Gorsuch versus Scalia: How Will Antitrust Change?"

Keith N. Hylton, in an article written just before the confirmation of Neil Gorsuch as the newest associate justice of the Supreme Court, discusses his antitrust jurisprudence while at the Tenth Circuit and concludes that, in contrast to the “reductionism” of his predecessor, Antonin Scalia, Gorsuch has a more objective and complicated approach to antitrust issues.

Contact Lenses and Contact Sports: An Update on State RPM Laws

One of the Source’s most utilized resources is our State Resale Price Maintenance chart. Michael Lindsay’s article this month highlights some interesting state RPM developments (including one involving the NFL) and updates the RPM chart.

Managed Care Marketplaces: Growing Drivers of Payer-Provider Vertical Integration,

Brian J. Miller and George L. Wolfe use the recent district court antitrust decision in Omni Healthcare v. Health First as a springboard to explore empirical data showing various ways that vertically integrated health network designs have cut costs and improved patient care.

Populism, Economists, and the FTC

Former FTC economist Oliver Grawe draws lessons from the last time populism played an influential role in the FTC’s operations to predict—and recommend—where the Bureau of Economics can play important roles in the new administration.


Aaron J. Burstein praises Chris Hoofnagle’s book as a singular contribution to understanding both the FTC’s long history in privacy law and policy and its future challenges.

Paper Trail: Working Papers and Recent Scholarship

Paper Trail editor William Page reviews two papers examining historical cartels—the vitamin cartel in the 1990s and the railroad cartel a hundred years earlier. In the second paper, the author examines the impact on competition from interlocking board membership by private banks and concludes that the net result was harmful to competition.
Gorsuch versus Scalia: How Will Antitrust Change?

Keith N. Hylton

Before writing this review of Judge Neil Gorsuch’s antitrust opinions I took a quick look at what others have written on the topic. It was not hard to find several reviews of Gorsuch’s antitrust opinions. Why should I write a review of his opinions, I wondered, if others have already done so? Why not simply refer the reader to one or more of the published reviews?

One topic still looks interesting, however, and that is the Scalia question: how will Gorsuch compare to Antonin Scalia, the Justice he has been picked to replace?

Gorsuch has written three antitrust opinions: Novell, Inc. v. Microsoft Corp., Four Corners Nephrology Associates v. Mercy Medical Center, and Kay Electric Cooperative v. City of Newkirk. Novell and Four Corners address the scope of a dominant firm’s duty to deal with a rival under Section 2 of the Sherman Act. Kay Electric is on the exception to state action immunity for municipalities that act as market participants.

All three opinions are fun to read. On this score—fluidity and engagement of the reader—I think that Gorsuch has an advantage over Scalia. Of course, Scalia was a fluid writer, too, but he sometimes fell into the rut of providing a bit more technical arcana than necessary to make his point. For example, in Verizon Communications Inc. v. Law Office of Curtis V. Trinko, perhaps Scalia’s most impressive antitrust opinion, he includes an exhaustive (and exhausting) discussion of the regulatory and procedural background of the case, frequently referring to acronyms that force the reader to look back a few paragraphs to recall their meaning. I have not seen the same tendency in Gorsuch’s writing so far, and that is a pleasant feature. In comparison to Scalia, Gorsuch is more of a storyteller.

Perhaps this is a “bait and switch” strategy. Being told a story puts the reader at ease and disarms him early on. Maybe Gorsuch does this intentionally to put his reader in a position where he does not expect surprises because everything seems to flow so naturally from what came before. In such a relaxed state, the reader can be eased into potentially contentious claims and find them more acceptable.

Scalia, by contrast, always seemed to have a target in the cross hairs. An informed reader could tell early that he was going to take a poleaxe to a certain idea, one that lay furtively under the surface of a long string of judicial opinions, staring at the reader from between the lines, and only occasionally surfacing to state its presence explicitly. He leaped at the opportunity to maim such a creature in Trinko, when he argued that the Sherman Act applauds monopolization when it induces investment and innovation—in contrast to Learned Hand’s baleful view that monopolization...

---

1 731 F. 3d 1064 (10th Cir. 2013).
2 582 F. 3d 1216 (10th Cir. 2009).
3 647 F. 3d 1039 (10th Cir. 2011).
lization is first and foremost a sin, tolerated only when it results from luck, or superior skill and industry. The same can be said of legal doctrines that Scalia had learned to detest.

Gorsuch does not give the impression that he is out to destroy any idea or overturn any particular doctrine. Of course, it cannot be true that he is really indifferent about ideas and legal doctrines. But he manages to hide the intensity of his feelings well, even to the point of seeming to joke about the ideas he rejects. Again, I see this as part of the storyteller’s arsenal. You would turn off quite a few readers and listeners if you made clear at the beginning of your story that you were going to kill off a beloved character.

But when that beloved character has to go, Gorsuch is ready to deep-six him. He does so pretty ruthlessly in *Novell*. It was not an easy case in which to jettison this particular beloved character, the earnest competitor who is not asking for a handout but only needs access to your platform, which it appears you can provide costlessly, to be able to compete against you.

In many ways, *Novell* was a replay of *United States v. Microsoft Corp.* (*Microsoft III*), but the plaintiff’s argument is a bit more sympathetic than that of Netscape Navigator, the real “plaintiff behind the scenes” in *Microsoft III*. Novell, maker of the WordPerfect word processing software, claimed that Microsoft kept secret the applications-operability features of its new operating system in the mid-1990s that would have enabled WordPerfect to function more efficiently on the system. Why would Microsoft do such a thing? Because Microsoft determined that it could give its own office software, Microsoft Word, an advantage by bringing it to the market fully integrated with the Microsoft operating system while at the same time forcing competitors like WordPerfect to scramble and figure out on their own how to become integrated at a high level with Microsoft’s platform. The gambit succeeded, giving Microsoft Word a crucial period of unquestioned superiority over WordPerfect. Since that interval, WordPerfect has never been able to catch up.

Novell argued that Microsoft violated Section 2 of the Sherman Act by hiding its intellectual property from Novell and other rivals, in an effort to advantage its own software. Interestingly, Novell claimed that Microsoft did this to maintain its monopoly in the operating system market rather than to gain a monopoly in the office-suite market.

*Novell* takes us squarely into the duty-to-deal question, and therefore squarely into a comparison with Scalia’s *Trinko* opinion. Compared to *Novell*, *Trinko* is a relatively easy case. The plaintiff in *Trinko* argued that Verizon had a duty to (in effect) subsidize its rivals by selling access to information at cost, as determined by regulators, instead of at a market or negotiated price. Scalia refused to find such a duty in the antitrust laws, and there are easy arguments to make against a duty to subsidize rivals.

*Novell* does not involve a subsidization (i.e., handout) claim as in *Trinko*. Microsoft’s actions had reduced the value of its own operating system in order to shield its word-processing package from competition. The finding of an absence of a duty to subsidize in *Trinko* does not immediately imply an absence of a duty in *Novell*.

Although relying heavily on the rationale of *Trinko*, Gorsuch clarifies, and to some degree extends, its reach in *Novell*. He argues that a dominant firm should be permitted to fully reap the rewards from its investment, even if that means allowing the firm to take actions that have a short-
run negative impact on the goods and services it produces. While Trinko refuses to find intent to monopolize in the refusal to aid rivals, Novell refuses to find intent to monopolize in a firm’s self-interested exclusionary actions designed to protect or to maximize the rewards from its own investment. This is certainly not a new doctrine in antitrust law, as it seems to be entirely consistent with Berkey Photo, Inc. v. Eastman Kodak Co. But Novell puts it on a broader plane, not limited to the specific facts as the Second Circuit seemed to do in Berkey Photo.

Viewed from the high plane of doctrine, Four Corners involves the same antitrust question—duty to deal with a rival—and answers with the same general theory: that a firm may, consistent with the antitrust laws, exclude a rival for the purpose of protecting its investments. This case is a bit closer to Trinko because if the medical center (specifically, nephrology services center) that excluded the plaintiff had been forced to give him staff privileges, it might not have been able to meet its own minimum revenue targets and would therefore suffer substantial costs for the sole purpose of enabling a rival to compete.

The final opinion is Kay Electric, one of the rare cases applying the “market participant doctrine,” which, although hazy, appears to remove state action antitrust immunity when a municipality, acting as a participant in a market, uses its power to hamstring rivals. The city of Newkirk, Oklahoma, refused to supply sewage services to a new jail unless it also purchased electricity from it, harming its rival Kay Electric.

The market participant doctrine originated in Union Pacific Railroad Co. v. United States, a case that predates the opinion that announced the state action rule, Parker v. Brown, and received its strongest endorsement as an exception to Parker immunity in City of Columbia v. Omni Outdoor Advertising, Inc., a Scalia opinion. But Gorsuch does not rely on the endorsement of Scalia; he derives the market participant exception from looking at the basic rules on state action immunity and the special facts of the case, failing to find any clear authorization from the state for the municipality to engage in the anticompetitive acts alleged. As in the other Gorsuch opinions, the writing is clear, logical, easy to read, and thorough in its consideration of the arguments that the defendant offered for finding immunity.

Returning to the big question: how similar is Gorsuch to Scalia? I’ve suggested that he is more of a storyteller than Scalia, and appears to set out in his stories without an apparent axe to grind. Yet, he does have some axes to grind. It is well known, for example, that Gorsuch dislikes the Chevron (judicial deference to administrative agencies) doctrine, and thinks that the delegation of law-making power to agencies has gone too far. He tends to dive into details in antitrust doctrine, and is less reductionist than Scalia. In Trinko, for example, Scalia boils everything down to the question of intent, while Gorsuch, in Novell, takes us through special doctrines (e.g., profit sacrifice) courts have employed to answer the intent question from a more objective viewpoint.

7 603 F.2d 263 (2d Cir. 1979).
8 313 U.S. 450 (1941) (suggesting market participant rule).
11 Gutierrez-Brizuela v. Lynch, 834 F.3d 1142, 1149 (10th Cir. 2016) (Gorsuch, J., concurring, “There’s an elephant in the room with us today. We have studiously attempted to work our way around it and even left it unremarked. But the fact is Chevron and Brand X permit executive bureaucracies to swallow huge amounts of core judicial and legislative power and concentrate federal power in a way that seems more than a little difficult to square with the Constitution of the framers’ design. Maybe the time has come to face the behemoth.”).
Therein is the crucial difference between Scalia and Gorsuch on antitrust: reductionism. Otherwise the differences appear to be mainly stylistic. Unquestionably, Gorsuch will become one of the leading voices on antitrust in the Supreme Court, and his will be the closest to Scalia’s.

On reductionism, there are arguments to be made on both sides. If Gorsuch is appointed, which appears likely at this stage, we will get a test of whether his approach to antitrust is more influential and instructive to lower courts than the reductionist method of Scalia. While Gorsuch’s views on antitrust don’t appear to be very different from Scalia’s, we could see antitrust doctrine become a bit more complicated under his influence.
Contact Lenses and Contact Sports: An Update on State RPM Laws

Michael A. Lindsay

The year 2017 marks the 10th anniversary of the U.S. Supreme Court’s 

Leegin

1 decision that overruled the longstanding Dr. Miles

2 rule that had considered resale price maintenance (RPM) agreements to be per se violations of the federal antitrust laws. The Leegin decision and its rule of reason approach to RPM agreements, however, did not directly apply to state antitrust laws, and as The Antitrust Source has documented over the last decade, not all of the states have embraced the federal interpretation. Since 2007, The Antitrust Source has published a series of articles tracking developments in state approaches to RPM agreements and has maintained an online chart providing relevant state-law authorities for each of the 50 states.  

The last two years have seen litigation in two areas—the contact lens industry and the contact sport of NFL football—that will provide insight into the last decade of state RPM jurisprudence. Before reviewing those two litigations, however, it is useful to understand the decade’s earlier developments:

● Two years after Leegin was decided, the Maryland legislature amended its state statute—which clearly would have embraced the federal rule—and legislatively adopted an express per se condemnation of minimum RPM agreements.  

● Through a series of civil enforcement actions resulting in consent orders, the California Attor-

---

4 See Lindsay, State Laws After Leegin, supra note 3, at 2. For a recent case discussing the Maryland statute, see Yellow Cab Co. v. Uber Technologies, Inc., File No. RDB-14-2764 (Balt. County Cir. Ct. Feb. 29, 2016) (“Price-fixing is thus a per se violation of the Maryland Antitrust Act... Plaintiffs allege that Uber, with the participation of its drivers, including the Driver Defendants, conspired to set a minimum price threshold below which the drivers may not charge... Even if Uber was the driving force behind the alleged scheme, the Driver Defendants are alleged to be participants and co-conspirators within the ambit of the Maryland Antitrust Act.”).
ney General has steadfastly maintained that the state’s Cartwright Act still condemns RPM agreements as per se violations. Two non-AG cases have reached the same conclusion.

- The New York Attorney General pursued a similar interpretation of New York state law but has not persuaded courts to agree.
- The Kansas Supreme Court held that Kansas law prohibited RPM agreements as per se violations, but its decision was overturned by the state legislature.

Contact Sports, NFL Football, and Resale Price Floors

In January 2016, the New York Attorney General issued a report on the sale and resale of tickets for live entertainment events. Until 2007, New York had an anti-scalping law dating from the early 20th century that was designed to address the problem of “gross profiteering” by “ticket speculators.” In 2007, the state legislature replaced that law with a new approach of legalizing, licensing, regulating, and taxing ticket resellers. The statute makes it illegal for the entertainment provider to “restrict by any means the resale of any tickets included in a subscription or season ticket package.” The report generally described the Attorney General’s “serious concerns about several ongoing practices related to the sale and resale of tickets in New York” and specifically referenced a rule of the NFL Ticket Exchange setting a price floor for the resale of individual tickets.

According to the report, the NFL Ticket Exchange set a minimum resale price for tickets sold over the exchange, with the floor typically being the face value of the ticket. The report identified two concerns with this arrangement. First, a ticket-buyer may not be aware of the rule and may therefore be led to believe that the price paid is a market price. Second, and more important, buyers are deprived of the lower prices that the “market-based” approach of the New York statute was intended to provide. The pricing restraint on the official NFL site, either directly or because of the relative difficulties of using other sites, might prevent sales at market prices.

The New York Attorney General partnered with the Attorneys General of Pennsylvania, Massachusetts, Ohio, and the District of Columbia (collectively, the AGs) to investigate the NFL ticket exchange. In November 2016, the AGs reached a settlement agreement with the National Football League. As a result of their investigation, the AGs concluded that “there was a League-wide Ticket Exchange Price Floor” but that it “was removed in 2016 and is no longer in effect.” As of the date of the settlement agreement, “the NFL . . . leaves the decision whether to maintain a ‘price

5 See Lindsay, A Tale of Two Coasts, supra note 3, at 1–3.
6 Lindsay, Repatching the Quilt, supra note 3, at 1–3.
7 Lindsay, A Tale of Two Coasts, supra note 3, at 3–4; Lindsay, From the Prairie, supra note 3, at 2–3.
8 Lindsay, From the Prairie, supra note 3, at 3–6.
11 Id. at 7–8.
12 N.Y. Arts & Cultural Affairs Law § 25.30. The prohibition applies to any “operator of a place of entertainment, or operator’s agent.”
13 Settlement Agreement, In the Matter of NFL Ticketing Investigation, Assurance No. 16-181 (Attorney General of the State of New York, Antitrust Bureau) (hereinafter Settlement Agreement), https://ag.ny.gov/sites/default/files/11.15.2016_-_nfl_tix_investigation_final.pdf. Although the agreement is entitled a “settlement,” there was no underlying litigation. Depending on the state, the agreement was actually an “assurance of discontinuance” or an “assurance of voluntary compliance.” Id. at 1 n.1.
floor’ on the NFL Ticket Exchange for tickets resold on that platform for its own home games to each individual member club, to be made unilaterally.” 14

Somewhat curiously, the Settlement Agreement also reported that the AGs had not “identified an injury to consumers resulting from the League-wide Ticket Exchange Price Floor, alone or in combination with other ticketing practices.” 15 Unless one’s view of antitrust is based purely on allocative efficiency (without regard to wealth transfers), consumer harm is the touchstone of antitrust. If the AGs were unable to identify consumer harm (and the practice had already been discontinued anyway), then one wonders why the Settlement Agreement was “appropriate and in the public interest.” 16 Nevertheless, the agreement did obtain a ten-year ban on the NFL’s reinstating a price floor on the exchange, as well as a prohibition on any NFL efforts to facilitate member teams’ ticket resale prices in a way that would result in a resale price floor on the NFL exchange. 17

The Settlement Agreement does not address the two clearly vertical practices that it could have addressed: resale price floors for tickets originally sold by the NFL, and resale price floors for tickets sold by member teams. Indeed, the Settlement Agreement explicitly excludes tickets that are distributed primarily by the NFL (rather than the member clubs), such as the Super Bowl or the Pro Bowl and games played outside the United States. 18 Individual teams remain free under the Settlement Agreement to set their own respective price floors. 19

Despite the vertical nature of the New York statute that precipitated the investigation, the issues that the Settlement Agreement addresses seem more horizontal. The exchange can be characterized as a collaboration among the member teams (through their other collaboration, the NFL). The prohibition on the NFL’s setting a price floor in the exchange is really simply a prohibition on the kind of rule to which the member teams can agree, and the prohibition on NFL coordination of member team agreements on price floors is clearly a ban on vertical orchestration (but of a horizontal agreement). 20 The Settlement Agreement also prohibits the NFL from facilitating agreements that would disadvantage competing ticket-resale platforms 21 —again, at most a prohibition on the kind of rules to which the member teams could agree.

