Antitrust in the Americas: Enforcers’ Roundtable Discussion
Agency heads from Argentina, Brazil, Chile, Mexico, and the United States provide updates from their respective organizations. Topics discussed include premerger notifications, cartels, and economic liberty.

Paid Prioritization and Zero Rating: Why Antitrust Cannot Reach the Part of Net Neutrality Everyone Is Concerned About
Hal Singer opines on why antitrust law might not provide the appropriate framework for addressing issues related to non-discrimination as part of a “net neutrality” policy and argues in favor of forming a new tribunal to adjudicate discrimination complaints on the Internet.

The Flaws in Using the Hypothetical Monopolist Test from the “Payor Perspective” in Health Care Merger Cases
Drawing from decisions in recent hospital merger challenges, Kenneth Field, Louis Fisher, and William Coglianese discuss the difficulties involved in appropriately applying the principles of the Hypothetical Monopolist Test in hospital merger cases, particularly when attempting to apply that test from the perspective of the payor.

Jorge L. Contreras discusses the recent UK High Court decision in Unwired Planet v. Huawei, with a particular focus on its use of competition law principles to assess FRAND royalties and its implications for international licensing transactions.

Paper Trail: Working Papers and Recent Scholarship
Monica Lu and Bryan Ray review a recent working paper by Castanheira, Ornaghi, Siotis, and de Frutos that examines the impact of events that differentially affect competitors in a market (“asymmetric competition shocks”) by looking at the effects of generic product launches in pharmaceutical markets.
Antitrust in the Americas:
Enforcers’ Roundtable Discussion*  

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**Editor’s Note:** The 2017 Antitrust in the Americas program, held in Mexico City on June 2, 2017, concluded with an enforcers’ roundtable of leaders of the antitrust agencies of Argentina, Brazil, Chile, Mexico, and the United States. The questioning was led by Section Chair William MacLeod and former ICN Steering Group Chair and Mexican agency head Eduardo Perez Motta.

—Russell Damtoft

**William MacLeod:** It’s time to hear from the enforcers in the Americas. We will follow the pattern that we have used throughout our conference, and that is to find the best moderator and interrogator that we can.

In my case, that is Eduardo Perez Motta, who probably needs little introduction to those in the room. But if you do not know him, he is a Partner at Agon. In 2012, while serving as the President of the Mexican Federal Competition Commission, he was elected as the Chair of the Steering

* This Roundtable has been edited for publication. Panelists were speaking in their official capacities as of the date of the Roundtable (June 2, 2017). Tad Lipsky and Brent Snyder have since left their agencies.
Group of the International Competition Network. He had also been Mexico’s Ambassador to the World Trade Organization and a negotiator of the free trade agreement between Mexico and the European Union. There is no better candidate to weave together the strains of competition and trade and the intricacies of enforcement than Eduardo.

Eduardo, can you introduce our panelists?

EDUARDO PEREZ MOTTA: Thank you very much.

I am going to start with Brent Snyder, who is representing the Department of Justice, the Deputy Assistant Attorney General of the Antitrust Division. Then we have the Commission President of the Mexican Antitrust Authority, Alejandra Palacios. On my left is Felipe Irarrazabal, who is with the Fiscal Nacional de Economica from Chile.

Esteban Greco is the head of the Argentinian antitrust agency. Alexandre Macedo is Commissioner of Conselho Administrativo de Defesa Econômica (CADE). Last but not least, I would like to present Abbott Lipsky, who comes representing the Federal Trade Commission. He is the Acting Director of the Bureau of Competition.

With that, I think we should go straight to the questions.

Our first question of the panelists—and we will proceed down our panel alphabetically by first name, in which case that means we will ask Alejandra first, is for a report on what are the hottest issues, or the hottest issue, at your agency.

ALEJANDRA PALACIOS: Thank you for having the Competition Commission in this panel and for choosing Mexico for this event.

As we have heard along this day and a half, our competition reform of 2013 has provided us, the Mexican Competition Commission, or COFECE, with an unprecedented opportunity to improve competition conditions in the Mexican markets. Since then we have undertaken the task of turning COFECE into a stronger, more efficient, and more transparent regulator.

As we have heard this day and a half, several cartel investigations with high expectations have been initiated in markets that are critical to the Mexican consumers, such as healthcare, food, banking, and transport. As Judge Tron Petit mentioned this morning, last February we announced the lodging of COFECE’s first criminal complaint before the Office of the Attorney General against several individuals who participated in cartel activities in the healthcare sector. This is an important step in materializing the criminal sanctions for cartels, present in the Mexican Criminal Code since 2011 and then strengthened in 2014. As I always mention, my perception is that more often companies are investing resources in the implementation of antitrust compliance programs. I always say it’s a new line of business for Mexican antitrust practitioners, and I find that very rewarding.

Regarding merger analysis, the Commission is working towards more effective merger review, as was just mentioned. At the Competition Commission, we believe that the new law makes it complicated for the Authority and the economic agents to have very open conversations, but we are working with these restraints as best as we can.

The 2016 highlight was the Delta/Aeroméxico merger. It was talked about yesterday, so I am not going to go into that.

In the upcoming days and months, the Commission will take important final decisions regarding two preliminary findings presented by our investigative authority regarding first, the procedures for essential facilities and barriers to competition in slot allocation in the Mexico City Airport; and second, on competition conditions prevailing in the Mexican railway market. If lack of com-
petition conditions is confirmed in one or both procedures, then sector regulators should act accordingly.

We will also launch our market study—and this will probably happen next week—on off-patent drugs and the role of generic entry on prices. Our findings show that the number of generic competitors and the rate of entrance is low and this is having an important impact on the prices that Mexicans pay for medicines.

Then also, we will launch a report with our analysis of some aspects of the Mexican trade policy. As Minister Guajardo said yesterday, we are organizing a seminar—this will be on the 13th of June, and you are all invited—to talk about Mexican trade issues. We are pushing for a trade policy that includes a competition perspective when deciding what is best for our country.

Important judicial precedents will be known in the near future. They have been mentioned in this forum: client/lawyer privilege, particularly complaints for the initiation of an investigation under Article 94, and immunity revocation in cartels. The system is in constant construction. We are waiting for these judicial precedents so we can use them and apply them to strengthen our activity.

Finally, we are about to arrive at our four-year mark. By the end of this year, we will assess how we did in implementing our four-year strategic plan. We will write on paper what we want to accomplish for our next four years.

MR. MACLEOD: Thank you very much. Can we go to Brazil?

ALEXANDRE MACEDO: For the past three years Brazil has been facing a lot of challenges. We have a big change involving a new law that has come, and a lot of things are new for us. We are improving every day and every day and every day. This law came with three big changes. Those changes were: the new CADE structure, the mandatory premerger notification, and the monetary penalty changing.

We have some data that can show what I am trying to say, and this is one thing that I want to just talk about a little bit. To have an idea about how big the changes are, in terms of the amount of money received based on the agreements, in 2007 we received 27 million reals ($10 million) and in 2016 it was about 700 million reals ($250 million). That is a huge increase because we changed the procedures, we changed a lot of things, we changed the way that CADE used to think. We gave back more power to CADE for people to work properly. The guys who changed the law and worked to build this new structure did a very good job, so we are seeing the results right now. But we still have a lot of changes to make and a lot of challenges to face, to go on.

MR. MACLEOD: Thank you very much.

Let's cross the equator and go to the Department of Justice in Washington, D.C. What will we be reading in the headlines, Brent, or what should we expect in the headlines?

BRENT SNYDER: I think the big news in the Antitrust Division right now—in addition to, obviously, the fact that we are still in a Presidential transition and are still in the process of getting our political leadership, which I’ll comment a little more on later—has been the number of cases that have gone to trial. Since just October, the Antitrust Division has tried nine cases to verdict, including one that is literally going to the jury right as we speak, so hopefully we may have a verdict later today or tomorrow.

Those nine cases involve a range of different things, from two very large healthcare mergers between four of the largest healthcare insurers in the United States, and in those cases we were able to block both of those mergers; to bid rigging on school bus routes in the Commonwealth of
Puerto Rico; bid-rigging trials involving real estate investors in California; and a trial involving a merger between two providers of low-level nuclear waste disposal. So we have quite a range of different cases.

Nine cases have gone to trial. In six of the cases we received verdicts. We won five of those cases. We did get an acquittal in one real estate case, but then we have a couple of cases where we are also waiting for verdicts. So it has been quite a run of litigation for us.

And it is not stopping now. On the criminal side of the Antitrust Division, we have another seven cases that are scheduled to go to trial, six of those probably in the next year or so. So we really stand with the prospect in the criminal program that over the course of a year and a half, we will have tried as many cases as we have tried in the last five years combined. So, for whatever reason, there has been a sharp uptick in our litigation, which means that we are investing enormous resources in those cases.

But the investment of resources, I think, is offset by the fact that we are developing very, very experienced attorneys. I say that you always learn better how to investigate cases once you have tried a case and see how your investigative decisions actually play out. We now are going to have probably more seasoned litigators than we have ever had in the Antitrust Division. In the cases that have gone to trial so far, I think well over a hundred of our Division lawyers have been involved in those cases. So that's a hundred lawyers, probably most of whom had never been in trial before—some now actually have multiple trials—and we will be adding more experienced litigators from the trials to come.

That's very important, I think, not only for our ability to litigate, but also our ability to investigate on both the civil side of our shop and the criminal side of our shop. Knowing that you can try the case makes you more confident as an investigator, it makes you more confident as a negotiator, and it gives you more credibility when you are dealing with defense counsel who know that the Division is willing to take cases to trial if they believe the merits require it. Whether it's on the civil side of the Antitrust Division or the criminal side of the Antitrust Division, this experience is giving us that credibility, and that will continue to pay dividends.

And on the merger side we continue to be very, very busy as well. We have some very large mergers that we are continuing to look at, including Bayer/Monsanto, AT&T/Time Warner, and some other large mergers.

On the cartel side, we have a very large cartel investigation regarding generic pharmaceuticals; ocean shipping, which I think we are going to be talking a little bit more about when we discuss the transportation sector later; and a wide variety of other criminal investigations as well.

MR. MACLEOD: I remember Judge Diane Wood mentioning that about 1.5 percent of cases in the United States are tried before juries these days. It sounds like most of those are coming out of the Antitrust Division.

MR. SNYDER: We actually are attracting attorneys from U.S. Attorneys’ Offices, where they normally get more trials. But some are coming to us because they view it as a better opportunity to get trial experience right now.

MR. MACLEOD: Esteban, can we hear a little from Argentina?

ESTEBAN GRECO: Thank you to the ABA for having me here. It is a good opportunity to talk about Argentina's competition policy.
Following the advice of my friend Felipe, I will point out only three points and leave the rest for the talk later.

The number-one hottest issue in Argentina is competition policy, and competition law enforcement is a top public policy priority for the government in Argentina. You can see this in different ways: in presidential decisions—for the first time our Commission has a formal structure with directions, and also because competition issues are taken into account in other policy decisions in different fields.

A second big issue is that this week began the debate and discussion of a new competition law that is under consideration by the Congress and the lower chamber. I had to make a statement for the Commission before the committees of the Congress last Tuesday talking about the new changes of the law. This is a big change to the Competition Act where we are introducing very important changes — an independent agency, premerger review, a leniency program, and more clear higher fines against cartels and for different anticompetitive conducts. So I think this is a hot issue.

Number three, I think you have to take competition law enforcement in Argentina seriously. I think this is good advice for all of you. We are enforcing this in a very serious way, taking into account best practices, but we are doing it now.

These are the three points.

MR. MACLEOD: This is yet another example of an amazing rise of antitrust in the Americas.

Let’s continue that with Felipe. Felipe, is anything happening in Chile?

FELIPE IRARRAZABAL: I hope so. I think we have been very active in the last couple of years, not just in the prosecutor’s office, but also the Tribunal as well.

But if I can follow my own advice to Esteban, and if I restrict myself to just one main hot issue, I would point to implementation of the law. When you are receiving more faculties and more responsibilities, it is always a challenge the way you will be implementing those rights, those faculties. And it’s tough. In our case, our new law was approved in August of last year. I think we have a couple of challenges. We would like to do the job in a smooth and reasonable and sound way.

