exclusive dealing contracts.


The third article further extends the analysis and considers exclusionary practices more broadly than in the previous two articles. Wright describes the Raising Rivals’ Costs (RRC) paradigm as “formalizing and extending economists’ existing concerns with vertical exclusion.” The RRC paradigm is commonly applied in evaluating the potential competitive effects of a wide range of practices, including exclusive dealing, loyalty and market-share discounts, tying and bundled rebates, and refusals to deal. Wright states:

[RRC analysis] requires courts and agencies to assess whether the defendant’s distribution contracts substantially foreclose rivals from a critical input for a period sufficient to decrease market output and raise market prices. Foreclosure analysis is at the very core of legal application of modern RRC theories.

However, Wright explains that the methods used by courts and agencies to measure foreclosure have not evolved and thus do not align with these modern theories. He criticizes the fact that courts measure foreclosure simply by counting up the percentage of the input market “foreclosed” from rival suppliers. Wright then proposes a But-For Foreclosure (BFF) method for measuring foreclosure properly. Wright’s BFF methodology involves measuring the foreclosure attributable to the defendant’s conduct by comparing the defendant’s share of the input market under the restraint with an estimate of the “but for” share of the input market that the defendant would have in the absence of the restraint. Wright states:

The BFF test incorporates a “counterfactual” approach to assessing foreclosure that isolates the true competitive impact of the allegedly exclusionary agreement from other factors. Thus, the BFF rate is

81 A partial explanation appears in Joshua D. Wright, Moving Beyond Naïve Foreclosure Analysis, 19 Geo. Mason L. Rev. 1163, 1182 (2012) [Wright (2012)] (“It is fairly safe to assume that the foreclosure necessary to create an anticompetitive effect is substantially greater than 40 percent, which would leave at least 60 percent of distribution available to rivals. Thus, it may be the case that a 40 percent safe harbor, applying the naïve rate, is a rough indicator that anticompetitive effects are unlikely.”).


83 Wright (2012), supra note 81, at 1163.
defined as the difference between the percentage share of distribution foreclosed by the allegedly exclusionary agreements or conduct and the share of distribution in the absence of such an agreement.84

To illustrate, suppose a dominant manufacturer uses exclusive dealing contracts with all retailers and has a 70 percent market share. If a but-for analysis reveals that the manufacturer’s share would be 60 percent in the absence of exclusive dealing agreements, then the BFF rate equals 10 percent.

Wright claims that such “counterfactual” analysis is common in other areas of antitrust—with respect to both assessment of damages and liability—and focuses the analysis upon the actual competitive effects of the restraint at issue.

Based on the three articles I have reviewed, one might expect that Commissioner Wright will favor antitrust policies that are based on down-to-earth approaches rooted in empirical facts.

84 Id. at 1186.
Josh Wright on Criminal and Complex Litigation

By D. Daniel Sokol

University of Florida Levin College of Law

How might we predict new FTC Commissioner Josh Wright’s policy approach? Commissioner Wright’s work hints at some common themes with which to draw some inferences as to a number of important policy issues. Commissioner Wright believes in an evidence-based antitrust. For the creation of effective antitrust policy there need be not only evidence that certain conduct should be condemned but proof that the antitrust system can be effective in administering policy. Two papers by Commissioner Wright suggest a limited capability for adjudicators to understand the complexities of antitrust conduct cases. Another paper suggests that current policy tools by the Department of Justice are inadequate to make cartel enforcement more effective.


In Antitrust Sanctions, Ginsburg and Wright (G&W) note that current cartel enforcement does not approach optimal deterrence. This much seems to be almost universally shared with commentators across ideological approaches. G&W thus argue that penalties should be built along a Goldilocks principle—not too strong as to over-deter and not too weak as to under-deter firm behavior. Instead, penalties should be just right. They suggest that such sanctions must also be reflected at both individual and firm levels.

One noteworthy departure of G&W’s article is that in contrast to some Chicago thinkers, G&W support penal sanctions for corporate crime. The reason for this departure is due to G&W’s analysis of the empirical studies on cartels. The early Chicago hostility to anything other than monetary penalties seems ill-equipped to deal with low rates of detection and sub-optimal fines due to the pervasiveness and durability of cartels even in the face of significant DOJ successes in enforcement due to the leniency program.