One final observation on the Settlement Agreement: its provisions are not limited either to resale price floors for tickets for games played within the jurisdictions of the AGs who secured the

14 Id. at 2.
15 Id.
16 Id.
17 Id. at 3 para. 2 (“The NFL shall not reinstate a League-wide Ticket Exchange Price Floor during the Term of this Settlement Agreement.”).
18 Id. at 3 para. 3(a) (prohibiting NFL from “formally or informally coordinating or encouraging any pricing practices among its member clubs that would result, directly or indirectly, in formal or informal agreements among its member clubs with respect to price floors for the resale of tickets for preseason, regular season or postseason playoff games”).
20 Even the “vertical” aspect of this characterization ignores the fact that the NFL itself is a collaboration among competing member teams.
21 Settlement Agreement at 3 para. 3(b) (“promoting or requiring that its member clubs implement ticketing technologies or practices that are designed or intended to substantially impede or preclude the ability of consumers to buy or sell tickets on secondary ticket exchanges unless permissible under applicable law.”); id. at 4 para. 5 (prohibiting NFL from “intentionally and substantially interfere[ing] with or otherwise preclude[ing] any member club from coordinating with any secondary ticket exchange in efforts to combat ticket fraud”). The latter provision is particularly important in promoting competition between platforms because the NFL Ticket Exchange is “frequently billed as the official resale site and the only ‘safe’ place to buy secondary NFL tickets.” NYAG Report, supra note 10, at 32.
agreement or to games played by teams within those jurisdictions.\(^{22}\) In other words, the Settlement Agreement applies to tickets for games played at such stadiums as Lambeau Field in Green Bay, U.S. Bank Stadium in Minneapolis, and the Los Angeles Memorial Coliseum, as well as to games played within the AGs’ respective jurisdictions. Perhaps it may not have been practical for the NFL to structure its platform according to game location or buyer/seller zip code, and the NFL may not have cared in any event, since it had already discontinued its price floor. Nevertheless, it is worth noting that the Settlement Agreement applies to events clearly outside the jurisdictions of the participating AGs.

Contact Lenses

Contact lenses require a prescription from an eye care professional (ECP), such as an ophthalmologist or optometrist, and those ECPs can also sell contacts to their patients. Once the patient has a prescription, however, the patient can buy the contacts (but only the prescribed brand, unless the prescription specifies private label lenses\(^{23}\)) from other retailers, including big-box stores and online discounters. Perhaps unsurprisingly, these non-ECP channels are able to offer contact lenses at lower prices than ECPs.\(^{24}\) The contact lens industry has a history of previous antitrust litigation, and it is now regulated by the Federal Trade Commission\(^ {25}\) under the Fairness to Contact Lens Consumers Act.\(^ {26}\)

At various times in 2013 and 2014, each of the four leading manufacturers (accounting for approximately 90 percent of contact lens sales) announced its own “unilateral pricing policy”\(^ {27}\) or RPM policy.\(^ {28}\) In April 2016, Johnson & Johnson Vision Care (J&JVC) discontinued its policy,\(^ {29}\) and Alcon discontinued its policy in December 2016.\(^ {30}\)

\(^{22}\) Indeed, the Washington D.C. team does not actually play its games within the jurisdiction of the D.C. AG!


\(^{24}\) See, e.g., Press Release, California Dep’t of Justice, Attorney General Lockyer Announces Settlement of Contact Lens Antitrust Lawsuit (May 22, 2001), https://oag.ca.gov/news/press-releases/attorney-general-lockyer-announces-settlement-contact-lens-antitrust-lawsuit (“The settled lawsuits alleged that retail prices of disposable contact lenses were too high because Johnson & Johnson and the other defendant manufacturers agreed with Optometric Association representatives, in violation of the antitrust laws, that their lenses would be available only from eye care professionals (optometrists, ophthalmologists and opticians), retail optical stores or certain mass merchandisers.”).


\(^{27}\) This term and its acronym “UPP” have become increasingly common in the last decade, and they do properly focus attention on two features: that the text is “unilateral” and is a “policy”—and is therefore not an “agreement.” Labeling a text as a UPP, of course, does not necessarily make it so, as Leegin itself noted. 551 U.S. at 903 (“The problem for the manufacturer is that a jury might conclude its unilateral policy was really a vertical agreement, subjecting it to treble damages and potential criminal liability.”).


**Maryland Attorney General Action.** In February 2016, the Maryland Attorney General filed suit against J&JVC, alleging an agreement to set minimum retail prices for the sale of contact lenses to consumers.31 Until 2009, Maryland law provided that courts “be guided by the interpretation given by the federal courts to the various federal statutes dealing with the same or similar matters.”32 In 2009, Maryland adopted a statute that excluded the *Leegin* decision from this general rule by providing that an agreement setting “a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service” to be an unreasonable restraint of trade.33 The complaint against J&JVC is the first enforcement action that the Maryland AG has brought under this statute.34

The Maryland Act (like the Sherman Act) applies only to “agreements” that restrain trade, and not to unilateral policies that might have the same effect. The Maryland AG alleged that for an RPM policy to be legal in Maryland, the policy “must result from the purely unilateral decision of a manufacturer, without negotiation as to its terms, and must be enforced unilaterally.”35 Consequently, the Maryland AG had to identify and allege an agreement between J&JVC and someone else: Costco. After J&JVC announced its RPM policy, Costco objected, but J&JVC told Costco that it had to “bring its prices up to UPP levels or work out an adjustment to the pricing policy so that Costco would not have its supply of lenses cut off.”36 According to the complaint, J&JVC and Costco “negotiated” over the content of the policy.37 The Maryland complaint attached as an exhibit an internal J&JVC email stating, “We have reached an agreement with Costco which is a good solution,” and although the writer recognized that “there may still be some noise” (because Costco “[is] not fans of our UPP policy”), J&JVC and Costco were “partnering on a productive path forward.”38 J&JVC answered the complaint, admitting that it had an RPM policy but denying that there was an agreement.

The court had not issued any substantive rulings, but on October 2016, J&JVC filed an “Assurance of Discontinuance.” (Like many states, Maryland empowers the AG to accept an assurance that a party has discontinued an act or practice that might be a violation of the state antitrust law.39) The Maryland AG rejected the assurance, and the parties disagreed both on whether the trial court could approve an assurance without the AG’s consent and whether the AG’s action was


34 Press Release, Maryland Office of Attorney General, Attorney General Frosh Announces Settlement of Price-Fixing Lawsuit Against Johnson & Johnson Vision Care, Inc. 1 (Mar. 30, 2017). Interestingly, the press release also notes that “while a state senator [in 2009], Attorney General Frosh sponsored an amendment to the Maryland Antitrust Act that prohibits any agreement setting a minimum price below which a retailer may not sell goods. The amendment was subsequently signed into law.”

35 Maryland Complaint, *supra* note 31, ¶ 17.

36 *Id.* ¶ 35.

37 *See, e.g.*, *Id.* ¶¶ 34, 36–37, and 41. The Maryland Complaint, however, did not name Costco as a defendant.

38 *Id.* at Ex. 2.

wholly or partially mooted. The parties finally reached a negotiated resolution, and on March 29, 2017, the court accepted an agreed assurance of discontinuance. Unlike the NFL Settlement Agreement and (as discussed below) the Utah statute, the assurance is clearly confined to sales made to consumers in a single state: the assurance provides that J&JVC will not enter into any agreement that requires a retailer “to sell contact lenses at or above a minimum retail price in Maryland.” Moreover, the assurance will terminate if the Maryland statute is held unconstitutional (although J&JVC waived its constitutional defense to approval or enforcement of the assurance). The assurance also provided for J&JVC to pay a civil penalty of $50,000.

Private Class Action Litigation. Beginning in March 2015, the class action bar swung into action, ultimately filing over 50 complaints in multiple jurisdictions. The Judicial Panel on Multi-District Litigation transferred the cases to Judge Harvey Schlesinger in the Middle District of Florida. The defendants filed a motion to dismiss the consolidated class action, which the district court denied in June 2016.

The complaint alleges both a vertical agreement (between the lens manufacturers and a wholesaler, ABB Optical) and a horizontal agreement among the lens manufacturers to adopt RPM policies. The complaint describes both the enormous market share (97 percent) of the manufacturers with RPMs and the unusual structure of the industry: the ECPs (who are also themselves retailers) act as gatekeepers by specifying the brand of the prescribed lens. A manufacturer who cannot persuade ECPs to prescribe its lenses will suffer: “Unless the patient comes back for another eye examination, or switches ECPs, he or she has to buy the prescribed brand of lenses for the length of the prescription, typically from one to two years.”

The court noted that vertical and horizontal conspiracies can intersect in a “hub and spoke” conspiracy—a vertical orchestration of a horizontal conspiracy, such as alleged in Toys “R” Us or United States v. Apple. The court was persuaded that the class complaint’s allegations of a horizontal conspiracy were sufficient to survive Twombly because the adoption of RPM policies represented a “fundamental” change in the industry, the policies were all adopted within a compressed time period, the number of persons (the ECPs) to be coordinated was very large, the price increases were dramatically large (40 percent to 112 percent), and no one lens manufacturer would be able to raise its prices significantly unless others went along. The large combined mar-

---

40 J&JVC consented to the entry of injunctive relief “in accordance with this assurance of discontinuance.” J&JVC Assurance of Discontinuance 3 & n.1, Maryland v. Johnson & Johnson Vision Care, Inc., File No. 03C16002271 (Balt. Cty. Cir. Ct. Oct. 20, 2016). J&JVC also argued that the state civil penalty is capped at $100,000 and that any further proceedings or mediation should be directed toward determining an appropriate penalty within that cap.


42 Id. ¶ III (assurance continues for five years unless statute “is repealed or held unconstitutional”) and at 1 n.2.

43 Id. ¶ IV.


46 Contact Lens Class MTD Order, supra note 28, at 4.

47 Toys “R” Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000); United States v. Apple, Inc., 791 F.3d 290, 314 (2d Cir. 2015), cert. denied, 136 S. Ct. 1376 (2016).

48 Contact Lens Class MTD Order, supra note 28, at 32–34. Here the court was certainly giving plaintiffs the benefit of the doubt, because every RPM policy worth undertaking involves either a price increase or protection of an existing or proposed price level. Furthermore, in a concentrated industry, a firm will take into consideration the likely—but still nonconspiratorial—responses of its competitors.
ket share and the compressed period of sequential adoptions were particularly important. As the court explained:

If the drastic sea-change in pricing of contact lenses stopped here, the Court would be examining no more than an alleged vertical agreement between Alcon and the ECPs through ABB, and would necessarily consider Alcon’s 30.6% market share as a factor in determining whether the adoption of the UPP was indeed a lawful independent action under *Colgate*. But the parade of UPPs did not stop there.\(^{49}\)

In the context of the hub-and-spoke horizontal conspiracy, the court found the vertical allegations sufficient because ABB had ample opportunity to facilitate communications among the manufacturers, had the goal of helping “ECPs to ‘make more money,” and had “acknowledged that it ‘worked closely’ with the Manufacturer Defendants to develop the UPPs.”\(^{50}\)

After analyzing the per se allegations of the horizontal conspiracy, the court turned to a rule of reason analysis of the vertical allegations. The court found that the plaintiffs had plausibly alleged a relevant product market of disposable contact lenses. The court also found that the market share at issue was large enough that anticompetitive effects were plausible. The defendants had focused on each individual firm’s market share (with the highest being about 30 percent), but because the vertical agreements were “integral” to the broader horizontal conspiracy, the court looked to the market share of all of the manufacturer defendants (97 percent) and of the affected products (40–80 percent of lenses).\(^{51}\) The court also considered that the ECPs who had driven the adoption of RPM policies “controlled” two-thirds of the disposable lens market.\(^{52}\)

But were there vertical agreements? The court recited a litany of allegations that it believed plausibly establish a flow of information up and down the distribution chain about UPPs, from the ECPs’ pressure on the Manufacturer Defendants to relieve ECPs of the price competition and thus the siphoning of sales of contact lenses to the Discount Retailers, to the Manufacturer Defendants’ dramatic response out of a concern for the ECPs’ ability to make a profit on selling contact lens which in turn would incentivize ECPs to prescribe their lenses.\(^{53}\)

Most of the specific factual allegations involved manufacturers communicating with their ECP customers about pricing policies. Citing and quoting *Monsanto*, the court acknowledged that manufacturers “have legitimate reasons to exchange information [with distributors] about the prices and the reception of their products in the market” and that “constant communication about prices and marketing strategy does not alone show that the distributors are not making independent pricing decisions.”\(^{54}\) But the specific circumstances (including, again, the compressed period in which the policies were adopted) persuaded the court that the allegations were sufficient.

The case remains in the discovery phase. Fact discovery is currently scheduled to close in August 2017, with dispositive motions due in April 2018, and a final pretrial conference set for October 10, 2018.\(^{55}\)

\(^{49}\) Id. at 37.

\(^{50}\) Id. at 36 (quoting Plaintiffs’ Corrected Consolidated Class Action Complaint).

\(^{51}\) Id. at 44.

\(^{52}\) Id. at 45.

\(^{53}\) Id. at 46.

\(^{54}\) Id. at 47 (quoting *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984)).

\(^{55}\) Order, *In re Disposable Contact Lens Antitrust Litig.*, File No. 3:15-md-2626 (M.D. Fla Nov. 17, 2016).
Costco Suit Against J&J. In March 2015, Costco filed an antitrust suit against J&JVC, alleging that J&JVC had conspired with ECPs to adopt an RPM policy. In June 2016, the MDL panel transferred this case to Judge Schlesinger in Florida. Although Judge Schlesinger had denied J&JVC’s motion to dismiss the complaint in November 2015, the parties stipulated to dismissal of the case without prejudice in May 2016.

J&JVC had argued first of all that Costco had not suffered any injury-in-fact. J&JVC claimed that Costco was actually making greater profits under the RPM policy, and that other retailers were charging higher prices (presumably meaning that Costco was still at a competitive advantage against other retailers). Costco argued that it was selling fewer units at the higher prices (as well as fewer units of other products), that any short-term gains were outweighed by long-term harm to Costco’s business model, and that the RPM policy hampered Costco in using low contact lens prices to attract new members. The court held that the Costco’s allegations of injury were sufficient at the pleading stage.56

The court similarly rejected J&JVC’s argument that Costco had not suffered antitrust injury. Its analysis required consideration of the product market and alternative “Wholesale and Retail Contact Lens Markets” that Costco alleged. The injury to competition in the wholesale market was that lens manufacturers were focused on “facilitating high minimum retail prices and margins rather than lowering wholesale prices,” and that without the vertical collusion with ECPs, the lens manufacturers would have competed with each other by using more efficient retailers.57 Costco also alleged that because of the prescription-based nature of contact lenses and the relative inability of retailers to substitute one brand for another, each brand was its own market, but even viewing contact-lens retailing as a single market, the court found that J&JVC’s 43 percent market share and the alleged effects on competition were sufficient to allege antitrust injury.

J&JVC also challenged the sufficiency of the allegations of any vertical agreement. Costco had alleged two different agreements: (1) between J&JVC and ECPs, and (2) between J&JVC and distributors. As to the first, Costco alleged that some ECPs had “urged” J&JVC to adopt the policy, that ECPs had complained about discounting, that J&JVC was “strongly motivated” to agree with these ECPs who had the power to write prescriptions, that J&JVC had sought and received “open and candid responses” from ECPs that helped J&JVC “define our strategy and implement the changes and actions that you [ECPs] told us were needed.”58 As to the distributors, Costco alleged that J&JVC “needed” the distributors’ help to enforce the RPM policy and that the policy on its face indicated that distributors had agreed to enforce it. As to both categories of agreement, the court held that the allegations were sufficient to get past Twombly.59

Costco alleged a third category of agreement as well—between J&JVC and non-ECP retailers—including Costco itself. J&JVC argued that the complaint alleged only “pricing suggestions, persuasion, and pressure”—but not enough to establish a coerced agreement. The court found that the alleged threat of termination was sufficient to establish coercion, in large part because J&JVC’s products accounted for such a large percentage (over 50 percent) of Costco’s contact

---

56 Order at 21–25, Costco Wholesale Corp. v. Johnson & Johnson Vision Care, Inc., File No. 3:15-cv-734 (M.D. Fla. Nov. 4, 2015). Costco (which is an investor-owned membership organization) also claimed standing based on injury to its members. The court discussed but made no decision on the concept of associational standing, because Costco had adequately pleaded direct standing. Id. at 21.

57 Id. at 26 (quoting complaint).

58 Id. at 33 (quoting complaint).

59 Id. at 34–35.
Lens sales. The court recognized that it was “[t]o be sure . . . unusual in this posture” for Costco to name itself as a counterparty to an illegal agreement, but the fact that Costco and J&JVC may have had different motives for making the agreement did not mean there was no agreement.

**Lens Manufacturer Challenge to Utah Statute.** In 2015, after the lens manufacturers had adopted their RPM policies, Utah enacted a statute prohibiting the enforcement of RPM policies or agreements against lens retailers in Utah. The statute makes it illegal for a lens manufacturer or distributor to “take any action, by agreement, unilaterally, or otherwise, that has the effect of fixing or otherwise controlling the price that a contact lens retailer charges or advertises for contact lenses.” Three points leap out from this language:

- The statute applies not only to “agreements” but also to a manufacturer’s unilateral actions. In other words, the statute is an express rejection, at least within its contact-lens domain, of the **Colgate** doctrine.
- The statute applies not only to actual selling prices, but to advertised prices as well. In other words, it rejects even the pre-Leegin law that applied rule of reason analysis to agreements on advertised price.
- The statute applies to both minimum and maximum prices (although the statute was prompted, presumably, by concerns about minimum prices). In other words, the statute rejected not only Leegin’s analysis of minimum price agreements, but also Khan’s analysis of maximum resale price agreements.