Probably the first big challenge is to move from a voluntary system to a mandatory merger system. That, obviously, poses and requires a lot of energy from the agency. Later I will show you how we are dealing with those challenges.

We increased our fines, which had a ceiling of (US)$25 million to up to 30 percent of the sales. Also, the Tribunal will have the responsibility of imposing damages after we finish our fine or administrative procedure. Also, we have criminal sanctions in the case of hard cartels.

So the Congress has given us a lot of responsibilities and we must carefully apply those faculties.

Just to finish on the implementation of the law, we also have something that I would say is a little original, which is a cross-ownership provision in the law. Under this provision, when a company acquires more than 10 percent of its competitor, it has to inform the Fiscalia of that transaction after the transaction has been materialized.

MR. MACLEOD: Tad Lipsky, tell us about the Federal Trade Commission. What have we missed in the news while we’ve been down here in Mexico?

TAD LIPSKY: First, I want to echo the point about the blossoming of competition policy in Latin America.
There is an old story, possibly even true, that back in the late 1970s, when Jimmy Carter was the U.S. President and John Shenefield was the head of the Antitrust Division, the Attorney General of Brazil paid a visit to the Attorney General of the United States. In the course of that visit, the U.S. Attorney General asked John Shenefield to explain the activities of the Antitrust Division to the Brazilian delegation, including the Attorney General. The story is that at the end of the presentation the Brazilian Attorney General turned to his colleagues and then turned back to the Americans and said, “You know, I’ve understood most of this presentation, but I really don’t understand what this antitrust law is all about. The story goes that Mr. Shenefield gave it another try, and finally the Attorney General for Brazil said, “Oh yes, trade practices, I understand. We have a trade practices law in Brazil too, but the only ones that use it are the Coke and Pepsi bottlers who sue each other.”

So this is miles from where Brazil was, and, obviously, the trend has entirely penetrated Latin America as well.

I have a slightly different perspective on antitrust litigation from the one Brent gave. He is obviously—and justly—overjoyed about the litigation success of the Antitrust Division. It needs to be said that 10 or 15 years ago there was significantly less joy about the litigation success of the U.S. antitrust agencies. There was really kind of a crisis and a great deal of introspection and some very intensive and well thought-through work at both agencies. Now it is fair to say that this has borne fruit because everything that Brent has said is absolutely true and should be credited seriously.

I would also like to say that the Federal Trade Commission has equally improved its statistics, and it really is a 12-cylinder Ferrari of a litigation machine these days. In all the areas that we cover—which, of course, excludes criminal—we share this enthusiasm for the vigor and the health of the agency.

Let me just make two other quick points.

First, one thing notable in Washington is the lack of noise about antitrust law, even though there has been a rather significant change in the party in power and the philosophy of the administration. I think it’s a great credit to the fact that a consensus was established many years ago that the purpose of antitrust law is to maximize the economic wealth that can be produced with society’s scarce resources and that antitrust enforcement should ultimately be guided with the consumer interest in mind. Apart from some stray remarks made in the previous administration that might have brought that into question, the enforcement program is still oriented along those lines. So we have a question: you say, “Well, that’s great that you have all this wonderful successful litigation in the United States coming out of the antitrust agencies, but in the service of what?”

I think it’s good that the central focus on sound economic analysis, growing economic wealth, and serving the consumer remains the central focus of U.S. antitrust—Democrat or Republican, conservative, or liberal.

I’d like to conclude by describing a recent initiative of Acting Chairman Ohlhausen. Due to some favorable judicial decisions that were the product of a long and very painstaking and well thought-through process, the U.S. agencies have more flexibility in the way they can limit state government intervention in the economic process, and particularly circumstances in which states assign regulatory responsibilities to competitors in an industry without supervising the outcome.

We won a very significant victory in the famous North Carolina Dental case, and now we have our first case, in effect, applying the same doctrine that was established in North Carolina Dental to the Louisiana Real Estate Appraisers’ Board. That administrative complaint was just filed, and we look forward to success in that litigation.
MR. MACLEOD: Thank you, Tad.

While we might be challenging the statements about the influences of and forces affecting antitrust analysis, let's start exploring them and perhaps begin with the world of mergers. Eduardo?

MR. PEREZ MOLTA: This is a very good topic, Bill, because what we have seen in the last five years in Latin America in mergers has been quite impressive. There has been a major movement from post-merger notification to premerger notification.

This started in Brazil with major reform in 2012. There was afterwards an important reform in Mexico in 2014 that made important changes, and Alejandra mentioned some of those elements, all the major procedures.

The case of Chile is quite interesting, quite important, and Felipe already mentioned this. Even yesterday, as far as I understand, the premerger notification mechanism started precisely yesterday.

The case of Argentina is also interesting because they are in the middle of this discussion in the Congress.

Let me start in a logical way so we will avoid any other classification, and let me start with Brazil.

The move from post-merger to pre-merger notification was a major challenge. How did you face it, and what is your impression and your reflections on that process, Alexandre?

MR. MACEDO: In my opinion, this was the big change of the law. Premerger notification was the most important thing that it changed.

First of all, we had a lot of people who were against it at the beginning. They thought that CADE could not handle it because the time was too short. CADE used to take around two years to judge a merger and now the maximum time, according to the law, is 330 days. The average right now is about 27 days to judge a merger.

Just for an idea about the time—I have the data here—over time it has changed a lot. Saying again, it used to be two years and now it is 27 days. This is the average. But for a complex case the average is more than that; it's about 200 days. But 95 percent of our cases are simple cases and we judge them sometimes in 18, so this brings the average down and the whole thing is 27 days.

The other good experience about the premerger notification is that we don’t have the parties going to the judiciary anymore. They used to do this. The old system used to allow the party to consummate the operation and after that notify CADE within 15 days. CADE used to take two years to decide the case. After that, if CADE blocks the operation, the party used to go to the court and get an injunction in order to keep operating together until the final judicial decision. We used to have a high number of injunction demands. The average time for judging a case in Brazil in the judiciary is about ten years.

We had a big case in Brazil, Nestlé/Garoto, that stayed for 14 years waiting for a decision. The market changed. Everything changed. It doesn't make any sense.

The old system was a good thing for the parties because they could consummate the operation and go to CADE and say, “Here is the merger.” If CADE blocked it, they were together already, so it was very hard to separate the companies, also because they used to go to the judiciary and get an injunction to stay operating.

Right now it doesn’t happen anymore because there is premerger notification. Before doing the merger, the parties have to go to CADE and ask for the authorization, and if CADE says, “no,” the
deal is done. We don’t have one case in Brazil where they went to the judiciary and got an injunction in order to consummate the merger, against CADE’s decision.

Why? Because it is hard for the judge to get into the merits about a merger case. How can they decide if CADE’s decision is really bad in order to grant an injunction to allow the companies get together and start to operate together? This is really hard. I don’t think that the judges have the courage to do this. It is a very hard decision.

So these two issues, in my opinion, were the big changes in Brazil that came from premerger notification. The first one was the time. The second one was no injunction anymore.

MR. PEREZ MOTTA: Thank you, Alexandre.

Alejandra, what do you think were the main challenges with the reform of 2014 in the case of mergers?

MS. PALACIOS: I think that the main challenge—and it comes out in every discussion—is that we cannot, as in other jurisdictions, discuss the merger issues from the premerger stage. In our case—and this is because how our merger procedure is structured in the new law and our bylaws—the staff can only begin discussing competition issues and possible remedies way into the procedure. That, I understand, generates discomfort within the practitioners’ community.

We are trying to be more transparent and open in the preliminary stages, but, to tell the truth, it is difficult for the staff to communicate in the earlier stages exactly how the Board of Commissioners will vote. They can be very transparent on what they think, but that at the end of the day might not happen. We have restrictions by law. This does not mean, of course, that we are not constantly trying to be as clear and as transparent as possible. Believe me, we are working on this.

What we are also trying to do is to decide fairly quickly in the process if cases need a full merger review. If they do not need further merger analysis, then we are trying to accompany that with a fairly quick approval decision. Our time average is 20 days, and it happens in most of the cases.

In more complicated cases, we have by law 100 working days before a final decision could be made. The challenge here remains issuing a timely decision in mergers that are filed in multiple jurisdictions. As I have said in other forums, for this to happen I would also like to ask the community that they file their cases in Mexico at the same time as they do it in other jurisdictions, because parties tend to notify in other jurisdictions before they do in Mexico and then they want us to take our decision right when the other jurisdictions have taken theirs. It is a two-party game and both practitioners and ourselves need to work to get this right.

MR. PEREZ MOTTA: That is particularly important for Mexico because we still have a free trade agreement with the United States. In many cases the relevant market is what the DOJ or the FTC might be analyzing in those cases as well.

Let me ask you, Felipe, in the case of Chile—you are now facing a major challenge in moving from post to pre merger notifications and analysis. How do you expect to deal with that, and what would be the optimal result that you would expect from the Fiscalia?

MR. IRARRAZABAL: Again, you would like to be reasonable, sound, and obviously in a very short period of time. Everybody wants that. But, as Alejandra said, that is not easy. Especially with international transactions, somehow you have to be in tune, and especially if there are some remedies that are coming from abroad.

The good thing is that, at least now, I cannot talk about our experience on premerger because the system, as you pointed out, was just started yesterday. But what I would like to do is just to
mention three or four main aspects of the Chilean system which might be interesting, especially for attorneys who practice in international transactions.

The first thing is that we planned this in advance. I know that planning is not that sexy. But we planned this in advance, which means that we approached the OECD, I would say, in 2012 and we asked them for a report to evaluate the system.

This is different from Brazil. We were not that negative on the former system, and the Tribunal was doing their job in a very diligent way, and we were just taking the very, very big transactions. So the voluntary system obviously has a lot of positive things, especially for a small agency.

We asked the OECD and we said, “You have to come to Chile. You have to knock on the doors of our counterparts and in the Chilean legal community and ask them about their experience with the system. And not just that, but also you have to interview the minister from the antitrust court; and also you have to go to the Supreme Court and interview them, just to have a fine-tuning on what is going on. They did, I would say, a wonderful job. It helped us a lot, because somehow we have the brand of the OECD saying that the system must be changed and also giving some basic guidelines on the way we can change the system.

The law at the end was approved unanimously by all the political parties.

So, as you can imagine, the idea is not to be so creative if you are establishing a system because you would like to be in tune with the most well-known international practices.

As you know, we have a Phase one of 30 days and then we have a phase two of 90 days. Then, we have an administrative silence system, so if we don’t say anything the transaction should be considered approved. Then, remedies can only be offered by the parties and not by us, so they have to draft the remedies. Then, if we don’t like the remedies, we should prohibit the transaction. So the law pushed us in the sense that if you don’t like the remedies you have to prohibit the transaction, then we go to the antitrust court. The antitrust court, as a check-and-balance, will be looking at the cases where the Fiscalia decides to prohibit the merger on the grounds that the mitigations offered by the parties do not outweigh the competitive harm.

In terms of the threshold, which is a tricky part of our mandatory system, at the beginning of the bill it was said that the threshold would be determined by the Minister of Economics. I don’t know why in the Senate they decided to give to us that faculty. Now I am very happy with that.

What we did is that we asked an independent economist to explain the methodology and then to calculate the current numbers for our Chilean system. Then, with that report, which we made public—it’s a 15-page report, and obviously that economist took a look at all the jurisdictions and all the thresholds all over the world—we requested opinions from five very well-respected economists in Chile, with one requirement: just one page. Have you tried that, to push an economist—just on one page? It was like a legal opinion but coming from an economist. The good thing is we were lucky enough to hire the most well-known Chilean economists. In one page they said, “We think that the methodology is reasonable and we think that the numbers are also reasonable based on that methodology.”

The result of that was around (US)$72 million and also (US)$12 million for the joint and individual thresholds, respectively. Also what is interesting is that we didn’t fix that amount in Chilean pesos because of inflation. Although inflation is not that high in Chile, it is very much under control, but we decided to use UF (Unidades de Fomento or adjustable units), which is a unit which incorporates inflation so the adjustment would be automatic.

We think probably we will be looking at and reviewing the thresholds, and if we think they are not appropriate, we can change them. Obviously, we will be trying to use the same procedure as I already described.
Then, the President of Chile signed a Supreme Decree which pointed out in a very detailed way which are the documents that must be filed to begin merger analysis. That was published yesterday.