Overall, this article fits within a broader goal of Wright’s work—to use empirics to better shape antitrust policy. The strength of the article is that G&W recognize the limits of fines to achieve optimal deterrence. This article is not empirical but draws upon the empirical scholarship on cartel enforcement to suggest an alternative policy approach.

Based upon the limits of traditional enforcement mechanisms, G&W argue that a different sort of sanction may be required. Consequently, G&W suggest a sanction that would “de-emphasize fines for publicly traded corporations and, instead, debar individuals responsible for price-fixing from further employment in a position from which they could again violate or negligently enable their subordinates to violate the antitrust laws.” This idea builds upon insights in the securities

87 Ginsburg & Wright, supra note 85, at 6.
area, where debarment is frequent, as well as policy in other competition regimes (such as the UK) that includes director debarment for cartel participation (where debarment exists in principle but almost never in practice).88

An important insight that G&W raise has to do with agency costs. Agency costs are a useful way to understand cartel activity.89 An agency cost occurs when an agent (employee of a firm) might do what is in his or her best interests rather than that of the principal (the firm’s owners), absent effective monitoring by the principal. By increasing the penalties on directors for cartel activity that goes on by the firm, this increases the probability that directors will push a firm to invest in adequate cartel compliance. This shifts enforcement from antitrust enforcers who suffer significant information asymmetries to those within the firm who have fewer asymmetries. However, G&W note that too high a cartel fine might increase agency costs so that such costs of increased compliance will be passed onto consumers in the form of higher prices. If we assume (as the authors seem to do) that more individual accountability and less cartel activity will improve the firm’s bottom line and thus better align incentives between principal and agent, then director debarment in the United States offers a new and perhaps more effective way to reduce cartel activity than increased fines and jail time.

Wright has a broad portfolio of antitrust scholarship, of which the study of cartels is merely one part. In another line of scholarship, Wright has analyzed behavior by dominant firms. In such settings, economic activities in which there is a trade-off of greater market power for greater efficiencies require a more complex set of calculations for an adjudicator than in the cartel context. Antitrust complexity, particularly given the economic analysis that drives antitrust analysis, may at times create confusion for judges.


In two articles, Wright attempts to empirically test whether or not antitrust is too complex for effective adjudication and identifies institutional design implications for such evidence. The first article in this research agenda, Antitrust Too Complicated for Generalist Judges? The Impact of Economic Complexity and Judicial Training on Appeals,90 was co-written with Michael Baye (Indiana University Bloomington) (together B&W). B&W are the first to examine with a quantitative dataset how district court and FTC administrative law judges deal with antitrust complexity. They analyzed published decisions for decided cases from 1996 to 2006 and found that antitrust decisions that are more complex are more likely to be appealed but that decisions by more economically sophis-

88 See Andreas Stephan, Disqualification Orders for Directors Involved in Cartels, 2 J. European Competition L. & Practice 529 (2011) (analyzing the UK experience with director disqualification).


ticated judges (as measured by basic economics training) are significantly less likely to be appealed than those of the unsophisticated judges.

B&W correctly note that the major revolution in antitrust has been the move to an economics effects based approach.91 Whereas legal doctrinal development and multiple non-economic goals competed with economic analysis up through the 1970s, by today, the revolution within antitrust has meant that economic analysis drives antitrust law and policy. The problem is that adjudicators (Administrative Law Judges and district courts) may lack the sophistication to handle such complexity. One way in which B&W claim that antitrust adjudication has been made more effective is through the George Mason Law and Economics Center judicial training program (LEC program). This program teaches basic economic principles to members of the U.S. judiciary, including in the area of antitrust. However, the program does not teach advanced topics such as econometrics.

Nevertheless, even with rudimentary economics training, B&W find that econ-friendly judges are less likely to be overruled in simple antitrust cases. This contrasts with economic complex cases, in which judges who have attended LEC programs are no better or worse than untrained judges. These results are robust even when regression analysis controls for such factors such as political ideology (party of appointment), expertise adjudicating antitrust cases of the judge, post-graduate education (as a proxy for intellectual curiosity), type of plaintiff, type of case, and the circuit in which the appeal is litigated. Overall, this research begins to answer how effective judicial training is. It also provides insights into that various background factors of judges that help to shape antitrust case law. From this article, one can suggest that Wright cares about using empirical data to shape policy.