Several contact lens manufacturers brought suits against the Utah Attorney General challenging the law as violating the Commerce Clause of the U.S. Constitution. The federal district court consolidated the suits and permitted intervention by two large lens-retailers, Costco and 1-800 Contacts. The district court denied a motion for preliminary injunction. In May 2015, the Tenth Circuit issued a temporary injunction pending briefing, but on June 12, 2015, the court vacated the temporary injunction. In December 2016, the Tenth Circuit affirmed the district court’s denial of a preliminary injunction (albeit in a nonprecedential opinion decided under the standard for review of denial of a preliminary injunction).

The Tenth Circuit rejected the lens manufacturers’ Commerce Clause argument on a 2–1 vote. According to the court, the state statute did not discriminate on its face between in-state and out-of-state businesses. The statute also applied only to sales to resellers in Utah and did not purport to apply to sales to retailers located outside of Utah. The statute’s prohibition of discrimination against a retailer who “sells or advertises contact lenses for a particular price” is not explicitly limited to the retailers’ sales and advertising within Utah, but the Tenth Circuit stated that the district court did not err in relying on the “Utah Attorney General’s interpretation . . . saying that the statutes don’t apply to the conduct of manufacturers or retailers selling outside Utah.”

---

60 Id. at 37.
61 Id. at 37–38.
62 **Utah Code Ann.** § 58-16a-905.1.
63 Id. § 58-16a-905.1(1).
64 An amendment to delete the phrase “unilaterally, or otherwise” was defeated on the floor of the state House of Representatives. See S.B. 169, Contact Lens Consumer Protection Act Amendments—House Floor Verbal Amendment No. 2 (Mar. 10, 2015), http://le.utah.gov/~2015/pamend/sb0169.hvfv.02.pdf.
65 State Oil Co. v. Khan, 118 S. Ct. 275 (1997) (holding vertical maximum price fixing is not a per se violation of the Sherman Act).
66 Johnson & Johnson Vision Care, Inc., v. Reyes, 665 Fed. App’x 736, 743 (10th Cir. Dec. 19, 2016) (“relying on the Utah Attorney General’s interpretation, neither section 58-16a-905.1 nor 58-16a-906 regulate the price retailers charge for contact lenses outside of Utah. Retailers outside of Utah are free to sell contact lenses for whatever price they would like, including the prices set by the Manufacturers’ UPPs.”).
The court also held that the statute did not have extraterritorial effect. The lens manufacturers argued that the statute “bars an out-of-state contact lens manufacturer from setting a minimum resale price for the sale of its products by a Utah contact lens retailer to a customer in California.”

The court noted that this argument “ignores Utah’s interest” and “ignore[s] the location of the retailer—Utah” and that the statute “doesn’t regulate conduct occurring wholly outside of Utah—it only regulates sales from a Utah retailer that is located within Utah.”

The Tenth Circuit majority appears to have conflated the location of the reseller with the nature of the commerce. One can easily envision business models that make this clear. For example, a manufacturer could have two agreements with a reseller: one applying to resales to consumers located in Utah, and a separate agreement relating exclusively to its sales to consumers located outside Utah. A law that prohibited RPM policies as to sales made under the first agreement would presumably advance the two interests that Utah identified—“(1) [the statute] returns intrabrand competition to the contact-lens market in Utah; and (2) it allows retailers in Utah to charge lower prices to consumers buying contact lenses in Utah”—even though non-Utah retailers might be commercially disadvantaged if they did not have the benefit of the same statute. In contrast, a law that prohibited RPM policies as to sales under the second agreement certainly does not advance those interests—but it does put Utah-based resellers at a commercial advantage relative to non-Utah resellers.

Indeed, the dissent was based on essentially this point. Although agreeing that the statute did not discriminate against out-of-state manufacturers, Judge Bacharach would have remanded the case for district court review under a strict scrutiny standard because the statute discriminated against out-of-state retailers. As Judge Bacharach noted, this discrimination “exists partly because Utah hosts a retailer, 1-800 CONTACTS, which sells roughly 99% of its contact lenses outside of Utah.” The practical consequence is that the Utah statute thus “allows 1-800 CONTACTS to always undersell retailers outside of Utah when competing for sales in 49 states.”

Certainly a manufacturer could avoid this discrimination for their non-Utah resellers by abandoning sales to all Utah resellers, but Judge Bacharach disagreed that the Commerce Clause allows a state to put a manufacturer to that choice, at least on the facts at hand.

Some Takeaways
Devising and implementing an RPM policy remains challenging, and counselors need to be aware of potential pitfalls. The last few years have taught or reminded practitioners of some key points:

Retailer-driven policies are more likely to be challenged, and the challenge is more likely to survive a motion to dismiss. A typical RPM policy will state that it is unilateral, that no agreement

---

67 Id. at 746 (quoting Alcon opening brief).
68 Id.
69 Id.
70 Cf. Lindsay, A Tale of Two Coasts, supra note 3, at 2–3 (“The Bioelements consent decree does not distinguish between Internet resellers and brick-and-mortar resellers, although it plainly applies to both, and it does not distinguish between in-state and out-of-state resellers. Arguably the consent decree’s reference to the applicable state statute means that the injunction applies only to in-state resellers (and possibly only to in-state sales by in-state resellers). But the consent decree also required Bioelements to notify all distributors and resellers with whom it had RPM agreements—seemingly without regard to whether the reseller or its customers were located in California.”).
71 Johnson & Johnson Vision Care, Inc. v. Reyes, 665 Fed. App’x. at 751 (Bacharach, J. dissenting).
72 Id.
73 Id. at 754–55.
is invited or accepted, and that no employee is authorized to say or do otherwise. A manufactur-
er that is considering adopting an RPM policy, however, may well want to understand how its
resellers will react. Moreover, there is a natural tendency to tell business partners “we’ve listened
to you, and we are responding to your request.” That does not necessarily mean that there was
an “agreement” in the legal sense, but those words may well be repeated in a plaintiff’s complaint.

**Beware of RPM Policies in Concentrated Industries.** As the contact lens litigation illustrates,
RPM policies adopted by multiple firms in concentrated industries are more likely to face chal-
lenges. This lesson certainly is not new. Back at the beginning of this century, the FTC obtained
consent orders against “the five largest distributors of recorded music who sell approximately 85
percent of all compact discs (CDs) purchased in the United States to end their allegedly illegal
advertising policies that affected prices for CDs.”74

**Products that consumers purchase repeatedly may be a poor candidate for RPM policies.** A
consumer who purchases a product on a regular and relatively frequent basis may see less value
in any pre-sale services or other functions that the RPM policy is supposedly designed to facili-
tate. Although the customer may have some brand preference (and, in the contact lens case,
some barriers to brand-switching), that may not signal any willingness to pay the higher prices that
an RPM policy would require.

**Large price movements get attention.** An RPM policy that is followed by large price increas-
es across a broad range of a manufacturer’s products is more likely to draw attention. Manufac-
turers might want to consider applying a new RPM policy to a narrower range of products, as well
as offering their own lower-priced alternatives to the higher-priced products covered by the RPM
policy.

---

74 Press Release, Fed. Trade Comm’n, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market—All Five Major
record-companies-settle-ftc-charges-restraining-competition-cd.
Managed Care Marketplaces: Growing Drivers of Payer-Provider Vertical Integration

Brian J. Miller and George L. Wolfe

Recent health insurance marketplace changes have brought about innovative risk-sharing arrangements and vertical integration along the healthcare delivery supply chain. This integration is occurring through full-asset acquisitions—such as UnitedHealth’s acquisition of Surgical Care Affiliates to provide a comprehensive ambulatory care services platform—and through joint venture and contractual arrangements—such as Aetna’s partnering with Inova Health System to create Innovation Health Plans. These vertical arrangements have the potential to provide significant quality of care and cost saving efficiencies by increasing transparency and collaboration along the healthcare supply chain. At the same time, vertical alignment between health insurance providers (“payers”) and hospital-centric health systems raises unique antitrust questions that require courts to balance foreclosure issues against enhanced quality of care and network design efficiencies.

This article examines the recent Omni Healthcare Inc. v. Health First decision and ongoing healthcare marketplace changes to examine the role that efficiencies play in antitrust enforcement policy when analyzing vertical healthcare integration. Despite the complex market structure of healthcare insurance and delivery vehicles, there does not appear to be any empirical evidence supporting the view that vertical healthcare affiliations pose a risk of antitrust harm greater than standard vertical theories would predict. Network design vis-à-vis using tiers and exclusion are integral parts of offering affordable plan products that enable vertically integrated payer-providers to implement cost savings and improve quality of care.¹ These include providing tangible benefits to consumers by streamlining care delivery, providing a seamless care experience, integrating clinical operations, and potentially increasing medical quality. We note, however, that “low” levels of risk shifting like Accountable Care Organization (ACOs) may be insufficient to trigger changes in clinical operations or physician practice patterns that would result in significant gains for consumers.

The Omni Healthcare Decision

In Omni Healthcare Inc. v. Health First, Inc., Judge Roy B. Dalton Jr. of the Middle District of Florida concluded that alleged vertical foreclosure issues raised triable issues of fact.² Omni Healthcare and a consortium of medical providers (Omni) had sued Health First and its subsidiaries (Health First) for violating, inter alia, Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act.

¹ Network tiering allows insurers to grade providers and subsequently incentivize patients to use preferred providers by reducing their copayment and/or co-insurance responsibilities. Tiered networks provide insurers with more precise tools for network design than the classical in-network and out-of-network dichotomy.

due to its varying alleged anticompetitive conduct in Southern Brevard County (SBC). Omni alleged that Health First is a dominant regional hospital system due to its 86.8 percent market share for inpatient hospital services vis-à-vis its Holmes Regional Medical Center and three additional nearby hospitals. Health First also offers multiple health insurance plans through its Health First Health Plans (HFHP) subsidiary, and operates its physician practices through its Health First Physicians (HFP) subsidiary.

The crux of Omni’s antitrust claims was that Health First, by engaging in various forms of exclusionary conduct, such as requiring its physicians and other in-network providers to only refer patients within the business group-owned hospital system, harmed competition in various healthcare markets. At the summary judgement phase, Judge Dalton concluded that the alleged exclusionary conduct, in conjunction with Health First's 86.8 percent market share in inpatient hospital services, created triable issues of fact for the jury.

For the payer-provider claim, Omni alleged that Health First attempted to monopolize the Medicare Advantage marketplace by refusing to contract for inpatient hospital services with other Medicare Advantage insurers. The court held that (1) Medicare Advantage is a relevant market, (2) Health First intended to monopolize Medicare Advantage based on its internal documents, (3) Health First terminated other Medicare Advantage contracts that were otherwise profitable, and (4) unilateral termination of an otherwise profitable arrangement “may be indicative of anticompetitive intent where it suggests a willingness to forsake short-term profits to achieve an anticompetitive end.” The court thus denied summary judgment because the exclusionary conduct created triable issues of fact.

Omni also alleged that Health First’s acquisition of Melbourne Internal Medicine Associations (MIMA) in 2013—the second largest physician group in SBC—was an impermissible merger in violation of Section 7 of the Clayton Act. Interestingly, Omni pled its challenge as a vertical merger between the largest inpatient hospital services provider and the second largest physician group. The acquisition allegedly harmed competition in SBC, where MIMA was the largest independent physician group, due to Health First requiring the acquired physicians to (1) accept only Health First Medicare Advantage Plans, and (2) only refer patients to other Health First providers (with limited exceptions).

In support of their allegation, Omni relied on three key pieces of evidence: (1) deposition testimony affirming that physicians employed by Health First were required to refer patients to other Health First facilities, i.e., exclusive steering, (2) an expert report concluding that the acquisition and referral requirement foreclosed “more than 25% of the physician services market,” and (3) an

---

3 Id. at *2, *14. Health First also owns Canaveral Hospital, Palm Bay Hospital, and Viera Hospital in Brevard. These three hospitals are not named as defendants in the action.

4 Id. at *2.

5 Id. at *18–19. The plaintiffs voluntarily withdrew their attempted monopolization of private health insurance claim. All other claims survived summary judgment.

6 Id. at *14.

7 Id. (citing Verizon Comm’ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004)).

8 Id. at *19. Interestingly, the court noted that Health First was free to argue at trial that their recently declining Medicare Advantage market share from 100% to 50%-60% due to recent entry negated their market power.

9 Id. at *2.

10 Id. at *12.
acquisition business plan detailing the elimination of all non-HFHP Medicare Advantage plans in SBC.11 Judge Dalton concluded that the evidence created a triable issue of fact for the allegations of harm raised by the vertical acquisition.

The Omni decision raises many interesting questions of law. For example, can a dominant hospital system’s acquisition of a large physician practice violate Section 7 as a vertical transaction? Can that hospital system’s unilateral expansion into Medicare Advantage violate Section 2 based on the hospital’s refusal to contract with other Medicare Advantage plans? Can a joint venture between an insurer and a hospital violate Section 1 if it establishes exclusive dealings? Judge Dalton’s summary judgment opinion answers “yes” to each of these questions as a matter of law.

Whether these allegations were supported as a matter of fact, however, is a different story. Health First, in its motion for summary judgment, alluded to being able to proffer evidence that its conduct was justified procompetitive behavior, and that any growth was a “consequence of a superior product, business acumen, or historic accident.”12 The case settled on the second day of trial before Health First was able to put on their defense. Settlement prevented the court from addressing the triable issues of fact on vertical integration. This begs the question of what are the procompetitive benefits from vertical mergers and other vertical payer-provider arrangements that can counterbalance such triable allegations.

The Antitrust Analytical Framework

There has traditionally been very little vertical merger antitrust enforcement in the United States.13 This is likely because courts, agencies, and economists generally view vertical arrangements as procompetitive, inasmuch as coordination along the supply chain is often necessary to innovate, lower costs, or achieve other beneficial goals.14 Although vertical arrangements are also less likely to raise antitrust concerns, “vertical concerns can arise if a network’s power in one market in which it operates enables it to limit competition in another market.”15 As the Federal Trade Commission stated in its recent Norman PHO Advisory Opinion, healthcare antitrust is concerned with “vertical arrangements that would enable [the system] to use any market power the network might possess in selling certain services to limit competition in the sales of any other services.”16 Vertical healthcare integration attempts to coordinate providers operating at different levels of our healthcare delivery system by increasing alignment of clinical and financial risk. Such arrange-

11 Id. at *13.
13 For example, a study concluded that there were only 48 vertical merger enforcement actions during the 1994–2015 period (most were consent decrees). Steven C. Salop & Daniel P. Culley, Vertical Merger Enforcement Actions: 1994–2015 (Oct. 30, 2015), http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2541&context=facpub.
14 See, e.g., Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 903 (2007) (recognizing the procompetitive justifications of vertical restraints and eliminating the per se prohibition against resale price maintenance); U.S. Dep’t of Justice & Fed. Trade Comm’n, Statements of Antitrust Enforcement Policy in Health Care 108 (1996) [hereinafter Healthcare Guidelines], https://www.ftc.gov/sites/default/files/attachments/competition-policy-guidance/statements_of_antitrust_enforcement_policy_in_health_care_august_1996.pdf (“In some multiprovider networks, significant efficiencies may be achieved through agreement by the competing providers to share substantial financial risk for the services provided through the network.”).
15 Healthcare Guidelines, supra note 14, at 19.
ments may include products where one is an input for another, such as surgeons and operating rooms. It can also include complementary products that are typically consumed together.\(^\text{17}\) We can exemplify this by adding an anesthesiologist to our preceding surgeon and operating room hypothetical; continuing to add complementary services to our hypothetical results in the package becoming akin to a hospital system. Our hypothetical hospital system can then offer its own insurance products to more fully integrate along the healthcare supply chain.

Vertical integration is generally viewed as procompetitive across the entire healthcare delivery system because it frequently eliminates costs, streamlines operations, promotes clinical integration, and facilitates innovation in care delivery design.\(^\text{18}\) These potential quality improvements and cost savings are exactly what health systems companies seek to unlock through vertical integration. For instance, vertical integration facilitates the creation and execution of capitated insurance plans whereby integrated payer-providers can undertake coordinated management of clinical and financial risk. Creating supply chain efficiencies can enable a vertically integrated undertaking to better compete by lowering prices or expanding output.

Streamlining operations may result in targeted marketing or research and development efforts that spur innovation. Customers also are often better informed by vertically integrated product offerings that share a brand, for example, because they know that their health insurance will be accepted throughout the vertically integrated hospital system. Without that information, in seeking emergency services, consumers may unwittingly be treated by an out-of-network emergency room physician, incurring significant costs.\(^\text{19}\) A vertically integrated payer-provider may help consumers avoid these risks.\(^\text{20}\) These examples are just a few of the many ways that vertical integration can “benefit suppliers, distributors, and consumers alike.”\(^\text{21}\)

In certain circumstances when a company has pre-existing market power, however, vertical integration “can create changed incentives and enhance the ability of the merged firm to impair the competitive process.”\(^\text{22}\) Vertical integration can impact competition in either the upstream or downstream product market. Where both markets are impacted differently, vertical integration raises open questions of law and policy as to how to decide whether the benefits outweigh the harm.\(^\text{23}\)

Vertical theories of anticompetitive harm typically focus on conduct that raises rivals’ costs through either input or customer foreclosure. Raising rivals’ costs through foreclosure may be accomplished through boycotts, tying, bundling products and services, contracts referencing

---


\(^{20}\) Another example is that of the surgeon-anesthesiologist pair: a consumer may see an in-network surgeon but be served by an out-of-network anesthesiologist, chosen by the surgeon.


\(^{23}\) See Salop & Culley, *supra* note 17, at 10.
rivals (most-favored-nations clauses, etc.), refusals to deal, or other methods that inhibit rivals from competing. Vertical mergers may also change competitive dynamics within a product market by creating cost symmetry or enhancing information exchanges that impede competition in the post-merger world. For example, network tiering by vertically integrated payers that is specifically designed to eliminate downstream competition in a healthcare provider segment can serve to foreclose rival providers from serving the health plan’s insureds.