Then we started working on guidelines. We have been working for months on the guidelines, and believe me it is not easy. Basically, yesterday we launched five guidelines:

- One on jurisdiction, where we specify which are the transactions that must go into the system for review.
- Then a guideline on how to calculate the thresholds. We already calculated the thresholds, but the companies must obviously do their math, so they can be using that guideline in order to find the number.
- Then two guidelines on the documents that must be provided. We have the law, we have the Supreme Decree, but we wanted to give more details, a very strict precision on which are the documents that must be provided. So we launched two guidelines: one on the short list of documents for simpler merger notifications, and the other on the long list of documents for complex notifications.
- Then we finish with the guidelines on remedy.

The good thing is that we were able to receive comments because we launched the draft first. So we were able to receive the comments not only from the local attorneys, but also from the American Bar Association, the International Bar Association, and from the Federal Trade Commission. That's interesting.

Because most mergers are global in nature, we need to fulfill our legal standards by focusing our analysis in their effects in Chile, but always considering not to introduce unnecessary distortions to the global context.

We have all those documents on our Web page. All of those documents will be translated into English to facilitate the whole process. We hope that the system will run smoothly. Most of the people ask us, “How many transactions?” We have been calculating that, but you never know.

We hope that with this threshold we will be able to catch really the most important transactions and have time to really review those, and those are not really imposing any risk to free competition, just to resolve in a very quick way.

MR. PEREZ MOTTA: Thank you, Felipe. I think we all agree that we would like to wish you the best in this endeavor. If you do well, I am sure that many other agencies will be able to convince their congresses to move to premerger analysis and notification in the case of mergers.

Esteban, let me ask you two questions. Let me ask you, first, how is your discussion in the Congress going at this moment? I understand that you just arrived yesterday morning because you were meeting with some commissions in your Congress. What is your expectation on that reform that includes premerger notification in the case of Argentina?

Second, how do you plan to deal with the big backlog that you received when you took your office of so many cases which are in the process of being analyzed and approved in Argentina?

MR. GRECO: About the discussion of the law, I think we took the first step. This is the discussion, and the debate in the Congress has begun. We had a good reception. I think there are no structural or ideological objections to the draft proposal. But this is an electoral year. We have a midterm election coming, so it is difficult to predict the time of Congress. That is a difficult task.

I have good expectations. I think the law will pass. But the thing is, when? It could be up to the end of this year or maybe early next year. But I think we have a good expectation about that.
Premerger review is one of the big issues to take into account in the changes that will come when the law will be passed. The law has a provision for premerger notification and also higher thresholds for notification. The first threshold in the draft proposal goes to (US)$150 million. Now, with this problem that Felipe mentioned, that in the actual law our local currency threshold takes it to 1999, so we have now a threshold of about $13 million. That is a problem because we have a lot of unimportant deals that have to be notified.

The law also proposes a fast-track procedure for these deals that will not have competition effects.

Also, the draft proposal provides for a one-year transition period between when the new law is passed and when the premerger system takes effect.

But at the same time we need to prepare for these changes. So we are making changes in our procedures and analysis within our current legal framework.

As you said, we received a very big backlog of cases. We could review these during the first year, 2016, about 70 percent of the backlog of cases. But we received, to give you an idea, almost 300 files with an average age of 3.2 years. So it was a great challenge to deal with that, and also with a lot of new merger notifications because of these lower thresholds.

So I think there are three issues.

One is that we needed to approach this by restructuring the agency with capacity building and with cooperation. I think international cooperation and interchange of information and experiences with our colleagues is very useful for us. We could take this with a practical perspective because we really think that these are useful tools. Our training programs with the FTC and DOJ and the World Bank and our talks with our colleagues from Brazil, Chile, and Mexico were really useful for us.

This has practical consequences. One is, because we can rethink our procedures. In the last year, we took an approach to prioritize cases and to improve productivity. But we realized that it was not enough, that we needed to change procedures. In May we made a change. We created a triage unit for mergers. All new cases came through this unit and we have guidelines to deal with which cases can be dealt with by fast-track criteria because they have no effect and which cases need a more in-depth analysis.

Yesterday, we had the first case where the Commission issued an opinion in a merger case that was notified on May 12, which was 13 working days. This is good news for our prospective new system.

We needed to change the approach and to improve the quality of analysis. We issued a document that is on our website with our new investigative tools and analysis. We are using different tools for assessing dominance by defining relevant markets, using critical elasticity criteria, and also we are approaching upward pricing pressure analysis as Darrell Williams told us in the last panel and we are applying this to cases.

Also, we are preparing new merger guidelines. I have the draft to read on my plane flight tonight. At the end of this month we are going to issue a consultation document about the new merger guidelines. These are important steps that we are taking to improve our practices.

But one more thing. We needed to change the approach to cases after 15 years of not applying best practices. We needed to change our staff. We made a restructuring of the staff. We will keep some staff who are valuable.

We need to focus on important issues. I can give you an example of a merger case where one firm acquired a farm. They had to notify their buying of a farm because of these low thresholds. I don’t know the theory of harm, but the Commission was asking about how many cows do they have at this farm. We cannot spend our resources on this kind of analysis.
Mr. Perez Motta: Thank you very much, Esteban. We also wish you the best on this project, which is a major, major project. We have a lot of expectations from Argentina, obviously.

Bill, if you allow me, I think another area that is quite important in terms of convergence in Latin America is cartels. I think the main feature is a convergence towards criminalization of cartel activities, which I think is very good news.

Brazil has been the leader in Latin America in the application of fines and criminal sanctions on cartels. If I remember correctly, your law started at the beginning of the 1990s. The case of Mexico was the next one in 2011, when criminalization was introduced in the Mexican law.

In the case of Chile, it is very recent. In the law of 2016, last year, it was approved the possibility to “invite respectfully”—as one of the Mexican presidential candidates used to say, “respectfully invite your people to go to jail” in the case of cartel activities—ten years in your case, two-to-five years in the case of Brazil, and five-to-ten years in the case of Mexico.

Now, the main challenge that I perceive here relates to our legal systems in most Latin American countries. We are here in a boat where you have two players: the competition agencies on one side, and on the other side the federal prosecutors, because they are the ones who have the possibility to invite very respectfully these people to go to jail and to convince judges.

My question here—and I would like to start with Brazil—is: How has this coordination been between competition agencies (in this case CADE) and the prosecutors? I think your system has been working for a much longer time than the other systems here at this table—except for the case of the United States obviously.

But I understand that in 2007 there was a program, the federal police’s cartel intelligence program. I think in 2009 the Ministry of Justice announced a national anti-cartel strategy, and you signed in 2013 a cooperation mechanism with the Ministry of Justice and the police. So what can you tell us about this? Do you think that is working correctly, that it is something that should be done in the future, Alexandre?

Mr. Macedo: Yes, for sure.

Our relation with the federal prosecutor and the police in the cartel cases is pretty good. The example of that is the “Car Wash” case. This is the big example.

Just to have an idea of what is going on in Brazil right now, the leniency program in our law doesn’t obligate CADE to sign the leniency agreement with the federal prosecutor in order to file them in the criminal area. So if the parties sign the leniency just with the CADE, according to the law, they are not going to be prosecuted in the criminal area as well.

But since the first agreement that we signed, we asked for the federal prosecutor to sit at the table with us and sign the agreement together. So we have not signed any leniency agreement without the federal prosecutor. We bring them to work together, as well as the federal police.

Right now we are working together in a lot of corruption cases that involve bid rigging and cartels. This is a very big challenge in Brazil because the anticorruption law brings a lot of people to work together. This is very hard. There is a kind of Administrative Tribunal whose role is to supervise the public account and the biddings and they want to participate in the whole process as well.

All of those institutions have a constitutional role in those cases. That is why sometimes it is very hard to sign a leniency program in anticorruption law, because a lot of people have to get together, but the political dispute does not allow them to reach a consensus.

In our law, in competition law, it is just two parties, it is just the CADE and the federal prosecutor. Our relationship is pretty good and we can see the results happening right now in Brazil.

Mr. Perez Motta: Thank you. That is quite interesting.
Alejandra, you mentioned at the very beginning that you had your first case that was brought to the federal prosecutor. Obviously, moving to the world of the penal system is a major challenge. What did you expect there? As you have in the case of the administrative courts — do you think there should be specialized federal prosecutors dealing with these kinds of cases? What kind of coordination do you think is needed there?

**Ms. Palacios:** Yes, as I said, we launched our first criminal complaint for bid-rigging activities in the healthcare sector in Mexico this last February. How has the coordination been or how should it be in the future? I think we can’t answer that question now, we are learning with this first experience. As I said, this is a system in construction. I hope this case moves smoothly so I can answer this question next year or maybe at the end of this year.

When the criminal complaint was first presented, the reactions were interesting. On the one hand, some people within the competition community said this was serious cartel prosecution in Mexico. Others criticized it because they said that criminal cases have higher evidentiary requirements, which is true, and that all this was new, so the probability of this case being successful would be low. To that I answer that we need to start. There is always a first time for everything.

I personally do not handle the investigations, but I am sure that if our prosecutor files a specific case, it is because he understands that the requirements and the merits for a criminal complaint are part of the evidence he has gathered and turned over to the national prosecutor. It is also important to notice that the national prosecutor has different and harsher powers to request that information that is deemed necessary in order to follow that path.

Our intention, of course, is to provide as much information as possible and to present all those cases that have the requirements and the merits for a criminal complaint. But we also would expect the national prosecutor to use its power to request further information, if necessary.

As I said, this is a learning-by-doing process. This is the first time. There is always a first time for everything. Maybe in some months we will have some answers.

**Mr. Perez Motta:** Thank you, Alejandra.

Felipe, this is going to be a new job for your office. Do you have to bring this case to the federal prosecutors directly or do you have to go first to the Competition Tribunal? How does that work and how do you plan to face this challenge?

**Mr. Irarrazabal:** Well, let me put it this way. So far it is not a marriage, not close to that. But we will see in the future.

I will answer your specific question. But first I would like to point out that a criminal prosecutor is very different because of many aspects compared with an antitrust prosecutor, in terms of the size of each institution, the media exposure, even on the specific regulation on secrecy. Obviously, they have criminal judges and we have the antitrust court. In the case of Chile, the Criminal Prosecutor is no more than 15 years old and the Antitrust Prosecutor is somehow old; we are in our ‘50s as an institution.

If I see a movie, I can bring four different scenes which would show you that although we are trying to build a relationship, we are still far away from having “a marriage.”

The first scene of this movie is when we faced the pharmacy case, which was basically a cartel case. We did it very well. It wasn’t easy; as a hard-core cartel it is never easy. But it ended up with the maximum fine imposed by the antitrust court, and also confirmed by the Supreme Court. But the case was so attractive that the criminal prosecutor was, in my personal opinion—let me
try to be diplomatic—anxious to have some participation in this process. They started a criminal procedure and an investigation against individuals in this cartel, but without a precise and clear criminal provision. They had a criminal provision—and I’m sure you have this in Mexico—but it was a provision regarding alteration of natural prices, which was part of the criminal code which was approved in 1874. I always said that if that provision is fully applied for cartel cases, then we have to defend that we are the country that invented antitrust in the whole world, which is not the case, much before Canada and the United States.

What we foresee on this, without being criminal attorneys, is that they will fail. And it happened, it failed, because a criminal judge said, “No way. Where is the provision? Where is the infraction?” They were trying to use that old provision, and they said basically “No way.” So that is one picture of the movie.

Then we have another case, which is the tissue case, where we received two leniency applications. Obviously, the case attracted a lot of media exposure and attention. One of the criminal prosecutors became interested in the case probably, and he requested all the confidential information that the applicant had provided to the Fiscalia. We basically said, “No way.” They made the same request even to the antitrust court. So not just against us, which is an administrative body, but against an antitrust court.

The antitrust court—this was not our idea—decided to bring a case regarding that petition before the Constitutional Court on the jurisdiction issue between an agency or a tribunal and another agency which was the criminal prosecutor.

We were obviously under stress. We basically understood that if they had won, then that would mean a real challenge to the leniency program, because the confidential files given to us with the leniency application would become public under the criminal provisions.