The dataset that B&W collected is incredibly useful. Hopefully, academics in law and economics will use it for further studies. As with all empirical projects, the perfect is the enemy of the good. In a small quibble with some of the measurements for complexity and what might have been helpful as additional measurements, it would have been helpful to include as one additional variable the background of the law clerks. A judge may rely upon the expertise of his or her clerks when the judge lacks specific knowledge of a particular field of law. Perhaps the most famous such clerk was Professor Carl Kaysen, an economist who served as a clerk in the United Shoe Machinery case.92

Another variable not included is citations in the decisions to economics journals (as a proxy for economic sophistication). For example, as my co-author and I note in a forthcoming article on the goals of antitrust, in its Leegin decision,93 the Supreme Court made multiple citations not merely to law review articles but also to economics works. This includes citations to an economic textbook, as well as articles from the following journals: Journal of Law and Economics, RAND Journal of Economics, Quarterly Journal of Economics, and the Journal of Political Economy.94

Additional factors may also explain B&W’s findings. I wonder if the quality of briefs of the parties and the language used and citations made by the parties affect the sophistication of the decision and lead to higher (or lower) levels of appeals. Ultimately, winning in court is about telling a
good story. Antitrust economic evidence needs to be presented in a way that supports a good story. It may be that some of the briefs did a better job than others in introducing complex economic concepts. Essentially, a good brief provides a roadmap for the judge to craft a decision that, based on the B&W's coding, seems more economically sophisticated. Another factor might be amicus briefs, and in particular briefs written by law and/or economics professors. Did “impartial” authority by experts in the field lead a judge to accept economic expertise and indeed use sophisticated terminology (such as those words coded by B&W)?

One also might quibble with the particular words chosen to be coded and indeed the contexts of these words within the decision.

To be fair, B&W acknowledge some of the limitations of their data. For example, they note some of the problems in examining only decided cases. However, what is not clear from the study is whether antitrust looks more or less different in terms of poor outcomes in complex cases than other areas where sophisticated economic analysis is also used, such as damage calculations and cases involving complex financial and securities issues. These potential shortcomings aside, overall, B&W should be applauded for their efforts to bring some clarity to what had been an area of significant concern for which only anecdotal evidence existed until publication of the article.

In a follow up article, Do Expert Agencies Outperform Generalist Judges? Some Preliminary Evidence from the Federal Trade Commission,95 Wright and co-author Angela Diveley (Freshfields) (together W&D) empirically examine a different type of adjudicator—the FTC Administrative Law Judges (ALJs). The importance of this article is its analysis of FTC ALJs’ published decisions between 1976 and 2010 (74 cases)96 and Article III federal district court decisions between 1977 and 2007 (644 cases). W&D test whether or not administrative agencies (here the FTC) produce higher quality decisions than generalist Article III judges. The interesting finding in their article is that ALJs perform less well than generalist judges, as measured by appeals rate of ALJ decisions. Moreover, they find that the FTC (of which Wright is now a Commissioner) does not provide significantly more value to ALJ decisions that the Commission reviews based upon Commission modifications to ALJ decisions.

Much of this article focuses on a discussion and an analysis of the methods of measuring quality of ALJs based on the data collected, as discussed above. Like in the B&W article, W&D compare higher quality of both ALJs and Article III judges by examining appeal rates. Appeal rates (based on the same premise as in the B&W article) measure the economic soundness of a decision. The higher the appeal rate, the greater the possibility that the adjudicator committed an error in economics. W&D make direct comparisons between ALJs and Article III judges based on three factors: First, both sets of decisions are appealed to circuit court judges; Second, it is exactly the trade-off between generalist Article III judges and expert agencies that motivated Congress to provide a specialized agency with an adjudicatory function based on its expertise to provide “better” outcomes; Third, the FTC reviews ALJ decisions de novo, which provides a further quality check.