Vertical integration can also reduce potential competition by raising barriers to entry. Entry becomes increasingly difficult under circumstances where a potential new provider would have to compete in two product segments to commercialize a successful product. In certain contexts market maturation obviates viewing the independent products as themselves comprising relevant markets. In other instances double-sided entry effectively impedes new competitors from entering the marketplace. Vertical integration may also increase a company’s incentives to charge more for the downstream product due to upward pricing pressure from the potential recoupment of lost sales of the combined product through individual sales of the two products. This dual product recoupment strategy is similar to the unilateral effects theory discussed in the Department of Justice and FTC 2010 Horizontal Merger Guidelines.  

Drivers Behind Vertical Healthcare Consolidation

The current vertical healthcare consolidation trend can be traced back to the initial shift towards managed care—the rise of Medicare Advantage and Medicaid Managed Care in the 1990s and early 2000s. The development of these specific product markets fundamentally changed healthcare by creating structured, transparent insurance marketplaces for health plan products for elderly (Medicare) and impoverished (Medicaid) Americans. The Patient Protection and Affordable Care Act (ACA), passed in 2010, similarly created public insurance exchanges for individuals and small business employees. The creation of these marketplaces and their accompanying regulatory overhauls has spurred innovation in risk-sharing arrangements and insurance design, and has consequently served as an impetus for enhanced vertical integration in the healthcare industry.

For example, public insurance exchanges—federally facilitated or state-run—function as direct-to-consumer marketplaces that enable individuals to seamlessly compare multiple insurance products across federally defined terms and categories. Specifically, insurance products sold on public exchanges are required to display transparent pricing, network information, and be priced according to four standardized plan actuarial values (bronze, silver, gold, and platinum). These metrics enable consumers to easily compare plan premiums, network design, and additional important features across multiple insurance products offered by competing plans. The ACA

---


25 In addition to creating the marketplace, the ACA includes various initiatives to balance both sides of the market. On the consumer protection side, the ACA removes lifetime medical expense limits on plan products, guarantees policy issuance and renewability, and requires payers to offer insurance coverage irrespective of “pre-existing conditions.” To prevent adverse selection—the phenomena of having only patients that need insurance enroll—the ACA mandates that all U.S. citizens and legal residents have qualifying health coverage or face an annual tax penalty. This is in turn balanced by a tiered insurance plan premium subsidy program to assist indigent Americans with purchasing insurance. Families earning up to 300%–400% of the Federal Poverty Limit (FPL) are only exposed to premiums up to 9.5% of their annual income. For families with incomes up to 133% of the FPL, states have the option to expand Medicaid in order to serve this population.
also stabilizes insurer risk pools by, for example, limiting enrollment periods. These features create market liquidity by establishing a centralized forum on which plans compete.

Healthcare companies are responding to managed-care marketplace changes by vertically integrating healthcare financing (i.e., insurance) and delivery (i.e., providers) in a variety of forms. Integrating financing and delivery weaves together clinical and financial risk. This dual-risk integration exists along two continua: (1) network construction, with the aim of increasing integration of clinical operations into the health plan; and (2) risk bearing or transfer, in order to distribute financial risk down the healthcare delivery supply chain.

With respect to network construction, corporations choose a strategy along a continuum that runs from contract-based constructed networks to fully owned and operated networks. A parallel continuum exists for risk management, ranging from fee-for-service (payment per “piece”), to fully capitlated risk (payment per member per month). Healthcare companies usually traverse these spectra in unison with increased network integration coupling with an increased degree of capitation.

Basic forms of risk shifting include one-sided risk schemes—e.g., “gain sharing” arrangements—that are frequently found in ACOs. ACOs are joint contracting vehicles for healthcare providers that were created by the Centers for Medicare & Medicaid Innovation Center (CMMI) to test new models of healthcare finance. ACOs contract with Medicare, which sets an acceptable per beneficiary target based on historical data. If the delivery system exceeds target spending, Medicare pays nothing. If the delivery system exceeds target expectations, the provider shares savings with Medicare.

These models serve to build core business operations for plans and providers and are often a precursor to more integrated risk-sharing models that are best exemplified by Medicare Advantage and Medicaid Managed Care programs. By their very design, these programs incentivize vertical integration between plans and providers. For example, Medicare Advantage plans have specific network and access requirements, rigorous quality rating review via the Centers for Medicare and Medicaid Services (CMS) “Stars” rating program and marketing oversight.

---

26 The ACA also further stabilizes the risk pool by establishing standard enrollment periods—November 1 to January 31 of each year—to ensure that individuals do not elect to purchase coverage only at the advent of illness. Individuals may only purchase insurance on the public exchanges outside of this enrollment period if they have a “qualifying event,” such as relocation to another state, marriage or divorce, change in family size, etc.

27 CMMI is charged with designing, implementing, and evaluating insurance experiments for the Medicare and Medicaid programs. Endowed with statutory authority to waive traditional requirements of the Medicare program in its insurance experiments, CMMI has great freedom to innovate. This enables the CMS Chief Actuary to explore novel programs and certify programs that lower cost without reducing quality. These successful programs can then be scaled out to the entire Medicare program, which covers 55 million individuals. See ACA, PUb. L. No. 111-148, 124 Stat. 393 (2010) (“The Secretary may waive such requirements of titles XI and XVIII and of sections 1902(a)(1), 1902(a)(13), and 1903(m)(2)(A)(iii) as may be necessary solely for purposes of carrying out this section with respect to testing models described in subsection (b).”).

Medicare innovations that successfully reduce government spending often serve as a “test model” for private plan products in other markets. Such innovation can lead to structural changes that affect multiple levels of the healthcare supply chain by reallocating financial risk for care delivery, realigning incentives, and steering the marketplace towards increased integration in an effort to improve patient outcomes.

28 These “risk lite” products serve as a precursor to risk corridors. Risk corridors have healthcare delivery systems take the financial risk for a defined patient population by providing baseline fee-for-service payments and, traditionally, a 5–10% risk corridor that is accompanied with a minimum gain/loss in order for the health system to “experience” the risk (i.e., be financially responsible to the insurer). Risk corridors effectively function as a limitation on losses for providers by having the plan issuer serve as a reinsurer for unforeseen expenditures and patient population variance outside of the predetermined risk corridor.

In response to increased risk-shifting structures, providers have vertically integrated into the payer space for private Medicare and Medicaid plan products through a variety of mechanisms with increasing operational complexity. Some health systems, such as Iora Health (a primary care clinic chain), serve as an exclusive network for Humana’s Medicare Advantage plans in many counties. Other hospital systems are partnering with traditional insurers to jointly launch both new health plans and products. For example, Inova partnered with Aetna to launch the Innovation Health Plans joint venture insurance company; Bassett Healthcare Network partnered with Excellus BlueCross BlueShield to offer an exclusive individual exchange product with Bassett as the only Tier 1 network provider.

Larger health systems are also repositioning their existing provider-sponsored health plans to enter additional regulated markets via new subsidiaries. For example, multi-hospital academic health systems like Johns Hopkins Medicine entered the Medicare Advantage marketplace through pre-existing payer subsidiaries, such as Johns Hopkins HealthCare LLC. Similarly, large community hospital chains like Geisinger Health System entered Medicare Advantage through Geisinger Health Plans. In other instances, health insurers partner with regional healthcare systems to create joint plans, acquire local healthcare systems outright, or exclusively contract with local providers.30 We outline certain tenets to help illuminate how entry into the health insurance marketplace works:

- **De novo** entry into the payer marketplace is usually simpler with respect to more regulated insurance marketplaces, such as Medicare Advantage, than broader commercial segments.31 This is because regulated marketplaces often contain more defined structures that require less geographically dispersed networks (such as Medicare Advantage plans being offered on a county basis). Large health systems have taken advantage of these simplified entry conditions by creating their own health plans and product offerings that utilize their healthcare delivery system as a pre-packaged insurance network.

- Expansion upstream into regulated insurance products may also encourage entry into private commercial insurance for local businesses because the health system may offer the commercial insurance products to its own employees in order to jumpstart its plan (or vice versa). For example, in 1996 Johns Hopkins Medicine vertically entered the insurance market by creating a new health plan subsidiary, Johns Hopkins HealthCare LLC, offering a self-insured plan product to Johns Hopkins Medicine employees and later expanding horizontally into adjacent, regulated insurance markets, such as Medicaid Managed Care (late 1990s) and Medicare Advantage (2015).

- Significant private Medicaid payers are also expanding into public exchanges with owned and operated vertically integrated models. For example, Molina Healthcare, a Medicaid Managed Care Organization with its own chain of clinics, has successfully entered and thrived in multiple public exchange markets.32 This has occurred in parallel with the exit of “single level” (i.e., pure plan) health insurers, such as Aetna, who specialize in employer-group market models. This parallel entry/exit dance may suggest that public exchanges,

---


31 For example, Catholic Health—one of the U.S.’ largest hospital operators—decided to abandon its entry into the commercial employer insurance market due to posting mounting losses, including $109.6 million in its last fiscal year that ended in June 2016.

which typically require broader networks than Medicare Advantage, paradoxically have low entry barriers when coupled with increased vertical integration. Alternatively, it is possible that these companies have a managed-care experience advantage due to their strength in managing indigent patient population pools through state Medicaid programs.  

Achieving Cognizable Efficiencies

Vertical healthcare arrangements promise significant potential efficiencies for consumers, be they patients, clinicians, or employers’ purchasing plan products. Consumers may benefit from a seamless care experience provided by integrating health plans and provider operations, for example, by providing single-source billing for consumers. Increased vertical alignment may also improve quality and safety through central planning and the design of safety and IT systems. Vertically integrated payer-providers can also eliminate insurance coverage disputes that occur in loosely integrated provider networks.

We discuss recent empirical healthcare literature to help ascertain how varying degrees of vertical integration—from shared-savings to outright merger—impact healthcare cost and patient care quality outcomes. Perhaps the best data set to analyze quality improvements is offered by the Medicare Advantage marketplace due to CMS tracking each insurer-sponsored plan’s quality by its 2016 star ratings. Star ratings are an integrated quality measurement system used by CMS to assess Medicare Advantage plans. We can compare standalone insurance sponsored plans with hospital-sponsored plans to compare quality improvements. We rely on data available through the McKinsey Center for U.S. Health System Reform for two findings.

First, the study indicates substantial quality rating improvement from vertical integration, concluding that vertically integrated delivery networks received a higher weighted average rating of 4.45 (out of five) than plans offered by private insurers (3.96) or by the Blues (3.86). For example, Kaiser Permanente, a traditionally vertically integrated healthcare system, stands out with a perfect star rating (5.00). The 2016 star ratings analysis is consistent with prior-year results since at least 2012. The difference in stars ratings may indicate that vertical integration provides significant procompetitive consumer benefits by improving healthcare quality through increased clinical and financial integration.

Another study found that “health plans integrated with provider systems may offer better enrollee experiences and higher quality of care than nonintegrated plans do.” Vertically integrated Medicare Advantage plans were found to improve both quality of care performance—i.e., managing chronic conditions—and process quality, for example by timely administering screenings, tests and vaccines. The study concluded that vertically integrated payer-providers “ha[ve] significantly higher” quality performance.

We expect to see the aforementioned quality improvements achieved from vertical integration due to increased organizational planning and integrated clinical and financial information. This is especially true in insurance marketplaces that reward enhanced quality of care coordination.

---


36 Id.
through bonus payments (such as Medicare Advantage). However, these sustained expected quality efficiencies were not observed in weakly vertically integrated networks, at least based on an ACO performance retrospective that yielded minimal to no benefits in traditional quality of care outcomes and process metrics.37 This could be due to a variety of reasons, including: initial high performance could “top out” quality measures; plans may incorrectly attribute members to the wrong providers; or high variability in performance on quality metrics may mask meaningful quality improvements (i.e., high signal to noise ratio). These reasons might explain why quality gains in low levels of vertical integration may be occurring but are not detected.

Analyzing cost-savings produced by vertically integrated payer-provider companies is more difficult “given the opacity of present [payer-provider] disclosure of key operating information” and there being “very little empirical research on the performance of provider integration with insurance vehicles.”38 Recent literature, however, indicates that health systems vertically integrating upward into health plan markets may be able to achieve insurance economies of scale benefits with narrower insurance product offerings than previously thought. As an example, one study finds that economies of scale for operating insurance plans “begin to converge above 100,000 lives” due to the greater organizational complexity required for having more lines of business across varying states.39 This helps explain why health system-sponsored health plans are able to effectively compete with larger insurance competitors.

**Antitrust in Managed Competition Marketplaces**

The rise of managed care marketplaces incentivized vertical integration through improving transparency, promoting risk-shifting, and fostering innovation to provide lower-cost and higher-quality healthcare. As we explored in the previous section, recent empirical evidence reveals that vertical integration improves performance on quality metrics, and having a single payer-provider creates cognizable efficiencies vis-à-vis consumer convenience and quality improvements. Healthcare systems can achieve these benefits through *de novo* entry into the insurance marketplace as the evidence supports health systems realizing meaningful economies of scale due to offering plan products in multiple markets (e.g., Medicaid Managed Care, Medicare Advantage, etc.), all built upon the same core insurance business operations and an owned and operated network.

These health systems are able to field competitive products in the insurance segments that they enter *de novo* due to effective marketplace entry and maximizing desired cost savings and quality improvements by vertically integrating. Health systems that offer managed care insurance products also forgo many of the initial barriers to entry identified in *United States v. Aetna*, such as reputational barriers and network incipiency constraints.40 Compared to full integration through *de novo* entry or acquisition, “low” levels of integration have produced mixed results. Fully-vertically integrated arrangements may be necessary to fully achieve desired cost savings and quality improvements.

37 J. Michael McWilliams et al., *Early Performance of Accountable Care Organizations in Medicare*, 374 N. ENG. J. MED. 2357 (2016).


Our analysis supports the proposition that meaningful vertical integration is generally procompetitive and yields tangible quality benefits for consumers. There is "scant empirical evidence on the anti-competitive effects of vertical integration by hospitals,"41 which further supports recommending a cautious approach in determining whether to assert antitrust challenges to vertically integrated healthcare systems. Because of the significant potential procompetitive benefits for consumers we recommend thoughtful enforcement in the absence of direct evidence of anticompetitive intent. This is especially true with network design, where network tiering is an integral part of affordably offering a plan product. A similar policy may make sense for network exclusion, in the absence of clear anticompetitive intent, because careful, integrated network construction can play a vital role in maximizing the benefits of vertical integration.

At the same time, vertical arrangements may raise antitrust concerns where a dominant health system leverages its downstream power to steer patients into its insurance products or to foreclose rivals from access to healthcare providers that are necessary to field a competitive product. This is likely what Judge Dalton was envisioning when the court denied Health First's motion for summary judgment. We commend Judge Dalton for focusing on contemporaneous business plans depicting anticompetitive intent but wonder whether the case would have been ripe for a directed verdict if it had not settled on the second day of trial.

Omni's vertical theories of harm were based on foreclosure—customer foreclosure through restrictive referral practices or input foreclosure through forgoing contracting with third-party Medicare Advantage plans. Based on our review of recent empirical studies, there may be procompetitive justifications for both forms of conduct. Medicare Advantage plans operated by a vertically integrated payer-provider perform better on customer ratings and provide a better customer care experience. Similarly, it appears that having closed provider networks enables the plan to exert more quality control and implement initiatives that may yield cost savings. The DOJ may have agreed with this assessment, as they investigated Health First and decided not to intervene with an enforcement action.42

Vertical healthcare integration does not appear to raise significant anticompetitive concerns. At the same time, the most recent past Director of the FTC Bureau of Competition recently stated during a healthcare law symposium that the Commission may bring a vertical merger case where such arrangements "cause problems"43 and would examine "whether competition as a whole would be harmed from the foreclosure."44 Any enforcement action may be aimed at securing conduct relief based on the recent FTC merger retrospective concluding that “[a]ll vertical merger orders were judged successful” in restoring competition through conduct relief.45

41 Goldsmith et al., supra note 38, at 10.
CMS recently projected an expected average 5.6 percent annual increase in national healthcare expenditures over the next decade. As the United States continues to strive to improve quality and reduce healthcare costs, we expect vertical healthcare arrangements to continue to flourish irrespective of what changes occur to the ACA.

Based on our analysis of the recent empirical evidence, we recommend that competition regulators who are keeping a watchful eye over healthcare industry consolidation give due consideration to efficiency claims made by companies integrating along the healthcare delivery supply chain. We also recommend that healthcare companies seeking to take advantage of the substantial benefits that vertical integration offers be prepared for a detailed antitrust review in markets where they have dominant positions that carefully scrutinizes the merger-specific efficiencies and evaluates whether the combination results in any structural marketplace changes that facilitates anticompetitive conduct.

Populism, Economists, and the FTC

Oliver Grawe

The 2016 election cycle will be remembered, among other things, for its populist uprising on both the left and the right.1 Populists appear to share a fear or concern about concentrations of power. For example, Candidate Trump expressed opposition to the pending AT&T/Time Warner merger as concentrating too much power in too few hands.2 Populists can oppose the supposed influence of railroad or Internet barons, petroleum companies, or renewable energy moguls on government policy. Populists could, as occurred in the late 1960s, urge much closer scrutiny of private enterprise or they could urge much closer scrutiny and control over government regulatory agencies perceived as benefiting special interests through onerous and ill-considered regulations. Therefore, when considering the transition’s effect on FTC enforcement it is instructive to consider the last time populism played an influential role in the FTC’s operations.