I remember Brent helped us a lot on the confidentiality issue, as well as the Federal Trade Commission. Also we requested some advice from the United Kingdom, from Spain, and also from Brussels. And Judge Javier Tapia was on the hearing before the Constitutional Court as well as me. As you can imagine, we were not friends in that part of the movie.

What was the result? Well, we won. We won 9-to-0. Not one vote to the criminal prosecutor. And the confidential documents were kept that way.

And then we got the new law. What happened was that the criminal prosecutor wanted to be involved from the beginning in the investigation, as if it were a criminal investigation. As Eduardo said, we included a criminal offense which is from three-to-ten years, only for hard core cartels.

But I think Congress was wise enough to not allow parallel procedures. So the criminal system must wait until we have finished our case vis-à-vis the antitrust court and the Supreme Court. Only once we finish that, which is basically the procedure where we request the fines, then we can go to a criminal system, and only if the head of the antitrust prosecutor’s office decides so, in grave cases.

They were not happy when we were dealing with this in the Congress because the Criminal Prosecutor wanted to participate from the beginning. That is the third scene.

In the future, and despite the scenes that I have already described, I see myself working together with the criminal prosecutor. And also, we will be facing a challenge trying to specify in a legal way what does “grave cases” mean, the cases that will trigger a claim against individuals for criminal offenses.

We also—and I will finish with this—have launched guidelines on leniency three months ago, which we received very helpful comments on from the American Bar Association and the International Bar Association.
Mr. Perez Motta: Thank you, Felipe.

Brent, this is going to be a very good new opportunity for the DOJ to get better coordination with some Latin American agencies in the case of international cartels. What can you tell us about this?

Mr. Snyder: Well, first, my job at the Antitrust Division is to be responsible for our criminal prosecutions. I am personally very enthusiastic and I have been watching with great interest the developments of the last several years in the various countries that have been adding criminal sanctions.

One of the key things about this trend toward increased criminalization is that I think it reflects a shifting in public attitude, where people are now recognizing the harm that is caused by cartels and are willing to try to deter and ultimately punish that harm with much more severe sanctions than has been the case in the past. I think that shifting of public perception is good for all of us because I think it shows greater support for our mission to protect competition.

In terms of whether there are going to be opportunities or challenges presented by this increased criminalization, I view it as really nothing but opportunities. For instance, the United States has mutual legal assistance treaties with a sizable number of countries in the Americas. These allow us to share evidence and to share information with other countries. We can request information from them, and they can request it from us. It allows us to share information within the context of criminal investigations that we would not be able to share, or even request, if the other country did not also have criminal sanctions. So really this is creating an opportunity for us to coordinate our cartel investigations more closely and to share more information.

Likewise, we have extradition treaties. But extradition from one country to another normally requires dual criminality, meaning that the conduct for which, for instance, the United States is trying to extradite somebody from a foreign country also has to be criminal in that country. For a long time, really it was only the United States and Canada that had criminal cartel sanctions. But the more countries that add criminal cartel sanctions, the more likely it is that we will be able to extradite people from one country to another for cartel violations. That is also a very important deterrent to cartel conduct.

A great example of just how this works relates to an investigation we recently, about a year or so ago, wrapped up in a bid-rigging investigation involving a hazardous waste cleanup site in the United States. One of the key defendants in that particular investigation was a Canadian national and he lived in Canada. During the course of our investigation we were able to send a Mutual Legal Assistance Treaty, or MLAT, request to Canada in order to get information related to this individual's company, and the cooperator was key to building our case. Then, ultimately, when we determined that we had enough evidence to actually bring a case and indict that individual on conspiracy and major fraud against the U.S. charges, we then were able to apply for extradition to Canada. Because both Canada and the United States have criminal sanctions for the crimes with which we charged the defendant, we were able to extradite that individual to the United States. We tried him about a year ago and he was convicted and he is now in prison in the United States. That's not a one-way street. We periodically receive MLAT requests from Canada where we are providing them with information that they are using in their investigations as well.

I think this is only going to create more of those types of opportunities between the Department of Justice and the other enforcers in the Americas that have criminal sanctions.

Mr. MacLeod: Thank you.
I would like to put the agencies on the spot. Let’s go back to where we began our discussions yesterday, and that was with the Minister calling on the competition community to stand for the principles of competition law and economics. We heard Tad give a brief history of that when he gave his opening comments today, but this is now going to be a fundamental debate over the next several months. As a matter of fact, there is a request for comments right now by the United States Trade Representative, with comments due on the 12th of June, on issues to consider during the NAFTA renegotiations, one of which is “relevant competition-related matters that should be addressed in the negotiations.”

So my question to anybody who would like to pick this up is: (1) what role should competition agencies have in international trade relations; and (2) should the tools of competition analysis be modified so that a competition case can speak to the public and say, “We have heard you and we have taken into account this particular national interest?”

Does anybody have any thoughts on this?

MR. GRECO: I think this is a big, big issue. I think from the point of view of antitrust in the Americas, international trade is one of the most powerful procompetitive tools. Mainly, when you have different markets and sectors with scale economies, if you have a closed market or you do not have international trade, maybe you will have a local monopoly or a few firms. So in this sense I think that competition issues are relevant to take into account when governments have to deal with decisions about international trade.

I think the competition agencies have an important role of advocacy in the sense of explaining the benefits of this tool to have more competitive markets and protect consumers, innovation, and productivity in the long term.

But, at the same time, these issues have to deal with other public policy issues. I think in this sense competition issues, at least in the short term, have to deal with tradeoffs between public policies, because you can have short-term effects on employment and industries and firms that you need to take into account as a government. I am not talking about competition specifically, but competition is one of the issues. In this sense, there are other effects that a government may take into account.

For this I don’t think that it is desirable to fail in a very good long-term policy that strengthens international trade because we do not take into account the short-term effect and who are the winners and losers. So I think the competition agencies have a role in these advocacy issues.

In our case, in Argentina we are making some sector and market investigations, for example in some markets where economies of scale are high, such as steel and aluminum and this kind of input, where we think that international trade is an important issue to take into account. We have made this in a case recently in the petrochemical sector, advising to eliminate some trade barriers because this is procompetitive. So this is, I think, a good role for competition agencies.

MR. MACEDO: Actually I agree with Esteban, especially about the advocacy. But one thing I really want to add is in our law we say that the collectivity is the owner of the rights that are defended by this law. What does the term “collectivity” mean? Sometimes you have a lot of interests that are not just the competition issue. Should our agencies consider another kind of national interest in our decisions, like protecting the internal market, international trade, industrial policy? Should we consider these in our decisions? This is an issue that comes up every time. There are some cases where the argument of saving jobs came up. Should we consider that?

I think that the principal role, the main role, of the antitrust agencies is the consumers and the competition. That’s the point. On the other hand, it doesn’t mean that I don’t have to consider the
other things, but the main issue is the consumer and the competition. After doing the analysis of the consumer and the competition, I can look for the other things and analyze the balance and the cost/benefits to take some decision in order to give some deference to another issue. . .

MR. IRARRAZABAL: No!

MR. MACEDO: . . . but the main point for me is competition and consumers.

MS. PALACIOS: Are you talking about merger analysis?

MR. MACEDO: Yes, I’m talking about the merger analysis and everything in a general way, the role of antitrust.

MS. PALACIOS: I would say I am not with him in this decision. As competition agencies, I think that our mandate is very clear: to protect competition in the markets. Specifically in merger analysis, we are not responsible for other industrial policies such as employment or investment. What I believe—and this is analyzed in one of our advocacy reports that is coming out soon—is that trade policies should take a competition perspective within their framework analysis.

As we all know, imports serve as a source of supply of inputs that maintain competitiveness in several markets, in the Mexican case in very important industries, for example natural gas, and imports also increase the local supply of products, pressuring local prices down through competition. So whenever you as a government decide to apply a tariff, that tariff will have a competition impact in the local market. So in that sense we believe that they should take into account a competition perspective when they do that analysis because, as Esteban said, this will have a medium- and long-term impact, not just a short-term impact.

MR. MACLEOD: I once represented the State of Alaska, or rather the legislature of the State of Alaska, which was concerned about the effects on employment of the BP/Amoco deal on the Alaska Pipeline.

So let me put a hypothetical to you, Tad. I now represent the International Association of Accountants and Lawyers. Two Fortune 50 firms are merging and half the accountants and lawyers are going to lose their jobs. Can I come into your office and advocate these job losses as a reason for you to challenge this merger?

MR. LIPSKY: Not in the United States you can’t, because we have a law that is very clear. You have to find substantial lessening of competition or the likelihood of the creation of a monopoly, and that’s all our law says.

MR. IRARRAZABAL: I also agree. I think the whole antitrust law is like a truck which is already loaded with many concepts and responsibilities. If you want to put more load, more weight, on that truck, I don’t think it is a wise decision, and in the long term it would not work. It is rather difficult to measure the impact of our enforcement and advocacy in terms of the national employment.

So I would prefer to stay with the standard concepts on antitrust. And we already have a lot of work to do, just focused on mainstream antitrust ideas and effects on the economy. That’s the reasonable approach, I believe. In the medium term it might not be a good business for the prestige of the antitrust institutions.
MR. MACLEOD: Let me broaden the question then and put it this way: How is the competition community, and especially the competition enforcement community, lending its credibility and prestige to the debates over who benefits from competition policy? Should we be doing anything different? Can we do anything different? What kind of successes are we having?

Let’s have a quick round as to whether we think the competition message is getting across. Debbie Majoras yesterday said it is easier to get the populist message across than the competition message across. How do we as competition enforcers and competition advocates most effectively explain to the public what we do? Does anyone want to take a bite at that?

MS. PALACIOS: As I was saying yesterday, at least in the Mexican case, which is the one I can talk about, when I listen to people say that markets don’t work and that’s why we need to pull back, I always answer that I think that analysis is not correct because in Mexico in many sectors we don’t have efficient markets. What we have are tons of privileges and tons of regulations and government activities that protect certain groups.

So, I would fight for more profound and efficient markets in Mexico. We need to go there before turning back.

MR. IRARRAZABAL: I would add that I think the magic word is cases. You have to bring cases. It is not that easy to explain the cases, especially if we are in the middle of their litigation, but that is the magic word. You need cases, and through the cases you maintain your prestige as a needed institution or a needed agency.

MR. MACEDO: I would say the same thing: a lot of regulation, inefficient markets, protecting specific people. We look for efficiencies as well. So I agree with you.

MR. GRECO: I agree with Felipe that cases are the best way. Competition, how markets work and how competition has effects on markets, may be a very abstract idea if you cannot translate this into cases and into direct benefits to consumers and to the economy. I think selecting the cases and constructing a good narrative about how this works is essential for that.

Also, the way things could affect the issue: We had an example in Argentina recently because there was a closed market for computers, so the prices of laptops and computers were really high. There was also, as there always is, an interest group, very small in comparison with the potential beneficiaries of opening the market. There were some firms that did not build but they imported parts of the computers and put them together and sold at a high price in the local market.

But there was, I think, a good explanation of how this could benefit. And also, the government took into account how they could deal with the losers of the liberalization, giving support and building capacity for workers and reallocation of workers. But mainly the high benefits were for the consumers and for the economy because of the high productivity that you can achieve with more use of computers.

In terms of employment, in the end the net effect on employment would be positive because new employments are coming in the distribution sectors, in repairs, and a lot of complementary activities that when you have a closed market people cannot see these potential benefits.

So I think it is challenging, but we need to consider this kind of narrative.

MR. MACLEOD: There is an interesting effort on this right now in the United States with a message that I think could resonate very well. It’s called economic liberty.
Tad, could you give us just a quick sense of what this means? You described it before in more legal terms. What is economic liberty and how does that play into this initiative?

**MR. LIPSKY:** Well, economic liberty, I suppose, is the freedom for people to engage in trade and commerce, just basically stated.

Maureen Ohlhausen, when she became Acting Chair, established an Economic Liberty Task Force that has been very active, advocating primarily to state and local governments that requirements to engage in occupations be held to a reasonable minimum that is necessary to address objective concerns about health and safety. Of course there are a number of professions regulated at the local level where licenses and training are required—law, medicine, accounting, engineering. But there is a host of professions—cosmetologists, people who work in hair salons and nail salons—and there is a tendency for local regulation to extend much further than would really be required in an objective sense to protect public health and safety. I don't know if there are many injuries that occur in hair braiding—maybe there are.