Two other points not mentioned by W&D are also worth noting in the context of ALJs, which might explain in part the W&D results. First, ALJs do not draw from the same quality pool as Article

---


III judges. Second, the staff size of ALJs (including clerks) is much smaller than that of Article III judges. Hence, ALJ-based litigation with sophisticated economic evidence may overwhelm the limited resources of ALJs. W&D do, however, note a number of other potential differences that could bias the results. First, most Commission decisions favor the FTC, which means that appeals may be systematically different from Article III decisions that are appealed. Second, the FTC can better select cases that it thinks it can win. Third, the FTC can leverage its power as an administrative agency to win cases. Courts provide the FTC, as an administrative agency, with greater deference than federal district courts. Because of this deference granted to the FTC, the FTC might be able to leverage this deference into court victories where the underlying quality of the decision-making in the case may differ as between a district court judge and an ALJ. Fourth, ALJs have developed a far richer factual record, which might lead to higher reversal rates.

A second comparison undertaken by W&D examines ALJ decisions in which the FTC provides its input versus those in which the FTC does not. Using this comparison analysis, W&D can estimate the effect, or what they refer to as the “marginal product,” of the Commission’s decision-making.

The findings show that FTC opinions are reversed 20 percent of the time while Article III court decisions are reversed 5 percent of the time. W&D also find that there is no significant incremental value (based on Commission modifications to ALJ decisions) that the Commission provides to the decisions that it reviews. Given the lack of empirical work in this area before W&D’s study, this article has potentially profound implications for institutional design and the effectiveness of the FTC as an expert agency. W&D suggest as many questions for further research as they answer. In doing so, they have done their job as scholars by forcing the reader to rethink assumptions based on an empirical record.

Overall, Commissioner Wright is an innovative antitrust thinker. His work demonstrates a desire to apply empirical insights to antitrust policy. One might expect that as a Commissioner, his focus will be on evidence-based antitrust.
Commissioner Joshua Wright on Dynamic Competition and Innovation

By James Langenfeld
Managing Director and Head of Antitrust and Competition Practice of Navigant Economics, Adjunct Professor at Loyola University Chicago School of Law, and former Director in the FTC Bureau of Economics.

These articles consistently argue for antitrust analyses based on evidence to account for “dynamic” competition (rather than what some argue have been traditional “static” competition models) and innovation. In general, these articles (1) state there is a consensus that dynamic analysis should be included in antitrust analysis and that in many instances it already does, (2) highlight the complexities of dynamic competition and innovation, (3) point to a lack of reliable models and empirical information that can be used to formulate aggressive enforcement policies related to dynamic competition and innovation, (4) argue that any of these policies must be sufficiently clear to be consistently applied by the antitrust agencies and courts, and (5) explain that expanding the FTC’s Section 5 to address intellectual property and competition issues is unwise. These views raise interesting questions about how Wright will view both future and existing FTC policy initiatives, such as the FTC’s so-called pay-for-delay cases.


Wright’s article with Stuempfle reviews Professor Michael Carrier’s analysis of antitrust’s role in evaluating the impact of standard setting activities on consumer welfare.97 As the article puts it, “[w]hile we agree [with Carrier] that it makes economic and legal sense to treat both standard setting activities (with the exception of cartel behavior) and IP rules of SSOs [standard setting organizations] as generally procompetitive and thus falling under rule of reason, we found ourselves either disagreeing with his analysis or hoping for a more complete treatment.”98

SSOs provide the common building blocks for the development of new and innovative products, since firms can predictably know what is acceptable technology. As the article explains, antitrust theories of patent “hold ups” focus on when a patentee participates in a standard setting process, and then demands higher royalty rates after the standard is adopted than would have occurred with a competitive process. Wright and Stuempfle criticize Carrier for not distinguishing potentially anticompetitive deception cases (deceptive conduct prior to the patent’s adoption) from breach cases (patentee breaches pre-standard setting licensing agreements establishing a reasonable and nondiscriminatory (RAND) royalty). The authors argue that pure breach cases, such as the FTC’s consent in N-Data,99 are potentially very problematic when brought under Section 5 of the FTC Act. In N-Data, the FTC alleged that N-Data demanded higher royalty terms than implied at the time the standard was adopted, and that this hold up is a form of unfair com-

---

petition under Section 5. Wright and Stuempfle point out this antitrust “evasion of contractual constraint” theory does not appear to have any limiting principles, regardless of whether the action is related to an SSO or not, and the dispute between N-Data and companies that infringed its patents may be better handled with patent law. They state:

In our view, it is unlikely that the conduct at issue in N-Data was the type of conduct Congress intended the FTC Act to prohibit since N-Data’s renegotiation of its royalty only proved harmful to large, sophisticated intermediate buyers who were in the best position to avoid the injury through either the SSO’s IP rules, or by operation of contract law and negotiation.