At the end of the 1960s, Ralph Nader’s “Raiders” issued a report highly critical of the Commission, as did the ABA.3 This was an era that saw the introduction of legislation by Senator Hart (Senate Bill 1167, 1973) to create a presumption of monopoly power whenever the Concentration Ratio—then the predominant structural measure—exceeded 50 in any line of commerce in any area of the country in any of the prior three years, or if accounting profits exceeded 15 percent for five of the seven years prior to filing a complaint. This period came just after the height of the Structure-Conduct-Performance (SCP) paradigm in economics that in its simplest form saw a straight line from concentration to anticompetitive conduct and performance that could be measured by high profits.

1 “Populism” is not a term tied to a specific political ideology—populists can have right, center, or left agendas. What populists seem to share is an antipathy to what they perceive to be an out-of-touch government beholden to or manipulated by more or less shadowy elites. The governing structure does not serve ordinary people very well. As Cas Mudde notes: “Many observers have noted that populism is inherent to representative democracy; after all, do populists not juxtapose ‘the pure people’ against ‘the corrupt elite’?” Cas Mudde, The Populist Zeitgeist, 39 GOV’T & OPPOSITION 541, 560 (2004).


3 In line with concerns about regulatory agencies more broadly, the Nader Report claimed that the (then) Division of General Trade Restraints was a favorite of the retail gasoline dealers’ trade association because the Division was quick to investigate any independent gasoline station’s low prices as a potential violation of the Robinson-Patman Act. Edward F. Cox et al., “The Nader Report” on the Federal Trade Commission 123 (1969) [hereinafter NADER REPORT]. Former Commissioner Mary Gardiner Jones, a 1960s appointee, expressed her and Chair Engman’s differences with other commissioners in a way that fits a liberal populist mold. According to former Commissioner Jones “[t]hey weren’t particularly consumer-minded. They thought that was kind of a nuisance. They didn’t take consumers very seriously. . . . I got angry at them, yes, because they were conservative and I wanted to move and they wanted to support the FTC as it was. There was a lot of cronyism, there was a lot of old line friendships between them and some of the business interests, and between them and some of the chief staffs. . . . Rufus Wilson, who was the Bureau of Competition Director and a friend of Rand [Dixon’s], was very much into small business and so was Maclntyre. I think Rand, himself, was probably just as much oriented to the interests of big business.” Fed. Trade Comm’n, Oral History Interview: Mary Gardiner Jones (2003), https://www.ftc.gov/about-ftc/our-history/oral-histories/oral-history-interview-mary-gardiner-jones.
As to economics at the FTC, Paul Scanlon wrote in an editorial:

The substance of the problem is that the FTC, an agency that has not historically distinguished itself for either political courage or economic sophistication, believes it has a “mandate” from the Congress to act only against certain forms of commercial “conduct,” e.g., false advertising, price discrimination, mislabeling, and the like. It denies that it has any responsibility to protect the consumer from monopoly (oligopoly) pricing. Since the FTC believes that it is perfectly legal for 3 or 4 firms to dominate an industry and charge prices that exceed by 25% or more the price that would have prevailed had the industry been more competitively structured, it logically follows, in the agency's view, that it would be a waste of public monies to investigate the matter of concentration and the resulting consumer overpricing. . . .

Alas, however, the FTC is not manned either by economic experts or political heroes. Its leaders are, by and large, lawyers with an ideological hostility to the whole notion of trying to reverse the long-term trend toward concentration in industry.4

The 1970s saw the FTC undertake the Line of Business Program to analyze, among other things, actual oligopoly price and non-price conduct, and it brought a number of ultimately ill-fated attacks on oligopoly and shared dominant firm industry structures, e.g., Ready-to-Eat Cereals, and petroleum in Exxon, facilitating practices in Ethyl (tetra-ethyl lead octane enhancer), and exclusion in DuPont (titanium dioxide). Much of the last half of the 1970s saw the FTC investigating the oil industry for anticompetitive practices and pricing largely at the behest of Congress. The FTC also pursued, again at the behest of Congress, territorial restrictions in the carbonated soft drink industry and conduct by the American Medical Association. Following the FTC’s Cigarette Rule, which was trumped by Congress, the FTC obtained a widened view of “unfairness” in Sperry & Hutchinson—which continued the Supreme Court's evolution away from FTC v. Gratz—and was codified in the 1975 Magnuson-Moss Warranty Act. As a result, there was an explosion of rulemakings at the FTC, and then Chairman Michael Pertschuk proposed going much further with rules that would have made, among other things, hiring illegal aliens and filing fraudulent income tax returns unfair methods of competition.5

What role did economists play—or were they expected to play—in all of this? Scanlon's editorial is suggestive:

Of a total professional workforce of some 500 people, the group that would have to do the bulk of the work in such an investigation [of oligopoly conduct], the economists, make up about 10% (about 50 people) of the total. The other 90%, the some 450-odd lawyers employed by the agency, are educationally unqualified to conduct such a study. And of the approximately 50 economists employed at the FTC, it is widely regarded as a conservative estimate to say that not more than 25 are capable of work much beyond the level of statistical clerking. Only about 10 of the FTC’s total of 50 “economists” are thus regarded as capable of conducting independent industry research and preparing publishable reports of the kind at issue here. . . .

In brief, a drastic overhaul of the FTC's Bureau of Economics, and particularly the hiring of additional economists with a higher level of training and skill in industrial organization, would be essential to any

---

4 Paul D. Scanlon, Investigation of Economic Concentration and Oligopoly Pricing: Congress or the FTC?, Antitrust L. & Econ. Rev., Winter 1970–71, at 19, 19, 21 (second emphasis added).

5 For a list of the rulemakings, see William MacLeod, Elizabeth Brunins & Anna Kertesz, Three Rules and a Constitution: Consumer Protection Finds Its Limits in Competition Policy, 72 Antitrust L.J. 943 (2005). At one point the FTC had 15 rulemakings underway at the same time, which qualifies as an “explosion.”
serious effort on the part of that agency to conduct an investigation of economic concentration in the United States.⁶

Yet only a decade after the 1969 critiques, a combination of Congressional disapproval of FTC activity during the 1970s and a change in industrial organization economic analysis—a change from the prevailing SCP paradigm that had been brewing since the 1950s—resulted in a second change in the role of economics and economists at the FTC. The period from 1969 to 1984, and in particular the early 1980s, saw significant changes in the role of economists at the FTC due to factors largely outside the Commission’s control.

The history shows that significant changes in the role of the Bureau of Economics (and the role of the Economic Policy Office at DOJ) can occur through a combination of changes in economic analysis, concerns in Congress about the agency’s competence and direction, and concerns about the role of public regulation. In short, populist movements have, in the past, changed the FTC’s structure, conduct, and performance. If the role of BE does change, and if history is any guide, the change will not yield a long-lasting effect on the FTC’s activities and analyses.

**Things that Matter**

The role economists will be asked to play in the current administration’s FTC depends largely on four things: (1) the agendas (if any) of the Chair, supporting Commissioners, and Bureau Directors; (2) the prevailing view regarding proper enforcement levels; (3) how BE is viewed within the agency; and (4) changes in the law. What BE may be asked to do, and some of the things it perhaps should do, are discussed below.

First, the agenda of the Chair, supporting Commissioners and Bureau Directors, if any, matters. Chairs in the past have cared more deeply about some aspects of the agency’s mission(s) than others or more about altering the type of analysis required in some areas than others. As examples, Chairman Lewis Engman instituted the modern competition advocacy program with his speech to the Financial Analysts Federation on the economic burden of inefficient transportation regulation in October 1974.⁷ Chairman James Miller expanded the role of competition advocacy in the early 1980s, and the number of filings increased from 11 in 1980 to 90 by 1988. Skepticism of federal regulations on the part of the incoming administration might encourage the FTC to be more active in commenting on federal agency regulations, old and new. Chairman Timothy Muris was interested in privacy issues,⁸ something apparently shared by former Commissioner Joshua Wright, who was an advisor to the new administration on competition policy.

For FTC management’s preferences to drive activity, FTC management must have significant discretion in how to allocate resources and set priorities. Not all federal agencies do. Professor Muris contends FTC management does have discretion because (a) the agency has no natural

---

⁶ Scanlon, *supra* note 4, at 20. As someone who joined the FTC’s Bureau of Economics (BE) in the early 1980s, I do not find the notion that it lacked economists with skills supportable. Economists associated with BE included J. Howard Beales, Jerry Butters, Jim Case, Pauline Ippolito, David Ravenscraft, Steven Salop, David Scheffman, Carl Shapiro, and David Tarr, among others. A number of FTC lawyers by 1981 also had degrees or advanced degrees in economics.

⁷ Legal authority for competition advocacy is found in Section 6 of the FTC Act. *See* James C. Cooper, Paul A. Pautler & Todd J. Zywicki, _Theory and Practice of Competition Advocacy at the FTC_, 72 _Antitrust L.J._ 1091, 1091 n.3 (2005) (citing 15 U.S.C. § 46(a), (f)).

interest group constituency that can capture it, unlike the old Interstate Commerce Commission and Civil Aeronautics Board, or the modern Federal Communications Commission, International Trade Commission, or Surface Transportation Board or the state regulatory bodies sometimes targeted by the FTC’s competition advocacy program, and (b) external observers cannot accurately measure either agency output or agency input.\(^9\) Wide discretion makes predicting what the FTC will do difficult without knowing who those directing it are.

While Professor Muris’s comments about input and output measurement may be correct, he is perhaps too sanguine about interest groups and the FTC. Perhaps the relevant interest groups are the antitrust bar and consultants whose livelihoods in some significant way are tied to FTC (and DOJ) activity or the lack of same.\(^10\) Without care, this combination may result in unnecessarily costly procedures. The FTC’s economists can certainly examine the incentives associated with agencies like the FTC, IRS, or courts with regard to the cost and efficacy of alternative processes.\(^11\)

Second, the prevailing view of proper antitrust and consumer protection enforcement, especially when there is a conflict between what an influential body of lawyers and economists believe policy should be compared to what the Commission has been doing, also matters. The Nader and ABA Reports critical of the FTC at the end of the 1960s provide a case in point, as does the subsequent criticism of a more active FTC by the end of the 1970s. Changes in how academia or Congress views antitrust and consumer protection affects the FTC, and with it the role of BE as a derived demand of a derived demand.

Third, how BE is viewed internally matters. BE might be viewed as an entirely independent channel of information and analysis to FTC management and then to the Commission. This approach—that BE is a co-equal and fully independent supplier of information was, from personal experience, one that was in place during the 1980s and early 1990s.\(^12\) Having two independent information channels helps keep Commissioners from being captive to a Staff-level information monopoly—Commissioners often only know what the Staff elects to tell them. Independence,

---


\(^10\) My observation is that suppliers of services where demand is based on government activity levels typically do not propose to reduce activity. Agencies where the procedure can be the punishment may be subject to “capture” by input suppliers. As a rule, one person’s “cost” is another’s “income.” For lawyers and consultants perhaps the worst news is that some behavior has been deemed legal per se. The next worst news is that it has been deemed illegal per se—at least one can argue for a case of mistaken identity as the respondent did not, in fact, do what it has been accused of. The best news of all is for a more or less unfettered rule of reason or “eye of the beholder” test. There are other federal agencies where capture by service suppliers whose demand depends upon agency rules, so the issue is not unique to the FTC.

\(^11\) Years ago, Martin Shubik introduced a fiendish game, his “Dollar Auction.” This ascending auction is relevant for litigation, arms races, innovation races, and other contests where everyone pays but only the high bidder wins. The optimal strategy for a Dollar Auction-like setting is not to pay if you are not the first mover. Once you are in a dollar auction with multiple players there is a least-worst strategy, but it entails losses for certain, just smaller losses than any other strategy. In the context of procedures for evaluating mergers or other practices, some care should be taken that using the latest techniques or as many techniques as possible results in better outcomes. Precisely which anti-competitive mergers would be blocked by the 2010 Merger Guidelines but not by the 1992 Guidelines? Alternatively, which pro-competitive mergers were blocked under the 1992 Guidelines but not under the 2010 Merger Guidelines? Given agency discretion, less than complete transparency, and the hindsight fallacy, this is perhaps unknowable. But it is the right question. The same question could be asked about the use of specific econometric tools—have outcomes been altered in a way that reduces error by their use or not?

\(^12\) At one meeting the author attended, then-Chair James Miller quipped that “[a]t the FTC, the lawyers work for the economists and not the other way around.” However, the perceived need for substantial economic input did not start with the first Reagan administration but began earlier with the *NADER REPORT*, supra note 3, and the *Report of the ABA Commission to Study the Federal Trade Commission* (1969), discussed below. Tension between some lawyers and some economists also did not begin in 1981. Some Commission lawyers were not overly fond of economists who had become part of the Commission during the Ford and Carter Administrations in response to criticism of the Commission.
however, can also lead to intra-agency bureaucratic antagonism when differences in viewpoints and analyses are subjected to relatively rigorous scrutiny. Alternatively, BE might be viewed as little more than a group of data analysts that help implement policy and case decisions made elsewhere. Where in the spectrum BE lies at any point in time has an impact on its role, its resources, its focus, and its size.

Fourth, changes in the law may change the role of economic analysis. One notable example is the Magnuson-Moss Warranty Act (1975). This Act, coupled with the decision in Sperry & Hutchinson Co., provided support for the Commission’s dramatically expanded rulemaking in the 1970s and early 1980s, and that rulemaking required economic input. Another example from the 1970s is the Hart-Scott-Rodino Antitrust Improvements Act (1976) that, over time, has replaced merger control through public litigation with control through regulation. More recent examples include the FCC’s decision to declare Internet Service Providers (ISPs) common carriers which, as a byproduct, removed FTC jurisdiction over ISP privacy and security issues, and changes brought about by both Gramm-Leach-Bliley and Dodd-Frank regarding the FTC’s role in financial market transactions. These external actions, as the examples indicate, can both expand and contract the FTC’s role.

Recently, former FTC Commissioner Wright indicated a preference for more economists at the FTC. It is assumed that, in addition to expanding headcount, Professor Wright proposes an increase in prominence of BE at the agency. It may be surprising to some that when the Federal Trade Commission was formed it had many more employees who were economists or analysts than it had lawyers. Table 1 sets out the size of BE within the FTC for selected years from 1918 through 2011. The last column lists the number of competition advocacy filings with significant input from BE. The periods were chosen to reflect the changes at the outset of the agency and then the changes that followed critiques of the agency in the late 1960s, the mid-to-late 1970s, and with the advent of new administrations in 1977, 1981, 1989, 1993, 2001, and 2009.

The second column reports full-time equivalent employment within BE for all personnel. The seventh column reports full-time economists within BE.

---

15 This table provides some imperfect quantitative measures of BE activity over time. Not all of the categories have data available for all years. The advent of the personal computer had an impact on staffing agency-wide between the late 1970s and the mid-1980s and accounts for some, but not all, of the apparent reduction in force.
<table>
<thead>
<tr>
<th>Year</th>
<th>BE Full Time Eq.</th>
<th>BE Bud. % Total FTC Budget</th>
<th>BE Reports/ Miscellaneous Reports</th>
<th>Total FTC Staff</th>
<th>BE FTE % Total Agency FTC</th>
<th>Econ FTE in BE</th>
<th>HSR Transactions</th>
<th>Advocacy with Significant BE Input</th>
</tr>
</thead>
<tbody>
<tr>
<td>1918</td>
<td>420</td>
<td>65.6</td>
<td>9</td>
<td>640</td>
<td>65.6</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1919</td>
<td>225</td>
<td>61.4</td>
<td>11</td>
<td>367</td>
<td>61.4</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1920</td>
<td>178</td>
<td>42.6</td>
<td>13</td>
<td>418</td>
<td>42.6</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1921</td>
<td>121</td>
<td>38.4</td>
<td>9</td>
<td>315</td>
<td>38.4</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1922</td>
<td>106</td>
<td>33.3</td>
<td>7</td>
<td>318</td>
<td>33.3</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>123</td>
<td>7.7</td>
<td>7</td>
<td>1150</td>
<td>10.7</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>123</td>
<td>7.9</td>
<td>6</td>
<td>1170</td>
<td>10.5</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>131</td>
<td>7.9</td>
<td>6</td>
<td>1244</td>
<td>10.5</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>131</td>
<td>7.0</td>
<td>3</td>
<td>1385</td>
<td>9.5</td>
<td>47</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>154</td>
<td>7.5</td>
<td>3</td>
<td>1390</td>
<td>11.1</td>
<td>53</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>173</td>
<td>6.8</td>
<td>1</td>
<td>1530</td>
<td>11.3</td>
<td>56</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>Na</td>
<td>Na</td>
<td>2</td>
<td>1668</td>
<td>Na</td>
<td>73</td>
<td>0</td>
<td>Na</td>
</tr>
<tr>
<td>1978</td>
<td>191</td>
<td>Na</td>
<td>4</td>
<td>1650</td>
<td>11.6</td>
<td>81</td>
<td>0</td>
<td>Na</td>
</tr>
<tr>
<td>1979</td>
<td>Na</td>
<td>8.8</td>
<td>0</td>
<td>1746</td>
<td>Na</td>
<td>78</td>
<td>861</td>
<td>Na</td>
</tr>
<tr>
<td>1981</td>
<td>204</td>
<td>9.7</td>
<td>3/10</td>
<td>1667</td>
<td>12.2</td>
<td>92</td>
<td>996</td>
<td>Na</td>
</tr>
<tr>
<td>1982</td>
<td>202</td>
<td>10.5</td>
<td>3/25</td>
<td>1491</td>
<td>13.5</td>
<td>98</td>
<td>1203</td>
<td>Na</td>
</tr>
<tr>
<td>1983</td>
<td>154</td>
<td>9.5</td>
<td>3/12</td>
<td>1310</td>
<td>11.8</td>
<td>89</td>
<td>1093</td>
<td>Na</td>
</tr>
<tr>
<td>1989</td>
<td>94</td>
<td>8.0</td>
<td>7/11</td>
<td>894</td>
<td>10.5</td>
<td>65</td>
<td>2883</td>
<td>25</td>
</tr>
<tr>
<td>1990</td>
<td>89</td>
<td>Na</td>
<td>3/5</td>
<td>903</td>
<td>9.9</td>
<td>79</td>
<td>2262</td>
<td>19</td>
</tr>
<tr>
<td>1991</td>
<td>98</td>
<td>Na</td>
<td>2/2</td>
<td>926</td>
<td>10.6</td>
<td>78</td>
<td>1529</td>
<td>13</td>
</tr>
<tr>
<td>1993</td>
<td>95</td>
<td>7.9</td>
<td>0/2</td>
<td>953</td>
<td>10.0</td>
<td>72</td>
<td>1846</td>
<td>4</td>
</tr>
<tr>
<td>1994</td>
<td>90</td>
<td>8.0</td>
<td>2/0</td>
<td>933</td>
<td>9.6</td>
<td>67</td>
<td>2305</td>
<td>7</td>
</tr>
<tr>
<td>1995</td>
<td>90</td>
<td>7.5</td>
<td>1/0</td>
<td>944</td>
<td>9.5</td>
<td>65</td>
<td>2816</td>
<td>7</td>
</tr>
<tr>
<td>2001</td>
<td>90</td>
<td>6.9</td>
<td>0/0</td>
<td>1007</td>
<td>8.9</td>
<td>69</td>
<td>2376</td>
<td>5</td>
</tr>
<tr>
<td>2002</td>
<td>101</td>
<td>7.5</td>
<td>1/0</td>
<td>1054</td>
<td>9.6</td>
<td>77</td>
<td>1187</td>
<td>13</td>
</tr>
<tr>
<td>2003</td>
<td>108</td>
<td>7.5</td>
<td>1/0</td>
<td>1051</td>
<td>10.3</td>
<td>77</td>
<td>1014</td>
<td>11</td>
</tr>
<tr>
<td>2009</td>
<td>103.5</td>
<td>6.4</td>
<td>1/0</td>
<td>1107</td>
<td>9.3</td>
<td>74</td>
<td>716</td>
<td>6</td>
</tr>
<tr>
<td>2010</td>
<td>108.3</td>
<td>6.6</td>
<td>2/0</td>
<td>1136</td>
<td>9.5</td>
<td>79</td>
<td>1166</td>
<td>11</td>
</tr>
<tr>
<td>2011</td>
<td>110.8</td>
<td>6.5</td>
<td>0/0</td>
<td>1160</td>
<td>9.6</td>
<td>80</td>
<td>1450</td>
<td>8</td>
</tr>
</tbody>
</table>