But in any event, the purpose of the Economic Liberty Task Force is to advocate on a consistent nationwide basis, and it has had a tremendous amount of success. It has been received very well in many states and localities. It is headed by our Office of Policy and Planning. They are constantly working on advocacy pieces that have usually been invited by the local authority.

But, if I may, Bill, this is part of a trend that has appeared at different times and with varying strengths in the U.S. antitrust community throughout history. You know that our transportation industries in the United States—and I don’t want to jump the gun on your transportation question—railroads, trucking, even barges in inland waterways, and of course air transportation, used to be regulated according to a very strict public utility model where entry and exit were very tightly controlled, prices were rigid and tightly controlled, you couldn’t change a price without filing a tariff and giving others an opportunity to object and so on and so forth. Actually, most of the agencies that regulated transportation in the United States have been abolished precisely because it became possible to identify very clearly and in ways that were easily understood by the general public that this form of regulation, because it restricted competition, was very bad for the consumer and for the economy.

The classic example being at the height of the most-restrictive regulation of commercial air transportation, the price of flying from Boston to Washington was, I think, about three or four times the price of flying the very same distance from San Francisco to Los Angeles because the Boston-to-Washington route was subject to this terribly restrictive federal economic regulation by the Civil Aeronautics Board, whereas the intrastate routes between San Francisco and Los Angeles did not suffer from that public utility regulation, and therefore the price was set by competition. It’s one of the great parables in the arsenal of stories that we true believers in competition have to demonstrate why economic liberty is very much in the interests of the economy and the consumer.

**MR. MACLEOD:** I think economic liberty is something that is very apparent in the COFECE activities. Brent, I’m hoping that we will never have to come up with a message that explains why we go after cartels. If the cartels start getting the upper hand on that messaging we’re in trouble.

But Tad mentioned transportation. Why don’t we finish with a note on transportation because it is now much more in the competition realm than it has been before. Transportation and antitrust have been intertwined for decades in the United States, but the action is relatively new in a number of Latin American states.

Eduardo, why don’t you give us the last question on that and then we will wrap up?
MR. PEREZ MOTTA: I would like to put this question to Alejandra. In Mexico there was a major set of reforms at the beginning of this administration, and it was a result of a political negotiation among different parties. From that discussion, which was called a political pact, there came reform in telecoms, competition, energy, education, and in some other areas.

But something that was just mentioned at the beginning, in the first document of the pact, but it was not operationalized, was a reform in transport, which is a very important sector, especially today when the telecoms revolution has generated a very important decrease in the price of information. Information is accessible to most people today, but in order to make that a reality in the marketplace you need a very efficient transport system.

I have to say, very frankly—I say this privately and I can say it publicly—I think that the only agency in Mexico that is actively promoting efficiency in the transport sector, which is something the players of the political pact didn’t do, is the Competition Commission. You mentioned this at the beginning, Alejandra, that the Competition Commission is working in air transport, in railroads, in auto transport. What do you think will come out from this effort that the Commission is doing?

MS. PALACIOS: Thank you, Eduardo, and thank you for the opportunity because I am going to mix the issue of economic liberty with transportation.

Yes, of course all the reforms, what they wanted to do—and the Minister said that yesterday—is to lower transaction costs for medium and small companies, and also the costs of basic services, and they did that in the energy reform and in the financial reform and in the telecom reform, and they did not specifically touch transportation. In the Commission, when we came in three and a half years ago, we elaborated a strategic plan, and we decided that transportation was an important sector. I would say that at least 30 percent of our resources are being used in the transportation sector. As I was saying, we are going to take a final decision regarding two preliminary findings in this sector soon: slot allocation and competition conditions prevailing in the railway sector.

We have an ongoing cartel investigation on the commercial airline industry, and the market is defined as landing and departing flights in Mexico.

We have two investigations in Mexican ports. One is an abuse of dominance investigation, and the other one is a barrier to competition—the new procedure under our law. Ports are very important, especially for a country that wants to become an export and import platform, we need ports to take our things out and bring products in.

We will announce in the next week our final decision, which we took two weeks ago, regarding an international cartel investigation in shipping lines.

One case that I love has to do with freight transporting in the Mexican State of Sinaloa. This case is for me emblematic because it is an Article 94 investigation. It has to do with barriers to competition, and these barriers come about because of regulation. What you have is a law and bylaws that basically foreclose a market. The state is divided by zones, so for freight transportation you can only take the product out of your zone, but if I go to the other zone, then I cannot bring my truck back full with a load. In reality, as a consumer you are charged for the service to go and come back, even though you can only hire a one-way service.

Then there is a committee that decides upon new concessions, but it is the old transportation associations that are sitting on that committee. So if they would ask one of them if they want competition, what is the incentive, and it is quite normal, to say “No.” So there are concessions waiting for an answer for 10, 20 years and nobody will answer them positively. Then the individual responsible for the transportation department within the government is the owner of a big concession. So when we talk about conflict of interest, that may be one.
And then prices are regulated and the prices are defined by this committee. So it is a legalized cartel. You cannot fight against a cartel when it is a legalized cartel.

The consequence of all this is that in certain municipalities you have one concessionaire that owns all the concessions for that zone. That happens in the construction sector and that also happens when they want to transport grain. This state is the most important state in Mexico in terms of agricultural production.

The construction people say that they pay at least 40 percent more for their transportation because they cannot do it by themselves, they need to hire these associations. And then what is really absurd is that many grain producers prefer to send their products 700 kilometers away to a port in another state because it is cheaper than to go to the port which is in their state 40 kilometers away from their production area, which is Topolobampo, because of the cost of the service.

This is all absurd regulation. So talking about economic liberty and transportation issues, this is the case. And what we find in the State of Sinaloa is replicated in many other regulations at the state level in Mexico. So if we want to lower transportation costs, I think there is a big battle to fight against in this sector.

MR. PEREZ MOTTA: That is the way in the States?

MR. MACLEOD: Yes, absolutely.

It reminds me of a comment that a senator, who was known for fighting for the little guy, made back in the 1970s. The senator was asked, “Why are you supporting airline deregulation, because only rich people fly?” His answer was, “That’s why I’m doing it, because I want everybody to.” That’s economic liberty.

I am just delighted to hear our panel converge on the issues that economics and law should influence and inform competition policy, and that advocacy for the marginal consumer, for the liberty of those who cannot break into businesses and sectors that are protected by barriers, is what we will continue to do in cases as well as in industry investigations. We in the private bar are here to help the agencies do it as well as we can.

Thank you, everybody.
Paid Prioritization and Zero Rating: Why Antitrust Cannot Reach the Part of Net Neutrality Everyone Is Concerned About

Hal J. Singer

As Internet-based distributors move up and down the stack to become vertically integrated platforms with a preferred suite of affiliated content, there is a growing concern among policymakers that innovation among independent content creators and websites may be threatened. More fundamentally, the Internet is not one thing—it is many things, and our current regulatory regimes are struggling to address that complexity.

These new platforms give rise to potential conflicts of interest, in which it might pay for a vertically integrated platform owner to sacrifice some profits (if any) in its distribution division in order to support an affiliated (or favored, third-party) application. For example, what happens when Amazon structures its Alexa voice platform to give one (and only one) response to a question about booking a car rental at an airport? (Amazon recently struck a deal with Avis to do exactly this.1) Can Amazon offer preferential treatment without distorting competition in ancillary markets? Or must it abide by some non-discrimination standard—for example, by offering to accept bids for the first response, or to rotate the first response among all similarly situated comers? Because such mild favoritism likely would not produce a short-run price or output effect, antitrust may not be suited to police such conduct.

This essay focuses on identifying and fixing this potential regulatory gap when crafting a “net neutrality” policy—a set of rules or standards designed to spur innovation at the “edge” of the Internet by preventing Internet service providers (ISPs) from engaging in discriminatory conduct.2 But the essay could just as easily be directed at the powerful online platforms wielded by Amazon, Facebook, or Google. The applicability of this remedy to other parts of the Internet is natural, not because market power is paramount there (though it certainly exists), but because there is a large enough threat to innovation in adjacent markets to online shopping, social media, and search, respectively.

Consider a hypothetical case in which an ISP offers preferential treatment for an online content supplier’s packets for a fee, but declines to make the same terms available to other content providers. To make the matter concrete, assume the preferred content supplier offers telemedicine

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2 The precise rules or standards used to implement net neutrality can take many forms and are subject to debate. For example, in 2015, the Federal Communications Commission banned all payments from websites to ISPs for priority delivery or terminating access, and banned ISPs from blocking or throttling websites to extract such payments. See Protecting and Promoting the Open Internet, Federal Comm’ns Comm’n, GN Docket No. 14 -28, FCC 15-24, Report and Order on Remand, Declaratory Ruling, and Order, Protecting and Promoting the Open Internet (Mar. 12, 2015), https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-24A1.pdf (hereinafter FCC 2010 Open Internet Order).
service, a real-time application that performs better with enhanced quality of service from the ISP. For wireless providers, preferential treatment could, for example, take the form of the ISP’s not counting the content provider’s packets against the customer’s data cap (known as “zero rating”).

To an economist, the precise nature of the preference afforded the content provider is not critical, so long as preference of some kind is provided for a fee. What matters from a competition perspective is that as a result of the pay-for-preference arrangement, the favored content provider operates at a competitive advantage vis-à-vis its content rivals with respect to quality of service. Because the offer of preference is, by assumption here, not extended to all comers, the arrangement is discriminatory, plain and simple.

But does it amount to an antitrust offense? This essay answers that question in the negative. Unlike traditional discriminatory-refusal-to-deal (DRTD) cases in antitrust, there is no effort by the ISP in my hypothetical to disadvantage a horizontal rival. Even if an edge provider could structure its antitrust complaint as a DRTD, private litigants who are denied the paid arrangement are unlikely to pursue antitrust cases where the only potential harm to competition is an innovation loss (in the form of less investment/innovation by edge providers in future periods). The anticompetitive effects here are assumed not to take the form of price or output effects, at least not in the short run. When an ISP favors one content provider, the primary effect is to shift views (or clicks) towards the favored website and away from the disfavored website. So long as the favored site is unable to exercise market power, there will not be a short-run output or price effect; to the extent that the quality of the preferred site rises due to the ISP’s special handling, quality-adjusted prices might even fall in the short term. In this case, using antitrust enforcement to remedy the alleged harm to the disfavored app provider likely would prove futile.

Even if the edge provider could structure what may be a violation of net neutrality as an antitrust complaint, private litigants would be reluctant to do so given the low likelihood of prevailing under the antitrust laws. Finally, competition is not the only value that net neutrality aims to address: end-to-end neutrality or nondiscrimination is a principle that many believe is worth protecting on its own.

Moreover, antitrust litigation imposes significant costs on private litigants, and it does not provide timely relief; if the net neutrality concern is a loss to edge innovation, a slow-placed antitrust court is not the right venue. The Internet-based industries at issue here are strongly characterized by first-mover effects and network effects, which renders antitrust’s slow-moving process especially problematic. While public enforcement of innovation-based claims is possible, it likely would take an edge provider months if not years to motivate an antitrust agency to bring a case.

Instead of an antitrust regime, this essay offers an alternative, an ex post regime patterned loosely on the tribunal used to adjudicate discrimination complaints against cable video operators pursuant to Section 616 of the Cable Television Consumer Protection and Competition Act of 1992 (Cable Act). Although that tribunal operates under the Federal Communications Commission (FCC), the proposed tribunal here could be independent, as are Article I courts, operating free from reversals by political appointees at federal agencies.

Like a rule-of-reason case under antitrust, the tribunal would begin with the presumption that preferential arrangements extended by ISPs to edge providers are presumptively not in violation of a (to-be-adopted) nondiscrimination standard, but would allow complainants to overturn that...
presumption upon meeting certain evidentiary criteria. Importantly, the tribunal need not import the evidentiary criteria verbatim from antitrust—for example, there would be no need to establish market power, profit-sacrifice, or short-term harm to consumers in the form of price or output effects. (Section 616 does require the complainant to prove that the conduct “unreasonably restrained” its ability to compete). 4

Because the enforcement gaps in antitrust identified in this essay also fail to restrain search-neutrality violations, there is no reason why the tribunal could not accommodate complaints against dominant Internet intermediaries, such as Google and Facebook. In this sense, a new tribunal could provide a “layer-neutral” approach—that is, neutral at both the edges and the core of the Internet—to dealing with neutrality issues.