To further illustrate their concerns, Wright and Stuempfle ask whether a licensee that refuses to pay an ex ante royalty should also be challenged under Section 5. The FTC’s approach in N-Data seems to say no, so N-Data may be read as imposing perpetual one-sided contractual commitments on licensors (but not licensees), which can deter rather than encourage innovation. Wright and Stuempfle conclude:

Mandatory antitrust rules imposed on the standard setting process, especially as applied in N-Data, threaten to create perpetual but one-sided ex ante contractual commitments that are backed by the possible threat of follow on state actions. . . . [W]e strongly doubt that optimal antitrust policy can possibly include the creation of perpetual contractual commitments backed by the threat of antitrust and state consumer protection remedies, as in N-Data, with no rigorous economic proof of substantial consumer injury that cannot be reasonably avoided. In our view, the current state of affairs described herein presents a critical threat to standard setting activity and innovation[
]

The theme of a need for “rigorous economic proof of substantial consumer inquiry” is also echoed in Wright’s other two articles, which more generally deal with the ability of antitrust agencies and courts to appropriately incorporate dynamic competition and innovation issues.


Both Antitrust, Multidimensional Competition, and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now? (Wright (2011)) and Dynamic Analysis and the Limits of Antitrust Institutions (Ginsburg & Wright) begin with the premise that there is a consensus that antitrust analysis should include dynamic analysis, and that the current challenges are to identify (1) ways to incorporate it and (2) circumstances where it is important. Both articles point out that it is difficult to meet these two challenges with current economic methodologies and research.

100 It appears that the authors have a similar view of N-Data-type cases as former FTC Chairman Deborah Majoras expressed in her dissent. Dissenting Statement of Chairman Majoras, In re Negotiated Data Solutions LLC, FTC File No. 0510094, at 5 (Jan. 23, 2008), available at http://www.ftc.gov/os/caselist/0510094/080122majoras.pdf.

101 Wright & Stuempfle, supra note 98, at 566.

102 Id. at 569.
Wright (2011) focuses on the observation made by Harold Demsetz that “[w]e do not possess an antitrust-relevant understanding of competition.” According to Wright, this argument is based on three premises. First, competition usually takes place on many dimensions, which is seen as non-controversial.

Second, the degree of competition associated with one competitive activity is often “negatively correlated” with the degree of competition in others. For example, innovation may be discouraged by perfect price competition, as Schumpeter suggests in his vision of “creative destruction.” For antitrust policy to take into account dynamic competition on these multiple dimensions, it is necessary to have some idea of the trade-off between the various forms of competition (“technical rate of substitution” between the competitive forms).

Third, economic theory does not provide an analytically coherent method for evaluating the trade-offs across competition, efficiency and consumer welfare, and there is a corresponding lack of an empirical basis for estimating these trade-offs.

Wright (2011) then addresses the analysis of innovative effects in conventional and innovation markets. He points out that innovation can substantially affect conventional product markets in the future by changing the market boundaries through the introduction of new products. However, innovation markets have their own set of challenges. For example, to the extent innovation markets rely on shares of research and development as a shortcut to determine the effect of a merger on innovation, such shortcuts have insufficient theoretical and empirical bases. In particular, Wright discusses the research suggesting intermediate levels of market concentration stimulate the maximum level of innovation. He concludes, in effect, that this research does not provide a sufficiently reliable basis to challenge mergers because of their impact on shares of competing research and development. Wright states:

[A]t this point, neither economic theory nor our empirical knowledge of competition and innovation provides a reliable basis to confidently answer the relevant policy question: which mixture of competitive activities will produce greater welfare?  

Wright favorably reviews attempts by researchers to develop better analytic approaches and empirical bases for evaluating trade-offs between different dimensions of competition, and believes dynamic competition still needs to be taken into consideration. However, he concludes:

It is critical that antitrust policy not adopt an analytical framework that presumes harm to competition when the procompetitive rationale for the conduct is not facially obvious. The requirement that plaintiffs demonstrate an anticompetitive effect is a sensible safeguard against this danger and especially pertinent in cases involving complex innovative activity.