Historically, BE has accounted for no more than 11 percent of the FTC’s staff and typically no more than 10 percent of its budget (and usually less). More recently, the share of BE staff to total staff and the share of BE budget to total budget has declined somewhat. As such, an increase in economic staff at the agency in line with Professor Wright’s stated goals would arrest two pre-existing trends. While inertia may be a hindrance, budgetary limitations should not be. BE’s size could be increased by 50 percent without adding to the FTC’s overall budget by shifting less than 5.6 percent of the non-BE budget toward BE.

But the FTC spends money not only on economists inside BE but also on third-party contractors, some of whom also serve as experts or consultants to parties that also have matters before the Commission. In Fiscal Year 2016, the FTC apparently spent over $13 million on economic consulting firms.\(^\text{16}\) By comparison, in Fiscal Year 2008, apparently economic consulting fees paid by the FTC were more than $4 million.\(^\text{17}\)

This is an evolution since the 1970s and 1980s, when the Commission tended to use in-house economists as testifying experts.\(^\text{18}\) The use of economists to provide analyses to the Commission now arises in four ways:

- The Bureau of Economics provides an internal economic analysis.
- Respondents may retain economists to provide their own, alternative analysis.
- Complainants may and do retain economists to provide yet another economic analysis of non-merger conduct or the likely consequences of proposed transactions.
- The Commission may retain outside economic, financial, or other consultants or experts either to provide an analysis or to review analyses done internally by the staff.

The growth in spending on outside economists and other experts perhaps signals (1) an intention to pursue more matters possibly through litigation (or that the cost per matter is increasing) or (2) in the case of consultants, that the Commission intends to engage in more rulemaking or conferences of the type former Chairman Robert Pitofsky employed in the 1990s.\(^\text{19}\)

Institutionally, the role BE has played has varied. During the late 1970s and 1980s BE’s role as a supplier of information and analysis about cases was as an independent, co-equal partner to BC on the antitrust side. Commissioners can benefit from having two independent sources of information if they choose to avail themselves of the opportunity to be less dependent upon what staff elects to tell them, or not tell them. A variety of proposals have been suggested to enshrine


\(^\text{17}\) See Federal Trade Commission: All Prime Recipients—FY2008, USA SPENDING.GOV, https://www.usaspending.gov/Pages/TextView.aspx?data=AgencyMostFundedRecipientsByAwardType&AwardType=C&agencycode=2900&fiscalyear=2008 (last visited Feb. 20, 2017). Many of the awards are to individuals as experts, or the contract data lists only “domestic contractor undisclosed” or “classified domestic contractor,” making assigning funds to consulting firms impossible. Some of the awards for expert or consulting services were made to attorneys, while others went to individuals with medical degrees. Other consultant spending was apparently related to human resources issues and to other activities not directly related to the FTC’s antitrust or consumer protection missions.

\(^\text{18}\) The author served in that role on a number of matters, including Shell/Montedison and Ciba-Geigy/Sandoz (Novartis) in the 1980s and 1990s.

\(^\text{19}\) This may occur if consultants/experts retained by the Commission insist on using more of their own staffs to prepare analyses for Commission review or for trial and fewer BE economists working under the consultant/expert’s direction.
BE’s independence over time, but as a practical matter BE’s role depends upon what the Chair, Commissioners aligned with the Chair, and the Bureau Directors want.20

Because of the Commission’s internal structure, BE as an independent Bureau can and has provided an alternative to BC and BCP as a source of analysis and information to the Commission.21 Commissioners may benefit from multiple sources of information and analysis within the FTC. At the same time, multiple sources of information can result in internal tensions that must be effectively managed. BE, BC, and BCP staff need to work together on cases, and collaboration can be tested when staff members disagree. A full and free information flow to and through BE is quite important, as is a culture that recognizes that good-faith professional disagreements can arise that require Commission resolution and that these disagreements can actually be productive. How BE is used—as a fully independent alternative source of relevant analysis or simply as an adjunct providing technical support on cases framed and brought by the Commission’s attorney-staffs in BC and BCP—matters.

Matters pursued by the Commission depend not only on Commission focus but on the pool of antitrust, advocacy, or consumer protection (including privacy) matters that arise. For example, an increase in HSR Second Requests as a fraction of filed deals can indicate either a heightened level of scrutiny by a Commission that is more skeptical of acquisitions, an uptick in the number of problematic mergers given the level of scrutiny, or both. Fewer Second Requests can reflect a perception among dealmakers that the agencies are less hospitable to mergers, so fewer deals are proposed. Quantitative counts record only paper output that does not reflect the quality of the actions taken.

Until we know whom the President appoints to the Commission and whom the Chair appoints as Bureau Directors and what their interests, concerns, or agendas are, it is difficult to predict how the role of BE will change, assuming it changes at all. Unanticipated changes in substantive antitrust or consumer-protection related law or administrative law could also change the role of economists.22

20 While the FTC’s Chair has significant authority, decisions at the Commission require a majority of the sitting Commissioners, and meetings require a quorum of the sitting Commissioners. Hence, Chairs need the support of two other Commissioners—often of the same political party—whose views are aligned with the Chair all or most of the time.

21 In the 1980s there was a sense, rightly or wrongly, that BE attorneys occasionally “hid the ball.” In an attempt to prevent that and to ensure that BE’s information requests were satisfied, the Commission adopted a policy that allowed BE members “to conduct” investigational hearings. The purpose was to allow BE members to ask, or have asked, questions they believed were important and also to allow economists to pursue economics-related lines of questioning. After leadership changed, some attorneys insisted that “to conduct” meant only that a BE staffer could be the hearing officer, not that BE could actually ask questions. Another proposal from the 1980s would allow more transparency by permitting BE to issue its own evaluation of, e.g., settlements or decisions to close investigations.

22 In 2015, Senators Lee, Grassley, and Hatch introduced the SMARTER Act (Standard Merger and Acquisition Reviews Through Equal Rules Act) that would bring the standard for pursuing an injunction in merger cases at the FTC into conformity with the DOJ standard, eliminating any doubt that they differ. S. 2102, 114th Cong. (2015). Rep. Farenthold introduced companion legislation in the House. H.R. 2745, 114th Cong. (2015). The Act would also remove the Commission’s ability to take mergers where it fails to obtain a preliminary injunction into administrative litigation, giving the FTC a second bite at the apple. The DOJ must engage in a real trial on the merits in seeking a preliminary injunction (PI). The FTC has claimed a lower-standard applies to its PI actions, one closer to showing that it has procedurally indicted the respondents properly. In the FTC’s view, the merits issues are the province of the Commission in administrative litigation. Not all federal judges agree with this position, though the appellate court decision in Whole Foods comes close to doing so. FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1 (D.D.C. Cir. 2007), amended by 548 F.3d 1028 (D.C. Cir. 2008); see also FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26 (D.C. 2009). Presumably, procedure matters, and may impact substantive rights. Holding mergers together through the FTC’s “expedited 18 month” administrative process is highly unlikely. Very few merging parties have elected to go through the process but, as in R.R. Donnelley and B.A.T./Appleton, they have frequently been acquitted.
Roles BE Can Play

There are three primary areas where BE can play a role: antitrust, including mergers and anti-competitive practices that may fall afoul of the Sherman or Clayton Acts or Section 5; consumer protection issues, including fraud, deception, and more recently privacy concerns; and regulation issues, mainly aimed at state or local regulation similar to the Competition Advocacy Program, which dates back to 1974.23

Within these primary areas, there are four areas where BE could play an expanded role: privacy, Internet cases, efficiencies, and competition and cost-benefit advocacy related to federal and state regulations.

Privacy. Professor Wright has expressed interest in expanding the economic role in the FTC’s privacy arena.24 Economists have written about privacy issues, including the costs and benefits of different rules, since at least the late 1970s.25 Privacy is not secrecy, and privacy issues of significance arise as a by-product of transactions of all kinds, coupled with cost-effective technology for recording the by-product information and analyzing it in near real-time. Transaction-related information can allow better matches between transacting parties and also may reveal information that can be used to harm one or both parties.26 Recently, Hal Varian has predicted that by 2025, “[e]Everyone will expect to be tracked and monitored, since the advantages, in terms of convenience, safety, and services, will be so great. There will, of course, be restrictions on how such information can be used, but continuous monitoring will be the norm.”27 Such a prediction should encourage substantial sound analysis, including more economic analysis.

Internet Investigations. The FTC’s checkered 22-month investigation of Google, the DOJ’s litigation with Apple, the Japanese antitrust raid on Amazon’s business28 claiming that Amazon’s product ratings lead consumers to overpay, and the recently proposed AT&T/Time Warner merger suggest that more activity regarding these two-sided platforms (or “gatekeepers”) is plausible,
and the complexity will require economic conceptual and empirical analysis. These economic analyses would include evaluations of the conduct as well as the business models of companies like Google, Facebook, and Amazon.

Firms like Google, Apple, Amazon, Facebook, Yahoo, and others have raised competition and consumer protection issues, including privacy, likely providing work for FTC economists going forward. This area is interesting as people of various political persuasions think there is something not right with competition in an arena that includes Apple, Amazon, Google, and other (two-sided) platform providers. In June 2016, Senator Elizabeth Warren singled out these three firms in a speech contending that the three firms abuse their market power and affirmatively block competitive entry. Earlier in 2016, Senator Orrin Hatch questioned why the FTC closed its investigation into Google when a leaked internal memorandum indicated the Staff had recommended litigation.

One interface between privacy and antitrust is related to property rights in the data created by interactions between consumers and platforms. One proposed solution to privacy and antitrust issues linked to big data is to assign to the consumer control over the use and transfer of data created through consumer interactions. That is, if a Google user shifted to Bing, the user could require Google to transfer all of the data tied to the consumer, as well. At the other end of the spectrum, as with Dwight’s EnergyData, agencies have required firms that have large, difficult-to-replicate databases either to sell off the acquired firm’s database or to clone a copy for sale to another vendor. This is not the same as the individual data transfer because the datasets in the Dwight’s

---

29 These economic analyses would include evaluations of the conduct as well as the business models of companies like Google, Facebook, and Amazon.


31 The investigating Staff may recommend suing, but their supervisors, also technically staff, may be opposed. The FTC can then claim “the Staff” recommended either suing or not suing, depending on the preferred result. In one matter on which I worked we knew that the line Staff recommended litigation but the managements of both bureaus and the general counsel’s office were opposed. The Chair told us, however, that “the Staff” unanimously recommended litigation.

32 Examples include telecommunications networks including cable, the Internet and satellite broadcasting (where content can be competitively supplied), railroad track networks (cars can be supplied competitively so long as car owners have rights to use the track network), and electricity transmission (where generation may be competitively supplied provided it has appropriate access to transmission accounting for loop-flow and thermal constraints), among others.

33 Press Release, Fed. Trade Comm’n, Dwight’s Energy/Data to Grant Perpetual License to Production and Well History Data (Dec. 5, 1996), https://www.ftc.gov/news-events/press-releases/1996/12/dwights-energydata-grant-perpetual-license-production-and-well. This merger involved two firms with large, historic databases on onshore and offshore oil and gas wells in the United States that were deemed economically infeasible to replicate and that were deemed essential in order to compete to supply data to oil and gas exploration and production companies.

34 This is the problem Coase analyzed long ago. R.H. Coase, *The Problem of Social Cost*, J.L. & Econ. 1 (1960). Absent transaction costs, the assignment of property rights does not alter the outcome. As Coase recognized, because he viewed transaction costs as endemic, the real work involves efficient rights assignments when transaction costs matter.
case belonged without much doubt to the merging firms. In the Google example, co-extensive
rights are assigned to a dataset created by an interaction between Firm G and Individual A, allowing A to endow G’s rival B with data that B did not help create.35

Data acquisition was the key driver in a number of recent significant transactions, so the area is an active one, which may explain the interest shown by members of Congress. Google, Apple, Microsoft, and Facebook have been active acquirers over the past 10 to 15 years. Google, for example, appears to have been involved in more than 200 acquisitions between 2001 and January 2017, or significantly more than the 140 acquisitions by Microsoft over the same period. Facebook apparently made more than 60 acquisitions between 2005 and the end of 2016. Fourteen large acquisitions by these three firms motivated by big data issues were worth more than $70 billion, including Facebook/Whatsapp; Microsoft/Linkedin; and Google/nest. Other data acquirers include IMS Health and Walter Kluwers in the health care data arena.

On the privacy side, big data is expensive to create (or replicate). Firms may use sophisticated sensor systems or offer free or low-cost products (e.g., smart phones, smart TVs, smart watches, or smart cars) or services (e.g., Google) to capture consumer information for later use, including resale. An issue is how to protect consumers who do not want their transaction-created personal information used or used without their consent while at the same time allowing firms to offer possibly valuable products that rely on large-scale representative data analysis.36 As the above discussion makes clear, the issues surrounding big data are complex and give economists inside and outside the FTC topics to explore in order to shape sensible public policy.

Efficiencies. The time has long since passed when the FTC viewed efficiencies as an aggravating circumstance in evaluating mergers and the lack of efficiencies as a mitigating one.37 While the Commission claims efficiencies are important, the review through which the agency puts effi-

35 A rationale for this assignment is the result of how computer search algorithms (and other algorithms) improve with more data observa-
tions. Such “machine-learning” ostensibly permits the creation of a better product or customer experience, and it may require access to a substantial amount of transaction or other data about both specific individuals and groups of individuals. Thus B would benefit from the generated data and would be willing to purchase it from G with authorization from A. The data required may include a significant tim e series of observations, and this time series, as in Dwight’s, may be difficult or impossible to recreate without the help of incumbents (like G, for example).

36 The FTC has suggested, as it did in comments to the FCC, dividing the kind of information into categories of products consumers appear to care very much about and those where they are less concerned—requiring an affirmative opt-in by consumers in the first case while requiring only an opt-out in the second, for example. Comment of the Staff of the Bureau of Consumer Protection of the Federal Trade Commission, In the Matter of Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, WC Docket No. 16-106, FCC 16-39 (May 27, 2016), https://www.ftc.gov/system/files/documents/advocacy_documents/comment-staff-bureau-consumer-protection-federal-trade-commission-federal-communications-commission/160527fcccomment.pdf.

37 Wesley J. Liebeler, Bureau of Competition: Antitrust Enforcement Activities, in THE FEDERAL TRADE COMMISSION SINCE 1970: ECONOMIC REGULATION AND BUREAUCRATIC BEHAVIOR 65–73 (Kenneth W. Clarkson & Timothy J. Muris eds., 1981) (finding that, between 1970 and 1977, either Administrative Law Judges or the full Commission argued that merger-created efficiencies should count against legality or that the absence of efficiencies should count in favor in 8 of 18 cases and none considered that efficiencies should count in favor of a merger).