Are the Antitrust Laws a Good Fit?

Monopolists are generally free from legal constraints to choose their suppliers and engage in price discrimination under the antitrust laws. Where such constraints exist, the source is often industry-specific regulation. For example, the obligation to deal with rivals or content suppliers on nondiscriminatory terms flows from common-carriage or program-carriage rules under Section 202 of the Communications Act and Section 616 of the Cable Act, respectively. As explained by Christopher Yoo, 5 telecom regulators historically ensured nondiscrimination by requiring the telephone company to offer service under the terms specified by a tariff to any requesting party that qualifies to receive the service. The FCC has also imposed nondiscrimination provisions in approving cable mergers, particularly for vertical mergers involving the acquisition of cable networks. Antitrust agencies have similarly imposed nondiscrimination obligations as part of consent degrees in vertical mergers involving cable operators (such as Comcast-NBCU and Time Warner-Turner). Setting aside these merger-related exceptions, nondiscrimination obligations generally do not flow from the antitrust laws.

Indeed, the recent tendency in antitrust jurisprudence has been to relax nondiscrimination obligations. In Terminal Railroad, the defendant discriminated against rival railroads by refusing to grant access to its terminal facilities. 6 The essential facilities doctrine, which grew out of that case, has been undermined by more recent developments. In Trinko, the Supreme Court ruled that telephone companies had no antitrust obligation to deal with resellers (horizontal rivals) above and beyond the unbundling obligations in the Telecommunications Act. 7 Trinko cast doubt in the viability of the essential facilities doctrine, particularly as applied to regulated industries, such as telecom and potentially Internet access.

The closest surviving cognizable antitrust offense for my hypothetical case of discrimination by an ISP is a DRTD. For example, a dominant firm may discriminate by refusing to deal with—or offering worse terms to—horizontal rivals or those buyers (or suppliers) who deal with horizontal rivals. In Aspen, the defendants discriminated against rivals by refusing to sell lift tickets to its rival

4 For a similar, case-by-case approach grounded in Section 706 of the Telecommunications Act (as opposed to Section 616 of the Cable Act), see Tejas N. Narechania, Federal and State Authority for Broadband Regulation, 18 STAN. TECH. L. REV. 456 (2015). Narechania explains that “applying strict antitrust standards [under Section 616 of the Cable Act] might have the effect of rendering the statute superfluous to the antitrust laws themselves,” and that “requiring antitrust scrutiny here also takes an overly restrictive view of the FCC’s authority under the [Cable Act].” Id. at 475 n.111 (citing H.R. REP. NO. 102-628, at 111 (1992)).

5 Christopher Yoo, Is There a Role for Common Carriage in an Internet-Based World?, 51 HOUSTON L. REV. 545 (2013).


at any price. In *Otter Tail*, the defendant discriminated against rivals by refusing to supply electric power to those municipalities that competed with the defendant in retail distribution. In *Dentsply*, the defendant discriminated against rivals (indirectly) by using exclusive contracts with dental-product dealers to limit rival manufacturers’ access to dental laboratories that purchase artificial teeth. And in *Lorain Journal*, the defendant discriminated against rivals (indirectly) by refusing to sell advertising space to those advertisers who dealt with its rival.

Based on a review of these and other seminal DRTD cases, Einer Elhauge explains that a duty to deal turns not on a prior course of dealings with the buyer or distributor, but instead on whether the dominant firm’s present dealings discriminate between rivals and non-rivals, in particular, whether the dominant firm deals only with non-rivals and excludes rivals. And even then, to prevail under the antitrust laws, the plaintiff would still need to demonstrate that the DRTD enhanced or maintained defendant’s monopoly power and harmed competition. Robert Kulick develops an alternative post-Chicago model of exclusive dealing where exclusive dealing takes the form of a DRTD.

It is important to distinguish between conditional refusals to deal and unconditional refusals to deal. For example, Carl Shapiro explains that a vertical conditional refusal to deal could involve a higher price charged to some downstream firms (such as direct competitors) than others, whereas with an unconditional refusal to deal, a dominant firm only uses its owned input internally. Like other conditional refusals to deal, a DRTD could be problematic if it results in exclusion of a rival and reflects other anticompetitive indicia such as profit sacrifice or degrading quality of one’s own product. But as a practical matter, the agencies largely have decided not to bring such cases. By failing to do so, they have created a perception that antitrust is not capable (or the agencies are not willing) to address such problems. Where the Federal Trade Commission has prosecuted DRTDs, the goal of the challenged conduct was to disadvantage a horizontal rival. For example, in *Transitions Optical, Inc.*, the defendant discriminated against horizontal rivals by refusing to supply lens distributors that also distributed a rival lens.

The fact pattern in my paid-priority hypothetical is significantly different from a DRTD in several ways. First, the ISP is not refusing to deal with telemedicine providers who deal with other ISPs. Rather, it picked its preferred vendor and agreed to an exclusive priority arrangement in return for a payment. There is no effort to disadvantage a horizontal rival, which was the salient feature in each of the DRTD cases reviewed above. (While the content provider could buy an exclusionary right to disadvantage content rivals, the preferred vendor is assumed to lack monopoly power in any relevant antitrust market.)

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Second, unlike a DRTD, there is no exclusion of other telemedicine providers, as they still have access to the ISP’s customers, albeit with less favorable treatment than the preferred supplier. This form of mild discrimination—in which the private harm to excluded content rivals takes the form of a relative but not absolute degradation in service quality—would seem to evade antitrust scrutiny. It is hard to imagine how this sort of preference could lead to higher costs for a rival ISP, the primary concern in a DRTD case. (Because there are no inputs that are close substitutes for quality of service—for example, increased marketing cannot compensate for lack of a higher quality of service—the costs of the disfavored website similarly would not rise as a result of the discrimination.)

Third, unlike *Otter Tail* and many other fact patterns giving rise to the “discriminatory impulse” (or tendency to favor one’s own input affiliate), the ISP in my hypothetical is not vertically integrated into content, and thus lacks the typical incentive to discriminate in favor of its own affiliate.

It bears noting that several major ISPs have recently integrated into content, including Comcast (NBCU) and Verizon (Yahoo! and AOL). Had my hypothetical ISP been vertically integrated into content, however, extending mild preference within the firm would likely be afforded some leeway under the antitrust laws relative to exclusionary arrangements with a third party.

Still other factors could weaken antitrust theories here. For example, if the vertically integrated ISP favored its own content, but says it will offer the same terms to other content providers that it is offering itself, then it would be hard to monitor and enforce nondiscriminatory treatment—the price for the preference would be a transfer price, which if raised by the ISP, would not affect the ISP’s profits across its upstream and downstream divisions but would raise the costs of content rivals. Alternatively, the rival content provider may be offered terms for preferential treatment that make it impractical or impossible to compete effectively against the affiliated content.

Even if a rival telemedicine provider could style its complaint as a DRTD, the standard balancing of efficiencies and anticompetitive effects in a rule-of-reason case would require the complainant to show harm to competition. Notably absent from such a complaint would be any evidence of price or output effects. By offering preference to a single telemedicine supplier, while carrying the packets of rival suppliers, the ISP at most has diverted eyeballs from rival telemedicine sites to the preferred site, ensuring no output effect (assuming no obvious degradation in quality in the rivals’ services). And the ISP would hardly be able to raise prices for Internet access to its customers as a result of giving preference to one telemedicine provider. Indeed, by the seesaw principle of two-sided markets, the new ISP revenue from the content side could put downward pressure on the ISP’s prices to end users. While it is possible that the preferred telemedicine provider might seek to raise its prices, its quality-adjusted price would be competitive: the hypothetical here allows for the possibility of competitive discipline from other telemedicine providers receiving preference from other ISPs. With no price or output effect, the complainant would be hard-pressed to demonstrate anticompetitive effects. And even if it could, there are what could be considerable efficiencies to consider before concluding that the paid priority is anticompetitive on balance.

In my hypothetical, the harm to competition takes the form of a potential loss in innovation. In particular, rival telemedicine providers might be less inclined to invest in R&D and develop superior real-time applications if they believed the playing field was somehow slanted toward the preferred vendor.

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16 As of the time of this writing, AT&T’s intent is to integrate into content by seeking to acquire Time Warner.
It is beyond the scope of this essay to prove that the ISP would not internalize the potential harm to innovation.\textsuperscript{17} But how would a complainant demonstrate that harm in an antitrust court? The best a complainant could offer would be evidence of exit by rival telemedicine firms, but even that would not prove a loss in innovation, as the exiting firm's connection to future innovation is tenuous. While the antitrust laws certainly recognize harm to innovation as an anticompetitive injury, a private litigant likely would not bring a case based solely on such a difficult-to-prove antitrust harm. Cases in which harm to innovation is the primary antitrust injury are brought by the agencies rarely (if at all), as was the case in United States v. Microsoft.\textsuperscript{18} There the harm was not a threatened increase in the price of browsers but instead a threatened loss of middleware providers evolving—that is, an innovation loss—into rival operating systems in future periods. And even this finding was controversial according to some of the antitrust literature on the Microsoft decision.\textsuperscript{19}

Even antitrust agencies shy away from bringing harm-to-innovation cases. Although the D.C. Circuit determined that Microsoft had liability without the Department of Justice having to demonstrate that the nascent threats would have developed into full-fledged competitors, the antitrust laws have evolved in a manner that makes it difficult to address discriminatory behavior that may adversely affect innovation. Increasingly, the agencies and courts defer to the business judgments of platform providers. While the Microsoft court suggests a balancing of harm and benefits, the agencies tend to stand down upon the showing of any plausible justification. It is one reason why one observes few, if any, Section 2 cases brought by the antitrust agencies. Correctly or incorrectly, agencies perceive the hurdles as too high and are loath to second-guess the decisions businesses make regarding their own platforms or infrastructure.\textsuperscript{20} Instead, regulators focus resources on restrictions that limit or exclude firms from working with horizontal rivals. Even if the agencies were inclined to prosecute DRTDs, for the reasons outlined above, they would be hard-pressed to style a net-neutrality violation as a DRTD.

Finally, the difficulties summarized above concern fitting my hypothetical fact pattern into a cognizable offense under the antitrust laws. An added difficulty, and one that arguably is more important than the lack of fit, is the practical impediment to prevailing in an antitrust court. Antitrust moves slowly. Motions to dismiss, Daubert motions, motions for summary judgment, and appeals can extend the timeline of many cases beyond five years. Because of this extended timeline, there may not be adequate remedies under antitrust law to cure the innovation loss. And the litigation expense is considerable. Recall that the purpose of net neutrality protections is to preserve innovation at the edges of the network. Offering foreclosed content providers—at least some of which will be startups—a venue that could take multiple years and millions of dollars in litigation expense is tantamount to offering no relief at all.

Dissenting Views
By contrast, some notable voices in competition policy argue that antitrust can accommodate net neutrality concerns. With respect to antitrust treatment of “preferred delivery,” Acting Federal...
Trade Commission Chairman Maureen Ohlhausen acknowledges that “[f]irms pay for preferred shelf placement in supermarkets, prominent locations in shopping malls, and expensive advertising opportunities,” but that “[s]uch agreements rarely create antitrust issues.” The reason they do not, of course, is that mild preferencing of the kind contemplated in my hypothetical often finds efficiency justifications, and, in any event, it does not pose a threat to competition recognized by antitrust. (Under certain conditions, economists can often justify on efficiency grounds not-so-mild preferencing such as exclusive deals.) Nevertheless, Ohlhausen insists that “antitrust would forbid efforts by ISPs with significant market power to foreclose rival content.” The kind of example she has in mind, however, is a preferential arrangement designed “to raise competing content providers’ costs or, absent an alternative ISP, to exclude rival edge providers from local markets altogether.”