His concerns are clearly linked to the ability (or inability) of the antitrust agencies and courts to systematically identify, challenge, and correct anticompetitive actions involving innovation.


104 JOSEPH SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY (1942).

105 Joshua D. Wright, Antitrust, Multidimensional Competition, and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now? in COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY: REGULATING INNOVATION 228, 239 (Geoffrey A. Manne & Joshua D. Wright eds., 2011) [Wright (2011)].

106 Id. at 250.
Where there is little evidence to suggest that antitrust enforcers and courts can systematically identify conditions when intervention will stimulate innovation and improve consumer outcomes net of reductions on other important margins of competitive activity, humility regarding the current state of knowledge implies that deference to the competitive process is an appropriate guiding principle in the absence of clear and convincing evidence of substantial consumer harm.107

Ginsburg and Wright (2012) addresses dynamic analysis and the role of antitrust policy in more detail. It provides a description of dynamic analysis in antitrust law, first focusing on what is currently being done (permitting monopolies legally obtained, including recoupment in attempted monopolization and predatory pricing cases, the impact of exclusionary acts to prevent entry, merger analyses addressing entry and potential efficiencies). They also address what is not being done by the agencies and courts (calculating trade-offs between static and dynamic competition, predicting the specific path of technological evolution), which they believe is wise given the limitations of the existing economic models, empirical analyses, and sources of information about likely future behavior. For example, they correctly point out that gathering information from potential competitors in an attempt to evaluate the likelihood of entry will often solicit a biased response, especially if the merger is actually procompetitive. They also indicate it may be appropriate to look beyond traditional economic and legal approaches to other disciplines or forms of analysis, such as performing industry-specific studies of the history and conditions for innovation that are similar to those found in business and economic history journals. If such approaches are taken, the authors express concerns that the agencies do not currently have the personnel to perform or evaluate such studies. Ginsburg and Wright believe at least three things need to happen before the agencies adopt a more active enforcement policy regarding dynamic competition and innovation.

First, if an antitrust agency is to base enforcement decisions to any degree upon an extra-legal body of theory, then that theory must be capable of yielding determinate results. Second, the agency’s staff and its leadership will need, respectively, to master and to understand the field from which the theory is derived. Third, to the extent an antitrust agency bases its enforcement decisions upon predictions more bold than, or different in kind from, what can be supported by economic theory or empirical evidence, reviewing courts must develop their own capacity to question those predictions, to demand and to understand the evidence upon which they are based, and to insist upon consistency in the agency’s analysis from one case to the next.108

Given some of the FTC’s long standing policy initiatives, Wright’s apparent caution on incorporating dynamic analysis in antitrust matters may be tested. For example, the FTC has long challenged “reverse payment” or “pay for delay” cases in Hatch-Waxman pharmaceutical matters, such as the one under review at the Supreme Court.109 In these cases, branded drugs’ producers offer generic producers a payment to delay entry into the market in an attempt to preserve a presumptively legal monopoly a patented brand-name enjoys. The terms of these settlements usually involve generic entry being allowed before the patent expires. As such, these agreements may be simply part of the settlement of patent disputes in the context of Hatch-Waxman Act regulations, and may represent an appropriate return to the patent holder that encourages innovation.

107 Id. at 251.
However, the FTC has focused on the potential loss of price competition that delayed generic entry entails, arguing such settlements should be presumptively illegal. The agency has not taken into account the potential reduction in innovation from eroding the incentives to innovate that such payments may entail.\textsuperscript{110} It is unclear from these writings if Wright will support the FTC’s “presumptively illegal” approach, since he has advocated not bringing dynamic competition cases by plaintiffs absent a reliable methodology and empirical evidence that address key tradeoffs between static and dynamic competition. It does seem clear he will not support the Section 5 approach to SSO cases adopted by the FTC in \textit{N-Data}.

\textsuperscript{110} For an example of the trade-off between short term price competition and long run innovation in these cases, see James Langenfeld & Wenqing Li, \textit{Intellectual Property and Agreements to Settle Patent Disputes: The Case of Partial Settlement Agreement with Payments from Branded to Generic Drug Manufacturers}, 70 \textit{Antitrust L.J.} 777 (2003).