For those who may have forgotten, Chicago-school adherents (Richard Posner, Robert Bork) initially opposed including efficiencies as a defense, while Harvard-school adherents (Donald Turner, Oliver Williamson) supported including them.
ciency claims tends to prevent efficiencies from moving the needle.\textsuperscript{38} Perhaps because of a perception that efficiencies ultimately do not matter much, parties may make the mistake of failing to do a credible job presenting them. Of 186 mergers evaluated by the Commission between 1997 and 2007, 71 BC memoranda and 68 BE memoranda did not include any discussion of efficiencies, presumably because the parties did not advance any.\textsuperscript{39}

The role of efficiencies in antitrust depends upon what the term “anticompetitive” means.\textsuperscript{40} According to the FTC’s website discussing “anticompetitive practices,” the agency “takes action to stop and prevent unfair business practices that are likely to reduce competition and \textit{lead to higher prices, reduced quality or levels of service, or less innovation}.”\textsuperscript{41} This is an outcome test for what is “anticompetitive.” It is in the spirit of Oliver Williamson’s 1968 paper on how to fully assess the consequences of a merger or business practice.\textsuperscript{42}

A different approach to what is anticompetitive or monopolistic turns on input—acquiring a rival is “anticompetitive” because a competitor disappears. Similarly, a merger that creates firm-specific efficiencies may be viewed skeptically because it will allow the firm to grow market share at the expense of non-copying rivals, pushing them from the market. Wesley Liebeler examined FTC merger cases between 1970 and 1977 and found that, in 8 of 18 cases, the Commission held efficiency claims to be aggravating, rather than mitigating, conditions on the apparent theory that a resource transfer that reduced the use of scarce resources would prejudice the ability of now relatively less efficient rivals to keep customers.

Recently, two circuit courts have made statements regarding efficiencies in merger cases that are problematic. In \textit{St. Luke’s}, the Ninth Circuit did more than find that the parties’ proffered efficiencies were insufficient to offset the alleged increase in market power purported to flow from the

\textsuperscript{38} Scrutiny of efficiency claims may benefit shareholders. Ideally, an asset transaction moves the asset from current ownership to owners who will use it more productively, raising shareholder value. This may happen when a deal is anticompetitive—output falls and price rises without any static or dynamic efficiencies arising that are contingent on the acquisition. But it also happens when real efficiencies lead to better products (demand enhancement) or real cost-savings of all kinds. However, shareholders and management are involved in an agency-problem that may result in so-called empire building, etc. A significant body of work exists on (a) whether mergers generally or of specific types have been wealth-creating and (b) how gains are shared between buyers and sellers, with typically the bulk of the gains going to the seller (which suggests that the gains are not specific to the particular buyer-seller pair). Knowing that efficiency claims in significant deals will be scrutinized may help favorably resolve an underlying agency problem for shareholders of the buying firm. When a significant merger occurs and the efficiency claims are poorly documented as part of the deal rationale, they are unlikely to be given weight. Finally, the Guidelines limit the arena where efficiencies can move the needle to cases where evidence for anticompetitive harm is itself weak: “In the Agencies’ experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great.” U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines 31 (2010) [hereinafter Guidelines], https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hrmg.pdf.


\textsuperscript{40} The other term is “attempt to monopolize” as related to the Sherman Act, 15 U.S.C. § 2. To have monopoly power means having “significant and durable market power”—“the long term ability to raise price or exclude competitors.” Fed. Trade Comm’n, Monopolization Defined, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/monopolization-defined (last visited Feb. 23, 2017) (emphasis added). This understanding of monopoly is also outcome based—can the firm raise price in a market or not?


\textsuperscript{42} Oliver E. Williamson, \textit{Economies as an Antitrust Defense: The Welfare Tradeoffs}, 58 AM. ECON. REV. 18 (1968); see also Oliver E. Williamson, \textit{Economies as an Antitrust Defense Revisited}, 125 U. PA. L. REV. 699 (1977). In the latter article Williamson wrote: “Even to recognize the possibility that economies might be regarded as a defense to an otherwise unlawful merger suggests that enforcement of section 7 of the Clayton Act may be amenable to rational design. This was not always so.” \textit{Id.} at 734.
transaction, further stating that “[w]e remain skeptical about the efficiencies defense in general and about its scope in particular.” The court justified its skeptical view by noting that the Supreme Court has never accepted an efficiencies defense and that no court has ever held that claimed efficiencies were sufficient to undercut a prima facie case of anticompetitive effects. The Third Circuit in FTC v. Penn State Hershey Medical Center wrote that “we are skeptical that such an efficiencies defense even exists.” Perhaps there is work that can be done here by economists at the FTC to address the apparent asymmetry in the way competitive effects and efficiencies are apparently treated during antitrust reviews.

A skeptic might see this as a movement since 1970 from a stance that efficiencies are bad—so no firm should do an efficiency analysis much less present one prior to FTC review—to the modern position that efficiencies may not add to merging parties’ guilt but they do not help in court either; efficiencies are just a “defense.”

Perhaps too much is read into these statements, but they suggest that courts do not yet understand that efficiencies are not a defense but are conceptually on the same footing as the claimed anticompetitive effect. In order to determine whether a transaction will adversely impact consumers under a simple consumer-welfare standard or will reduce social welfare under a standard that treats gains and losses by all members of society, consumers and producers, more symmetrically, both the probability of enhanced market power and the probability of cost reductions and quality improvements must be taken into account.

That said, in the treatment of efficiencies, three areas are contentious and have been so since the first set of revised Guidelines was released in the early 1980s.

First, how should fixed costs be treated? Economists have known since the late 1960s that fixed costs in general affect pricing. It is only in the Econ 101 world of perfect certainty and risk-neutral...
eral executives where fixed costs do not matter, and that is not the world that is relevant. Gregory Werden and Luke Froeb have taken a different approach by reframing the “unit” as a widget contract rather than an individual widget and arguing that there are often contract-specific periodic fixed costs that a merger might reduce. This is still within the framework that only variable (incremental) costs matter for pricing with a redefinition of the unit at issue. The problem is deeper. Uncertainty and non-linear preferences result in fixed cost reductions leading to lower prices. How non-incremental efficiencies are shared may also depend upon whether customers are individuals—often assumed to be passive walking demand curves—or more sophisticated enterprises that negotiate over the available gains from trade. In some industries, sophisticated or larger buyers are very good at extracting, through lower prices and possibly in line with Werden and Froeb, what appear to be fixed-cost savings.

Second, at least some personnel at the FTC discount efficiencies that arise outside of the “market(s)” where competitive concerns have been identified. This may or may not be sensible. Starting from the position of Pareto-improving changes, an anticompetitive effect in Market A may be offset by efficiencies in Market B if all or most of the consumers in A also buy B, as may be the case in large consumer-product mergers where only a subset of the merging parties’ product offerings raise competitive concern. Requiring the sale of Line A makes sense only if (1) the role of the agency is to engineer a more “competitive” asset reallocation than the status quo, (2) selling A has no impact on efficiencies realized in B, and (3) the acquirer of A will be no less efficient than the current owners.

There is a subsidiary problem from blocking a merger where there is an anticompetitive impact in Market A but efficiencies in Market B and a credible sale of A is not plausible. The Pareto Principle provides no guidance. The merger in this case will harm consumers of A but benefit consumers of B. Blocking the merger harms consumers of B to benefit consumers of A. Allowing or disallowing the merger harms someone. The theory then is that the status quo should be preserved perhaps because (a) the future efficiencies (and competitive harm) are speculative or (b) because B buyers will never know what they have missed by way of lower prices or better products, while A consumers will see a higher price.

49 Coate & Heimert, supra note 39, at 13–19, report that in the bulk of cases where fixed cost savings were reported, BC Staff failed to make any determination about them in the majority of cases. Fixed cost savings were rejected when there was a decision in 51 out of 63 cases, or about 81 percent of the time. BE rejected them, when evaluated, 20 out of 48 times, or about 42 percent of the time. Id. at 19–25. The reason why efficiencies were rejected or accepted is not given, nor is any explanation given as to whether any fixed cost savings that were accepted were deemed to affect pricing and, so, would be passed through to consumers.


51 See John J. McCall, Probabilistic Microeconomics, 2 BELL J. ECON. & MGMT. SCI. 403 (1971), and sources cited therein.

52 The relevant language from the 2010 Guidelines provides:

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger’s potential to harm customers in the relevant market, e.g., by preventing price increases in that market.

Guidelines, supra note 38, at 30–31 (emphases added) (footnote omitted).

53 Having worked at the FTC for 16 years, I have seen FTC-approved remedies that resulted in output falling to zero post-divestiture. Not all remedies work, and some, as in the case of output going to zero, are less competitive than the merger as initially proposed. A better solution in these cases may have been either to approve the merger or to block it entirely without getting involved in “fixing” perceived problems. Presumably errors of this sort that may be evident only in hindsight are not common. But neither are they unicorns.
Third, as noted, Shelanski and Katz\textsuperscript{54} formalized an analysis that had been informally discussed at the FTC during the 1980s. The issue is how to assign probabilities to both the predicted anticompetitive effect and to the predicted efficiencies, both of which are subject to some uncertainty. Typically, and conservative of the status quo, the agency often acts as if the anticompetitive harm is certain or very highly probable but the efficiencies are speculative or much less certain in deciding the fate of a deal. Whether that is correct is case-specific, but the agency might benefit from requiring some more formal probabilistic assessments of the likelihood of harm and benefit, if only to determine how robust an anticompetitive determination actually is.

\textbf{Advocacy.} The Commission has commented in the past on regulations. During the 1960s and 1970s scholars became skeptical that government regulatory agencies fostered competition.\textsuperscript{55} Largely as a result of economic analysis, a number of industries were deregulated. In the 1980s, more economic analysis resulted in a market-based regulation of natural gas pipelines by FERC.  

Given the current incoming administration’s expressed opposition to federal agency regulations, it is not implausible that the FTC’s Advocacy Program could be involved in evaluating the competitive effect of existing or proposed rules at a number of agencies, and that would involve BE input.\textsuperscript{56}

FTC competition advocacy filings peaked at 92 in 1987. Through the end of 2016 there were 23 filings. Table 2 reports quantitative data on advocacy filings since 1996. The recent level of activity has been much less than during the mid-to-late 1980s, reflecting the limited scope of activity of which the FTC, including BE, has been capable.

\begin{table}[h]
\centering
\begin{tabular}{cccccccccc}
\hline
\hline
1995 & 13 & 19 & 18 & 22 & 17 & 35 & 66 & 43 & 92 & 74 \\
1985 & & & & & & & & & & 15 \\
\hline
\end{tabular}
\caption{Advocacy Filings Since 1996}
\end{table}


\textsuperscript{54} Shelanski & Katz, \textit{supra} note 48.

\textsuperscript{55} James Miller III, Stephen Breyer, Richard Levine, George Douglas, and Alfred Kahn, among others, together pushed for deregulation of transportation, especially the airlines. Senator Philip Hart and Harold Demsetz both agreed on changes in SEC regulations to make the marketplace more competitive. See the testimony of Harold Demsetz on Sen. Bill 1167 in 1974 and Senator Hart’s praise for Demsetz’s position on the SEC’s regulations even though Demsetz testified against Hart’s Industrial Reorganization Act. \textit{The Industrial Reorganization Act: Hearing on S. 1167 Before the Subcomm. on Antitrust & Monopoly of the S. Comm. on the Judiciary, 93d Cong. 2271} (1974) (statement of Harold Demsetz, Professor, University of California).

\textsuperscript{56} Former Commissioner Wright touched on the role of BE in cost-benefit analysis related to privacy regulation or litigation at the FTC. This can be expanded to a review of other regulations through the Advocacy Program as well.
Newly appointed Acting Chair of the FTC Maureen Ohlhausen provides a recent review of the Commission’s efforts to rein in state-action immunity.\(^\text{57}\) Again, the policy focus of a new Commission and new Bureau Directors will determine whether and how economist resources are asked to analyze the area broadly or support specific cases.

**Conclusion**

Periodically, the FTC is given an opportunity—or required to take an opportunity—to change the way it allocates resources internally, including BE resources. Sometimes this affects merger analysis, as occurred in the 1960s and early 1970s before the pendulum swung back in the late 1970s and 1980s. Recently, some commentators have alleged lax merger enforcement once again.\(^\text{58}\) On other occasions changes to resource allocation has affected the FTC’s consumer protection and rulemaking functions. Given the Commission’s discretion, knowing what the FTC will do going forward requires knowing something more about new Commissioners the new administration will appoint.\(^\text{59}\) Given the new administration’s apparent interest in regulatory burden and the FTC’s competition advocacy history, the Commission and BE could find more activity in this area as well.

---

\(^{57}\) Maureen K. Ohlhausen, Reflections on the Supreme Court’s North Carolina Dental Decision and the FTC’s Campaign to Rein in State Action Immunity, Remarks Before the Heritage Foundation (Mar. 31, 2015), [https://www.ftc.gov/system/files/documents/public_statements/634091/150403heritagedental.pdf](https://www.ftc.gov/system/files/documents/public_statements/634091/150403heritagedental.pdf). A related area is the abusive use of antitrust litigation—sham litigation—to obtain anticompetitive outcomes and whether it is or is not protected under Noerr-Pennington and its progeny. Christopher C. Klein, The Economics of Sham Litigation: Theory, Cases, and Policy, FTC Bureau of Economics Staff Report (1989), [https://www.ftc.gov/sites/default/files/documents/reports/economics-sham-litigation-theory-cases-and-policy/232158_0.pdf](https://www.ftc.gov/sites/default/files/documents/reports/economics-sham-litigation-theory-cases-and-policy/232158_0.pdf). This is another arena where governmental rules may shield anticompetitive conduct. The FTC’s focus on so-called reverse patent settlements in the pharmaceutical industry can be linked to concerns that litigation and litigation settlements can be anticompetitive and that courts have been used to shield them from proper scrutiny. Economists can and have played a role in analyzing the various aspects of government rules that shield, or encourage, anticompetitive conduct.


\(^{59}\) At the time of this writing, the FTC has only two Commissioners, meaning the new administration can immediately appoint a new Chair as well as a majority of the Commission. This is a unique situation.
Book Review

Putting Privacy into Context

Chris Hoofnagle
Federal Trade Commission Privacy Law and Policy
Cambridge University Press 2016

Reviewed by Aaron Burstein

The title of Chris Hoofnagle's *Federal Trade Commission Privacy Law and Policy* radically understates its scope. The book comprehensively explores the FTC’s privacy program, but its singular contribution to the burgeoning literature on the FTC and privacy lies in how it connects the FTC’s privacy program to the agency’s history and broader role in consumer enforcement.

Hoofnagle has been in and around privacy debates for nearly two decades—about as long as the FTC’s privacy enforcement record under Section 5 of the FTC Act—beginning as a staff attorney at the Electronic Privacy Information Center. Hoofnagle is now an adjunct professor at the University of California, Berkeley School of Information and School of Law. His record of scholarship includes empirical studies of identity theft, technical studies of tracking mechanisms on websites, and commentary on economic analyses of privacy. With Professor Daniel Solove, Hoofnagle started the Privacy Law Scholars Conference, the premier venue in the United States for discussing privacy works-in-progress. Hoofnagle is also of counsel to Gunderson Dettmer, LLP, where he counsels companies on consumer privacy issues.

In *FTC Privacy Law and Policy* Hoofnagle approaches his subject with a pronounced point of view. He clearly admires the FTC and comes close to lionizing the agency and its staff. He advocates greater use of economics by the FTC, but he criticizes rational choice theory because it takes an unrealistic view of consumer decision making. Hoofnagle is skeptical of many of the business community’s arguments against privacy regulation as well as arguments in favor of “innovation” in the abstract. In his assessment the FTC is doing its job well but should go further.

Perhaps having one foot in practice and another in academia helped Hoofnagle identify the value to scholars and practitioners of a history of FTC privacy. Hoofnagle devotes nearly 40 percent of the substantive portion of his book—all of Part I—to FTC history, structure, and organization. The result is a richly detailed, thoroughly researched institutional study that begins with the debates over the FTC’s creation and follows the ensuing decades of debate over the appropriate

---

1. See Chris Hoofnagle, *Federal Trade Commission Privacy Law and Policy* 146 (2016) (hereinafter Hoofnagle, FTC Privacy Law and Policy) (stating that rational choice theory involves the “assumptions that individuals are the most important decision makers, and that they are informed and empowered to take good decisions to protect privacy”).

2. Id. (stating that “growing psychological and economic research undermines the assertions of rational choice theory”).

3. Id. at 118 (“The FTC could create a privacy rule, but a strong consensus holds that it would be too difficult and it would take too long to do so. Thus, FTC lawyers have pursued a policy-making enforcement agenda. For the foreseeable future, FTC privacy will be a series of complaints and settlement agreements that lawyers must decode when counseling clients.”).
role of government in protecting consumers. Those debates have never really been settled, so much as positions have risen and fallen with political tides. The 2016 election has certainly made fundamental questions of regulatory philosophy salient, but they were part of the day-to-day dynamic within the agency and among FTC practitioners long before then.

Devoting the time and attention to the details of Part I offers three major rewards for practitioners. First, Hoofnagle masterfully distills and concentrates the major steps in the development of the FTC’s consumer protection authority. Hoofnagle draws these details from an impressively diverse and scattered set of primary sources, including FTC reports, legislative materials, and decades of secondary materials. This is a serious work of historical scholarship. A practitioner can find accounts, for example, of how the FTC ended up with its Magnuson-Moss rulemaking authority, or of the events that led to the Unfairness Policy Statement.

A second reason that practitioners should pay attention to the history in Part I is that past events have left a deep mark on the FTC’s culture. Learning about, or re-familiarizing oneself with, reports on the FTC by Ralph Nader and the ABA in the late 1960s, and the “KidVid” controversy of the 1970s, will help shed light on the FTC leadership’s celebration of its incremental, case-by-case approach. An understanding of the FTC’s past should help inform views of how it relates to other agencies—particularly the Federal Communications Commission—that are active on privacy issues.

Finally, the historical portion of Hoofnagle’s book is simply a delight to read. Hoofnagle moves briskly through the legal, legislative, and administrative forces that shaped the FTC over the past century. Seeing this history laid out in a concise and linear fashion is impressive and tells a coherent story. Woven into this history are episodes involving some of the more colorful characters—both defendants and Commissioners—from the past. Readers of this book might feel they are walking among old friends the next time they visit FTC headquarters, where portraits of all but the most recently serving Commissioners adorn the first floor corridors. “Page turner” isn’t a label that fits many histories of federal agencies, but FTC Privacy Law and Policy has earned it.