While raising-rival-cost strategies are indeed cognizable under the antitrust laws, it is not clear how an exclusive arrangement for priority delivery (in which the preferred vendor pays the ISP) raises rival telemedicine providers’ costs; it is not as if the rival can attain the same special handling via some alternative higher payment. The rival pays the ISP nothing for standard treatment. The private harm to excluded content rivals takes the form of a relative degradation in its quality of service, which is not comparable to a cost increase; if anything, the excluded rival might be forced to drop its price. And complete exclusion from the market is also inapplicable. In my hypothetical, there is no exclusion “from local markets altogether.” Receiving lower priority may harm rival telemedicine providers. But there is nothing wrong with this from an antitrust perspective so long as consumers are not harmed, as is the case under the hypothetical used here.

To create a cognizable antitrust offense, Ohlhausen later uses a hypothetical of a “vertical boycott” in which “the ISP blocks or materially degrades competing content offered by other edge providers.” But again these are extraneous features of my hypothetical paid-priority contract with a telemedicine provider and an ISP; there is no blocking or material degradation of other providers in absolute terms under mild preferencing. She acknowledges that there may be no antitrust violation if the “edge provider partners with an ISP that agrees to prioritize its content over lesser alternatives.” This is precisely the garden-variety arrangement that concerns net neutrality advocates. While such mild preferencing may not raise a content rival’s costs, it might discourage content rivals from investing in the development of real-time applications that could exploit special handling by ISPs. Why bother with the innovation, an edge rival might ask, if the opportunity to serve the ISP’s customers with special handling is foreclosed? An exclusive arrangement could bestow a position of dominance to the preferred vendor’s application. In the absence of net neutrality rules, rival content providers would not have any effective recourse to challenge the discriminatory treatment.

The larger deficiency in the defense of antitrust is the lack of specificity in how a rival content provider, denied access to the ISP’s preferential treatment, would style an antitrust complaint.

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22 Id. at 119.
23 Id. at 139–40.
24 Id. at 140.
25 Id. at 142.
26 Id.
Ohlhausen argues generically that Section 1 of the Sherman Act “has sufficient teeth to capture vertical restraints that harm competition when entered into by parties that enjoy market power,” and that Section 2 would apply “if an edge provider is dominant.” In both examples, she relies on the assumption that the preferred content provider (our telemedicine firm) has market power in some relevant content market. But what if it does not? What if the ISP partners with an upstart content provider (which clearly lacks market power)? That Comcast makes one firm its preferred vendor of telemedicine does not prevent an in-region ISP rival, such as AT&T or Verizon, from doing the same (or from offering paid priority to all telemedicine comers), thereby disciplining any exercise of upstream market power. Proponents of an antitrust approach fail to cite any applicable antitrust cases that would provide a roadmap for complaining edge providers.

Joshua Wright argues that vertical arrangements that harm consumers via price, output, innovation, or quality effects are cognizable with antitrust and consumer protection law. As explained above, it is not clear whether, absent short-run price and output effects, a private litigant could demonstrate harm to consumers flowing from a paid-priority arrangement via a loss in innovation. To be fair, Wright and Ohlhausen take the view that antitrust is superior to net neutrality as defined by the FCC in its 2015 Open Internet Order, not that antitrust is superior to every other conceivable regime (including the regime proposed below).

Like Ohlhausen, Wright does not offer any cases that would provide guidance on how a similarly situated telemedicine provider should structure a complaint under the antitrust laws, or the likelihood of success. And while he embraces the traditional error-cost framework, Wright skips over the issue of whether the cost of enforcement under antitrust is so high as to render this remedy ineffective to cure any loss in innovation—the mechanics of modern antitrust litigation are exceedingly costly and time-consuming. In a related paper, Thomas Hazlett and Joshua Wright explain the conditions under which vertical arrangements between an ISP and an edge provider would be deemed vertical foreclosure under antitrust law. Under the hypothetical of mild preferencing considered here, however, rival edge providers are not foreclosed from accessing the ISP’s customers.

Another Gap in Antitrust: Search Neutrality

Like net neutrality, violations of search neutrality might also go undetected by the antitrust laws. Suppose a search engine vertically integrates into content, such as local search, and affords its affiliated properties mild preference in its search algorithm. In particular, the search engine’s affiliated sites appear higher in the search rankings. And in many instances, there is real exclusion of rivals from prominent placement, in the sense that users are not willing to look to lower-ranked search results. Because the offer of preference is, by assumption, not extended to independent content providers, the arrangement is discriminatory, plain and simple. But does it amount to an antitrust offense?

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27 Id. at 141.  
28 Id.  
Michael Luca et al. showed that Google deviates from its organic search results to favor its own local properties in a single search query (for cafés in Louisville, Kentucky).\textsuperscript{31} Luca et al. find that when Google reverted back to its organic search results, which elevated the rankings of competing independent properties, users were 40 percent more likely to engage with the search results, as measured by click activity. To the extent that fewer clicks (engagements) mean fewer matches between buyers and sellers on the Internet (and fewer consummated transactions), Google’s favoritism of its own local properties could reduce output. It also implies a profit sacrifice for its general search division, which presumably is made up for by a gain to its vertical (local search). And conduct by a firm with market power that restricts output (or leads to higher prices) without any efficiency justification is generally condemned by antitrust. Finally, degrading one’s own product can be considered the equivalent of a short-term profit sacrifice, which could trigger liability under the DRTD framework outlined above.\textsuperscript{32}

This hypothetical gets closer to the fact pattern in \textit{Otter Tail}, given Google’s vertical integration into a complementary service. Despite this similarity, however, a disadvantaged rival in the search vertical would be hard-pressed to prevail in antitrust court for other reasons. To begin, the Federal Trade Commission has concluded that, under a particular fact pattern, adding a box for vertical content was a product improvement, even if it excluded rivals.\textsuperscript{33} Moreover, any proof of output effects or profit sacrifice would turn on Google’s historical search records, which could prove complex in terms of constructing a but-for world—that is, how many clicks from search results would have been performed had Google not altered its search algorithms.

\section*{An Ex Post Alternative to Antitrust: A New Tribunal}

So, if antitrust is the wrong fit for innovation-based cases, what is the right way to deal with net neutrality? Before providing my answer, a brief review of the regulatory options is in order. At the highest level, the regulator must choose between \textit{ex ante} prohibitions (analogous to a per se rule in antitrust) and \textit{ex post} rules (analogous to a rule of reason in antitrust). The FCC’s 2015 Open Internet Order imposed a per se ban on paid-priority arrangements, yet subjected zero-rating deals to case-by-case review, despite their similarities in economic terms.\textsuperscript{34} (Although the preference is exchanged for payment in both instances, the economic impact of faster transmission and free transmission is arguably different.) Although \textit{ex ante} rules function as a sharper Damoclean sword, as with any blanket ban involving vertical restraints there is a risk that nondiscriminatory, procompetitive arrangements would be banned as well. When conduct can be motivated for both procompetitive and anticompetitive reasons, economists (and antitrust law) tend to favor \textit{ex post} rules so as to avoid those types of error costs.


\textsuperscript{32} For a critical review of Luca et al.’s methodology, as well as an argument for why there is no legal basis for imposing upon Google a duty to deal with a competitor like Yelp, see Geoffrey Manne, Ben Sperry & Kristian Stout, \textit{A Critical Assessment of the Latest Charge of Google’s Anticompetitive Bias from Yelp and Tim Wu} (ICLE Antitrust & Consumer Protection Research Program White Paper 2016-3).

\textsuperscript{33} To be fair, the FTC staff reportedly recommended the Commission bring a case against Google, which suggests a search-neutrality case was conceivable, though the staff may have grounded their case in the less traditional Section 5 of the FTC Act. And the European competition authorities perceive Google’s discrimination as cognizable under European competition law.

\textsuperscript{34} FCC 2015 Open Internet Order, \textit{supra} note 2.
Along the *ex post* branch of the decision tree, there are two choices: (1) any preferential arrangement between an ISP and edge provider involving a payment presumptively violates a nondiscrimination principle, as adopted in the FCC’s 2010 Open Internet Order; or (2) any preferential arrangement between an ISP and edge provider involving a payment presumptively does not violate a nondiscrimination principle, as contemplated in the FCC’s May 2014 Notice of Proposed Rulemaking. Under the first choice, the burden of proof to reverse the presumption is placed on the parties to the paid priority arrangement; under the second choice, the burden of proof to reverse the presumption is placed on the disadvantaged edge provider. It bears noting that the D.C. Circuit in *Verizon v. FCC* ruled that option (1) was tantamount to common carrier regulation, and thus could not be based in the Commission’s authority under Section 706 of the Telecommunications Act. And the court hinted that option (2) was feasible.

This is not the first time that Congress confronted the problem of discrimination by a dominant platform provider and the limits of antitrust. By the early 1990s, as noted by Tasneem Chipty, cable operators had vertically integrated into programming and demonstrated a willingness to favor their own content over competitive programming rivals. For example, in the early 1990s, Comcast and TCI were less likely to carry Home Shopping Network compared to their affiliated (and similarly situated) QVC. Chipty also finds that the cable operators’ favoritism is efficient in the sense that price-product mix for integrated offerings were superior, which suggests that the motivation for the program-carriage rules may have been outside the scope of traditional economic concerns such as efficiencies.

Rather than ban vertical integration by cable operators into programming, Congress permitted it. But as a compromise, Congress empowered the FCC to police certain kinds of discriminatory conduct that harmed independent programmers, presumably by discouraging innovation by independent voices or reducing program diversity. These protections were codified in Section 616 of the Cable Act in 1992. Importantly, Congress recognized that antitrust was too unwieldy an instrument and established an evidentiary burden (harm to the independent programmer) that was less than the burden in antitrust (harm to competition). In particular, the complaining cable network bears the burden of overturning the presumption that any differential treatment was nondiscriminatory by showing (1) it was similarly situated to the affiliated network, (2) it was afforded inferior treatment relative to the affiliated network for reasons relating to affiliation, and (3) it was unreasonably restrained or impaired in its ability to compete due to the disparate treatment. In *Comcast Cable Communications v. FCC*, the D.C. Circuit elucidated what kind of evidence would be needed to show affiliation-based discrimination—for example, that the cable operator sacrificed its downstream profits to benefit its affiliated cable network.

By adding these nondiscrimination protections, Congress meant to fill a gap in antitrust protection. At the time the Cable Act was amended, the largest cable operator in the country, TCI, served fewer than 20 percent of national cable subscribers; an antitrust complaint by a national

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36 Verizon Commc’n Inc. v. FCC, 740 F.3d 623, 655–58 (D.C. Cir. 2014) (vacating the Commission’s rule prohibiting “unreasonable discrimination” by fixed broadband providers on the theory that it “so limited broadband providers’ control over edge providers’ transmissions that [it] constitute[d] common carriage *per se.*”).


38 Comcast Cable Commc’n Inc v. FCC (Tennis I), 717 F.3d 982 (D.C. Cir. 2013).
cable network against TCI was sure to fail the market-power requirement. (And in some circuits, the “foreclosure share” flowing from the exclusionary conduct in an antitrust case must have exceeded 40 percent to establish a violation under Section 1 of the Sherman Act. 39) In the alternative, Congress sought to elevate non-economic concerns in regulated industries without reverting to a world where antitrust can have non-welfare-based goals.

In the past decade, several complaints have been brought against vertically integrated cable operators pursuant to Section 616. Some of the notable cases include NFL Network v. Comcast, 40 MASN v. Comcast, 41 Tennis Channel v. Comcast, 42 and GSN v. Cablevision. 43 In each case, the FCC’s Administrative Law Judge (ALJ) held an evidentiary hearing, and for the NFL Network and MASN cases, the complainant achieved a modicum of relief in the form of broader carriage than what was originally offered. The Tennis Channel prevailed before the ALJ and the FCC, but because the D.C. Circuit overturned those findings, the Tennis Channel never achieved relief. GSN prevailed before the ALJ, but the decision was overturned by a 2–1 vote at the FCC along party lines. 44

While this case-by-case procedure is by no means perfect, it does provide a template for how disputes between competing factions of the Internet ecosystem can be adjudicated. Plaintiffs in program-carriage complaints have secured favorable decisions before the ALJ, but often have not achieved injunctive relief from the discrimination while the cases were appealed to the FCC and, in the case of the Tennis Channel, appealed once again to the D.C. Circuit. One notable exception is the NFL Network, which secured a settlement (placing NFL Network on the same tier as Comcast’s sports network) before the ALJ reached his decision. The tweaks to this template are offered below.