Moving past the FTC’s founding and early history, Hoofnagle next provides an overview of the agency’s internal organization and procedures and a review of the legal machinery—the doctrines of unfairness and deception—that it uses in most of its privacy (and data security) cases. Hoofnagle argues that Congress deliberately chose these general terms “because business practices and technology were constantly evolving, causing new problems that Congress could not quickly act to remedy.”4 Hoofnagle defends the FTC against the charge of being “rudderless” or “not strategic” in its Section 5 case selection, noting that the FTC’s “100 years of cases,” the Policy Statement on Unfairness, and the Policy Statement on Deception, provide sufficient guidance for companies and their lawyers.5 This account not only discusses the political and legal forces that led to the two Policy Statements but also seeks to connect the decades of development in advertising and fraud cases to the younger field of privacy. Specifically, Hoofnagle predicts that the substantiation doctrine—the FTC’s standards for determining whether companies have a “reasonable basis” for factual claims they make in advertisements—will play an increasingly important role as companies offer products and services for which they claim privacy- or security-enhancing benefits.

4 Id. at 120.

5 Id. at 121.
Having laid the foundations of FTC privacy enforcement and policy in Part I, Hoofnagle turns in Part II to an examination of different branches of the agency’s privacy record. His chapter on online privacy covers the most territory. Drawing on the history established in Part I, Hoofnagle notes that “the privacy cases flow from the Agency’s decades-long experience and precedent in enforcing false advertising cases,” building not only on the law of deception but also looking to self-regulatory standards that can be “tweaked into broader protections.”6 It took a confluence of events to get these cases flowing: the rise of the commercial Internet, the widespread resistance to adopting privacy policies to avoid making representations that could be the basis of a deception action, advocacy campaigns that aimed to spur the FTC to act, and the need to develop a U.S. response to the European Union’s Data Protection Directive.7 With a 20-year record of cases to examine, Hoofnagle provides an assessment that weaves together theoretical perspectives and statements of black-letter law. Readers seeking in-depth treatment of either theory or hornbook law will be disappointed, but that is not Hoofnagle’s project. Instead, Hoofnagle wants to illustrate the various forces that have pushed and pulled the FTC’s privacy program over the years, from changes in control of the agency, to technological and business developments that challenge the effectiveness of privacy policies in informing consumers about companies’ personal data practices, to alternative frameworks for regulation and privacy governance within companies (e.g., privacy by design).

Hoofnagle also addresses information security, a topic that complements privacy and is a high consumer protection priority for the FTC. This discussion appropriately emphasizes the importance of the FTC’s unfairness authority—under which the FTC has developed its “reasonable security” standard—to its data security program. Again, Hoofnagle ably explains how this doctrine developed, pulling some of the major lessons from past cases. Payment card breaches were a significant focus of early data security cases, but the FTC has not brought a case involving an actual payment card data breach for several years. The FTC’s attention has shifted to breaches of other kinds of sensitive data and to the discovery of vulnerabilities in devices and services. This trend suggests a few questions that go beyond the discussion in the book. What kinds of information are sensitive enough to give rise to a “substantial injury” to consumers when misused, exposed, or lost? And at what point—if any—does an injury become “likely” before a completed breach and concrete injury to consumers? These questions are at the center of the FTC’s case against LabMD, which is currently under review by the Eleventh Circuit, and the outcome in that case could have profound implications for the FTC’s data security program.8

More specialized issues are also discussed: children’s privacy; email marketing; telemarketing; malware; and financial privacy. Many of the cases discussed arise under statutes that address specific practices or technologies, such as the Children’s Online Privacy Protection Act, the Telemarketing Sales Rule, and the Fair Credit Reporting Act. These discussions provide a reminder of how far privacy concerns stretch across the FTC’s jurisdiction. For example, Hoofnagle’s discussion of the Fair Debt Collection Practices Act highlights how issues of financial (and even physical) vulnerability can follow from the ways in which information is collected and used.

6 Id. at 146.
The FTC’s role in privacy extends beyond U.S. borders, and the international privacy activities described by Hoofnagle provide a good point from which to examine the broad challenges and opportunities that lie ahead for the FTC’s privacy program. The centerpiece of Hoofnagle’s international discussion is the U.S.-EU Safe Harbor Framework, which provided a voluntary, FTC-enforceable structure to allow companies to transfer personal data from Europe. Safe Harbor has been invalidated and replaced since FTC Privacy Law and Policy went to press. The replacement, known as the EU-U.S. Privacy Shield, works in much the same way: companies certify that they meet a set of agreed-upon standards, subject to FTC enforcement, and they are presumed to provide personal data protections that are “adequate” under the EU Data Protection Directive. The documents that surround the Privacy Shield principles, and the FTC’s own commitments under Privacy Shield, put the FTC in somewhat unfamiliar company. These documents include letters from the Office of the Director of National Intelligence, the Department of Justice, and the State Department, all explaining controls and oversight mechanisms that the United States has in place to regulate how intelligence and law enforcement agencies may obtain personal data. The presence of these statements in a commercial data transfer framework is a sign of the economic importance of privacy protections. It is also a testament to the results and the recognition that the FTC has earned in the international arena. The survival of Privacy Shield may well depend on continuing coordination among these agencies, including the FTC. Specifically, the FTC will need to maintain a delicate balance between working with its federal government partners while keeping its credibility with the European Commission and Member State data protection authorities as an independent regulator.

Another test of the FTC’s privacy approach is more clearly foreshadowed in FTC Privacy Law and Policy. Hoofnagle asserts that the “FTC simply lacks the resources to cover the privacy and security issues for the entire 21st century economy” and argues that the FTC “should welcome” the involvement of the FCC and other agencies. The FCC’s decision in 2015 to reclassify broadband Internet access service as a common carrier service set the stage for the FCC to issue a privacy rule that applies to ISPs, which the FCC did just days before the 2016 election and over the objections of the two Republican Commissioners.

The FTC was less welcoming than Hoofnagle of the FCC’s taking a larger role in privacy. The FTC’s Acting Chairman, Maureen Ohlhausen, is openly critical of the rule, citing the potential that imposing different rules on ISPs will confuse consumers and favor non-ISPs in the digital economy. The FTC staff also filed a comment on the proposed rule, which criticized substantive inconsistencies between the proposal and FTC law as “not optimal.”

Now that the opponents of the privacy rule hold the majority at the FCC, the pendulum is swinging rapidly back to an FTC-style framework. The FCC recently stayed part of the rule while it considers petitions for reconsideration. In connection with the partial stay, FCC Chairman Ajit Pai and FTC Acting Chairman Ohlhausen announced that they “still believe that jurisdiction over broadband providers’ privacy and data security practices should be returned to the FTC, the nation’s

---

10 HOOFNAGLE, FTC PRIVACY LAW AND POLICY, supra note 1, at 336.
11 Id.
expert agency with respect to these important subjects.”

Exactly what that framework will look like remains to be seen. Part of the difficulty is due to a Ninth Circuit decision that held—in a case unrelated to the FCC’s reclassification of broadband—that the common carrier exception to Section 5 is not limited to common carrier services but rather applies to any entity that provides a common carrier service. This decision casts doubt on whether the FTC could resume its former role as a privacy enforcer for broadband ISPs, even if the FCC removes broadband service from common carrier regulation. In the meantime, Chairman Pai and Acting Chairman Ohlhausen committed to “work together on harmonizing the FCC’s privacy rules for broadband providers with the FTC’s standards for other companies in the digital economy.”

Seen in the perspective provided by FTC Privacy Law and Policy, the FTC’s role in the ongoing tussle over the FCC’s privacy rule would seem a welcome reversal in fortune for the FTC. Hoofnagle’s concluding argument on “the need to defend the FTC” notes that “[t]he FTC is under constant attack from the business community” and asserts that “[t]his continuous browbeating is a tactic to weaken the Agency and to blunt its efforts to protect consumers.” During the FCC’s rulemaking, however, the FTC’s privacy framework became the flexible, innovation-friendly counterpoint to the FCC’s proposal.

This favorable attention is unlikely to be permanent or to lead to broader support for the FTC to expand its more controversial privacy actions and policy initiatives of the past few years, but the fact that the FTC has received such attention serves as recognition that it has developed a sustainable privacy program. Hoofnagle’s proposals to push the FTC privacy enforcement into closer alignment with more abstract conceptions of privacy seem to face slim odds in the near term. Through its involvement in issues like Privacy Shield and the FCC’s privacy rules, however, the FTC may end up strengthening its role among federal agencies. These issues are also politically charged. The substantive expertise and political sense that the FTC has developed in the course of its privacy program—and its much longer history as a consumer protection agency—should help the agency to navigate these challenges. Anyone looking to get up to speed on this history would be well served by starting with FTC Law and Policy.

---


14 See FTC v. AT&T Mobility LLC, 835 F.3d 993, 998 (“We conclude, based on the language and structure of the FTC Act, that the common carrier exception is a status-based exemption and that AT&T, as a common carrier, is not covered by section 5.”).

15 Ohlhausen and Pai Joint Statement, supra note 12.

16 HOOFNAGLE, FTC PRIVACY LAW AND POLICY, supra note 1, at 351.
Paper Trail: Working Papers and Recent Scholarship

**Editor’s Note:** In this Paper Trail, Editor Bill Page notes two papers that analyze famous historical cartels. One models and measures the incentives for international vitamin producers to collude in the late 20th century; the other examines the role of investment banks in facilitating railroad cartels in the late 19th century.

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

—William H. Page and John R. Woodbury

### Recent Papers


In *Measuring the Incentive to Collude*, Igami and Sugaya analyze the voluminous records of the international vitamin cartel prosecutions of the 1990s. Some of the cartels persisted until private and government investigations began in 1999; some, particularly the Vitamin C cartel, fell apart several years earlier because of the entry of major rivals. The goal of the paper is to measure how real changes in the market (like entry) or hypothetical ones (like merger) affect the incentive to collude. Implicitly, the paper tries to inform premerger review by providing a better empirical and theoretical basis for evaluating whether a proposed merger will enhance price coordination.

Game theory teaches that, in the abstract, oligopolists may achieve any profitable equilibrium if they repeat the game often enough. But Igami and Sugaya use evidence from the records in the vitamin cases to define the specifications of a model of the vitamin cartels, and thus to predict specific equilibria. They estimate demand from the rivals’ own price and cost data, then use evidence of the actual operation of the cartel to calculate the payoffs for collusion under actual and hypothetical conditions. For example, the authors found that there were separate cartels for each vitamin, and that conspirators agreed on the market supply and assigned quotas. The model assumes that conspirators charged essentially the same prices in any given time period because the “data showed [ ] that, even when a firm undercut[ ] its own price to oversell beyond the agreed quantity in the cartel, the prices charged by different firms [were] very close to each other.” (p. 7)

The model also assumes that the rivals were able to observe one another’s quantity after a three-month lag because the evidence showed that the rivals exchanged production data at quarterly meetings.

As to enforcement, the model assumes that the rivals produced the agreed upon quantity unless and until they confirmed cheating after the three-month lag. In the latter case, the firms took the static Nash equilibrium output for the market, and continued to do so (what the model refers to as the Nash reversion) as the sole punishment. This assumption was confirmed by records of cartel meetings, which reflect that the one threatened punishment was the resumption of compe-
tition. The model also assumes that each rival thinks the cartel will last forever, unless that rival personally cheats. In an alternate scenario, the model assumes that the rivals revert to the Nash equilibrium provisionally until government statistics confirmed that there was cheating; if it turned out there was no cheating, the rivals could return to the agreed output quotas. Based on these assumptions Igami and Sugaya identify the payoffs under compliance and noncompliance with the agreement separately, and measure whether the incentive to collude by the former exceeds the latter. They also assume in a baseline model that the firms know what factors determine demand and can predict what the factors will be in the future. In some variants, they assume that the rivals only learn the demand over time by a series of observations.

Igami and Sugaya describe the cartels in some detail. The markets were particularly suited to cartel formation and stability because of the products' homogeneity. The primary defendants in the prosecutions were European producers (Roche, BASF, and Rhone-Poulenc) and Japanese producers (Takeda, Esai, and Daichi). Different combinations of participants served as the four dominant players in each of the 16 cartels, although Roche and BASF were by far the most active in organizing and participating in them. The top executives of the participants agreed to fixed market shares and assigned sales quotas for each year; lower-level executives monitored the cartel in quarterly meetings to check compliance based on internal sales reports and to make adjustments based on changed demand conditions. At the annual meetings, participants would also make sales among themselves to compensate for over-production. Periodic publication of government statistics confirmed (or contradicted) the annual reports. The only threatened punishment was the common knowledge that the cartel would collapse and they would all be charging competitive prices for a long time (the Nash reversion).

Some of the cartels ended because of entry by Chinese state-owned enterprises into the market. For example, in the Vitamin C cartel, prices increased dramatically after 1991 when the cartel was formed, but then collapsed after 1995 because of the accumulated effects of entry. Other cartels persisted until private or government investigations began in the late 1990s, and executives of some of the participants began seeking amnesty or otherwise cooperating with the authorities. Igami and Sugaya note sardonically that a problematic outcome of the amnesty was the approval of a merger of two cooperating cartel members, Rhone-Poulenc and Hoechst.

Igami and Sugaya use the detailed information about Roche’s prices, output, and costs, to estimate both the firm’s demand and its (essentially constant) marginal cost. Since Roche played such a dominant role in most of the cartels, they are able to extend these estimates to the other cartel members based on evidence of their relationship to Roche’s cost and output. They show a dramatic drop in profits—a Nash reversion—after the collapse of the cartel around 1995. The authors are able to show graphically that the incentive of Roche (and therefore all firms) to collude was highest at the formation of the cartel, then dropped smoothly to below zero by 1996.

In two additional sections, Igami and Sugaya use hypothetical scenarios to draw broader conclusions about the effects of changes in market structure on the incentive to collude. First, they show that the elimination of fringe expansion after 1995 (which they characterize as the exclusion of a maverick competitor) would have kept the incentive to collude positive throughout the 1990s (albeit much reduced than in the early 1990s). Second, they show that a merger of BASF and Takeda in the early 1990s (instead of in 2001, when it actually occurred) would have kept the incentive to collude in positive territory throughout the 1990s. By characterizing this preservation of incentives as an instance of likely “coordinated effects” of such a merger, Igami and Sugaya apparently intend to indicate the relevance of their results to premerger review of a proposed merger of the second and fourth largest firms in a market with similar characteristics. They do not
distinguish (as the Merger Guidelines do) between an incentive to engage in explicit coordination (like the vitamin cartels) and tacit collusion, which may involve different characteristics.

In Villains or Heroes: Private Banks and Railroads After the Sherman Act, Miguel Cantillo studies the role of private banks on the boards of railroads, where they enabled noncompetitive behavior about a century before the vitamin cartels studied in the previous paper. For the first 15 years of the Sherman Act, private banks like J.P. Morgan had seats on the boards of non-financial institutions, particularly railroads, which they reorganized or consolidated. They also used voting trusts to control a large share of the stock of the railroads. In this position, they played an active role in management, both as “heroes” in improving management practices and as “villains” in facilitating collusion with rival railroads. This paper attempts to sort out the extent of these contributions to the railroads’ bottom lines.

In 1905, the Armstrong Investigation of insurance companies in New York revealed the extent of the connections between insurers and private banks, and created a perception that insurance executives “were personally enriching themselves at the expense of policy holders,” with the help of private investment banks. In the wake of the investigation, Jacob Schiff publicly withdrew Kuhn Loeb & Co., one of the leading private banks, from the boards of non-bank firms, including insurance companies and railroads. Cantillo conducts an event study of this controversial and very public action. He measured the effects of the action on portfolios of the stocks of categories of firms that the action affected, and found that:

1. Portfolios of the stocks of the railroads for which a Kuhn Loeb partner served as a board member fell by over 9 percent.
2. Portfolios of the stocks of railroads that competed with the Kuhn Loeb railroads—both those with a bank board member and those without—also fell substantially.
3. Portfolios of the stocks of firms that shipped products on the railroads, such as the American Can Co., received abnormal cumulative returns of over 24 percent.

Cantillo interprets these results provisionally to suggest that the principal contribution of the private bank director was to reduce competition among the railroads; when the director left, railroad prices fell, benefiting shippers and reducing profits for both the Kuhn Loeb railroads and their competitors.

In another section, the author studies the differences in shipping prices between the period in which bankers served on railroad boards (1894–1906) and the immediately preceding period. He found that the prices for shipping between New York and Chicago (primarily via railroad), were stable, while the prices for ocean and other shipping of the same products between two other city pairs dropped sharply during the same time period. These results also suggest that the presence of the bankers diminished competition by stabilizing prices during an adverse period in the market. Cantillo suggests that the bankers’ participation on boards of railroads in all regions of the country allowed the bankers to promote “communities of interest” and multimarket contacts among the competing railroads. Some evidence also suggests that they successfully promoted limitations on construction of new railroad track, especially in the West.

In order to distinguish the collusive and “better governance” effects of bank participation on railroad boards, Cantillo conducts a regression to isolate the potential effects of variables that might affect the likelihood of a price war in the industry other than the presence of a bank as a director. Those include, for example, higher HHI (making tacit collusion easier) and cross-ownership of stocks. The author concludes that bank directors added about 20 percent to the value of the firm, of which 13 percent was attributable to their effects in reducing competition and 7 percent to better governance. He suggests that the results do not justify the early efforts prohibiting
private banks from participating on corporate boards. Better antitrust enforcement targeted to the ways in which directors acted to reduce competition should have been applied instead to preserve their firm-specific improvements in corporate governance.

—William H. Page