The case-by-case regime contemplated here is significantly different from that conceived in the FCC’s 2015 Open Internet Order to assess zero-rating plans. There, the Chairman’s office undertook the investigation of whether an ISP’s zero-rating plan violated a newly adopted (and nebulous) standard called the “Internet conduct” standard. Under a complaint-driven process, by contrast, there is less chance for under-enforcement of discriminatory conduct under a Republican-led FCC or for over-enforcement under a Democrat-led FCC. Investigations would be triggered by complainants as opposed to FCC officials, and complaints would be just as likely to be filed under Republican control as under Democrat control. 45 An ALJ is also preferable to adjudicate formal complaints to the FCC: by using a neutral factfinder to adjudicate the disputes, politics would be largely removed from the process. 46 It bears noting that, before his term expired,
Chairman Wheeler (a Democrat) hinted that AT&T’s and Verizon’s zero-rating plans were in violation of the Internet conduct standard\(^\text{47}\); Chairman Pai (a Republican) ended the investigation.

It is not clear whether the FCC has the authority to establish this tribunal under Section 706, or even if it does, whether there is a sufficient appetite among the Republican-led Commissioners to extend Section 706 authority this way. Congress likely would have to pass legislation to empower the FCC to create the new tribunal, perhaps coupled with a clear statement that Section 706 is not an independent grant of authority and that ISPs are not subject to Title II (common-carrier regulation). While Congress could empower any agency to police the Internet for discrimination, the FCC is a natural forum given the agency’s experience in adjudicating program carriage complaints against vertically integrated cable operators. Alternatively, the tribunal could operate outside of a federal agency, along the lines of Article I courts, in which case the findings would not be subject to review by political appointees.

A major drawback for \textit{ex post} enforcement is timeliness and enforcement costs. To expedite this process, the new forum could require that, during the appeals process, the disparate treatment ends (via injunctive relief) upon a finding of discrimination by the ALJ. Alternatively, the decision by the ALJ could be binding, as is done in certain merger orders.\(^\text{48}\) Because ISPs are more likely to have greater litigation resources than websites, with the exception of such behemoths as Google, Netflix, and Facebook, this limitation on appeals would benefit edge providers more than ISPs. Binding arbitration would limit the duration of case-by-case adjudication to months instead of years. Another benefit of limiting appeals is that it would eliminate the FCC commissioners (and any whiff of politicization) from the adjudication process.

A burden-shifting approach could be used to reduce the initial litigation expense of complaining edge providers. The evidentiary criteria used in program-carriage complaints described above could be imported into the new tribunal. (By conflating antitrust standards with nondiscrimination standards, the profit-sacrifice criterion was ill-conceived, and in any event, cannot be applied in instances where there was no change in the treatment of the independent edge provider.) These requirements would serve as a proxy or surrogate test for proving harm to innovation, much like the avoided-litigation test from \textit{Actavis}\(^\text{49}\) serves as a surrogate for proving harm to consumers in reverse-payment cases.\(^\text{50}\) If the plaintiff makes a prima facie case of discrimination, the burden shifts to the defendant to prove an efficiency rationale; if defendants offers a credible rationale, the burden shifts back to the plaintiff to show a net harm. Special rules could be made for complaints brought by startups, in recognition of their financial burdens.

Finally, there is no reason to limit the forum for discrimination complaints against ISPs. This new tribunal could resolve claims that an ISP gave preferable terms of a paid-prioritization arrangement to an affiliated content provider as readily as it could resolve claims that a search provider gave preferable ranking to an affiliated web property. Extending the forum this way, however, raises issues of whether the FCC is the proper venue in which to house the new tribunal, as the FCC has never regulated those firms. An expanded tribunal could be housed at the FTC, or it could exist apart from any agency.


\(^{48}\) Whether such relief would be in violation of the Administrative Procedure Act is beyond the scope of this essay.

\(^{49}\) FTC v. \textit{Actavis}, 133 S. Ct. 2223, 2237 (2013).

\(^{50}\) See, e.g., Kevin Caves & Hal Singer, \textit{On the Utility of Surrogates for Rule of Reason Cases}, CPI \textsc{Antitrust Chron.} (May 2015).
Conclusion
In April 2017, the FCC issued a notice of proposed rulemaking (NPRM), in which it sought guidance in dealing with the thornier issues raised in the net neutrality debate.\textsuperscript{51} In paragraph 75, the NPRM seeks comment on whether, when dealing with zero-rating offers, the Commission should “consider another general rule and framework, such as Commission adjudication of [sic] discrimination complaints.” In paragraph 78, the NPRM notes that “[w]ith the existence of antitrust regulations aimed at curbing various forms of anticompetitive conduct, such as collusion and vertical restraints under certain circumstances, we seek comment on whether these [net neutrality] rules are unnecessary in light of these other regulatory regimes.”

For the foregoing reasons, antitrust is not the appropriate venue to adjudicate discrimination complaints on the Internet when the key issue is an innovation loss. A new tribunal is needed, even “in light of these other regulatory regimes.” And it can be patterned on an existing forum used by the FCC to adjudicate discrimination complaints under very similar fact patterns involving largely the same defendants.●

The Flaws in Using the Hypothetical Monopolist Test from the “Payor Perspective” in Health Care Merger Cases

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When a merger is challenged under Section 7 of the Clayton Act, market definition is always necessary, usually significant, and often dispositive. A plaintiff's failure to define a proper market is fatal as a matter of law. And, once defined, the size of a market can significantly influence the analysis of competitive effects. Generally speaking, any given merger of two competitors is more likely to have substantial competitive effects when the number of legitimate competitors in the market is relatively small to begin with. If the market is narrow, in many cases a merger will be presumptively illegal based on market concentration alone.

Previously, challenges to mergers of health care providers involved traditional market analysis, treating patients as the relevant consumers and assessing the market from their perspective. In more recent decisions, however, courts have concluded that health care markets should not be defined from the perspective of patients choosing providers. These courts have stated that the market instead should be defined from the perspective of a payor assembling a network of providers for a health plan. Taking the payor perspective, however, raises a host of problems on its own, particularly when it comes to applying the antitrust enforcement agencies’ “hypothetical monopolist test.”

The conclusion we draw is that the health care model—in which payors bargain with providers to form networks and then patients enroll in health plans that cover charges by in-network providers—makes it difficult to apply the hypothetical monopolist test in the health care context, whether proceeding from the patient perspective or the payor perspective. Although market definition is legally required, health care markets defined under that test should be used with caution. Instead, in health care merger cases the antitrust enforcement agencies and courts should focus on analysis of competitive effects, which need not be limited to formally defined markets.

Background

Market Definition Using the Hypothetical Monopolist Test. The typical framework for defining relevant antitrust markets—both geographic markets and product markets—is the “hypothetical monopolist test” described in the Horizontal Merger Guidelines. As its name suggests, the test hypothesizes that a single firm controls all the sellers within a proposed market. Under the test, a set of products or services sold in a geographic area is a proper market only if the hypothetical

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monopolist could profitably impose a “small but significant non-transitory increase in price,” or “SSNIP.”

Application of the hypothetical monopolist test is conceptually straightforward in situations where potential buyers simply decide whether to pay a seller’s posted price. The seller has the unilateral ability to set a higher price at any time, and the question is whether it would be profitable to do so. Of the buyers who would purchase from the seller at the current price, some also would purchase at the higher price and others would not. For the seller, the profitability of a price increase basically depends on whether the harm (from losing sales to some buyers) would outweigh the benefit (from making sales to other buyers at the higher price instead of the current one).

Without a merger, prices in the proposed market do not include a SSNIP, which by definition is an increase over the otherwise prevailing prices. The question then becomes whether hypothetical monopolization of sellers in the proposed market would change the circumstances enough to make a SSNIP profitable. Hypothetical monopolization can make a SSNIP profitable by reducing the amount of lost sales that a price increase causes. Because a hypothetical monopolist controls all sales in the proposed market, it cannot lose sales to another seller in that market. Instead, it loses sales only when a buyer purchases from a seller outside the proposed market (or does not purchase at all). If a SSNIP would be unprofitable even when no sales are lost to other sellers in the proposed market, the proposed market is too narrow under the hypothetical monopolist test.

In many contexts, therefore, the imposition of a SSNIP depends simply on profit margins and the proportion of buyers who would turn to outside sellers as a result of a price increase. Where sufficient information is available, one can calculate the “critical loss”: the maximum percentage of buyers that the hypothetical monopolist could lose before a SSNIP would become unprofitable. But even if one cannot calculate the number of buyers that could and would be lost, the hypothetical monopolist test usually turns on the concept of buyers switching to outside sellers instead of paying a SSNIP.

Adoption of the Payor Perspective in the Health Care Context. In the health care context, prices are set in a more complicated way. Through bargaining, payors and providers reach agreements that set prices for services to patients who are covered by the payors’ health plans. This means that when a provider is “in-network” under a patient’s health plan, the provider does not set its prices unilaterally. Covered patients, moreover, directly bear prices only to the extent that their plan requires them to pay some or all of certain charges. In addition, this payment might be fixed (e.g., co-payment as opposed to co-insurance) and disconnected from the total amount charged by the provider, such that a SSNIP by a provider might not impact the patient at all. Application of the hypothetical monopolist test in this setting, therefore, is not as simple as estimating patient substitution to outside providers that would result from a price increase.

The role of payors has long been recognized in health care antitrust cases. Also long accepted, however, is that patient demand drives provider prices. Higher patient demand for a provider means that payors, who need to attract and retain enrollees, have more to gain from reaching an agreement to include the provider in their networks. This gives the provider more leverage, which increases the reimbursement rates that result from bargaining.

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1. *Id.* §§ 4.1.1, 4.1.2, 4.2.1.
2. *Id.*
In challenges to health care mergers, the principal question is often the size of the geographic market—that is, which providers comprise the relevant group of competitors due to their locations. Previously, litigants and courts sought to answer this question relying (at least in part) on estimates of “patient flow,” in recognition of the connection between patient demand and provider pricing. One common measure of patient flow is the percentage of patients living in an area who also seek care in the same area. Another common measure is the percentage of patients seeking care in an area who also live in the same area. Under an analysis known as the “Elzinga-Hogarty test,” a proper market was viewed as one in which both percentages are relatively high—roughly 75 to 90 percent or more.\(^5\)

In its 2007 \textit{Evanston} decision, however, the FTC concluded that patient-flow data should be viewed “with a high degree of caution” and, at best, should be used “as one potentially very rough benchmark in the context of evaluating other types of evidence.”\(^6\) The Commission was persuaded that patients choose hospitals based in large part on a preference to receive care close to home, unless they have a particular reason—apart from location—to be treated at a specific hospital. The Commission also observed that, due to the role of payors, an individual patient usually bears little if any of the charges for her own hospital care. For both of these reasons, the Commission agreed that patients who travel into or out of a proposed geographic market generally do not do so based on the price of hospital services. In the Commission’s view, therefore, data about current patient flow reveals little about how patient flow would change if a given hospital’s reimbursement rates were to increase.\(^7\)

\textit{Evanston} marked a shift toward greater focus on the payor perspective. In particular, the Commission found that the proposed geographic market was partially supported by payor testimony questioning the viability of a network without any hospitals in the proposed market area. But the Commission also gave substantial weight to other evidence, including econometric evidence of actual price increases that coincided with the hospital merger at issue, which had taken place seven years before the case was decided.\(^8\)

Post-\textit{Evanston} judicial decisions have similarly trended towards a focus on the payor perspective.\(^9\) And most recently, three federal courts of appeals have endorsed, or even required, use of the payor perspective when defining geographic markets for health care services. First, in \textit{Saint Alphonsus Medical Center-Nampa, Inc. v. St. Luke’s Health System, Ltd.}, the Ninth Circuit stated that antitrust analysis focuses on payor-provider negotiations, rather than choices by patients to seek care from a particular in-network provider.\(^10\) The court therefore concluded that the district court had been correct in focusing on a hypothetical monopolist’s ability to obtain a SSNIP in bargaining with payors. It affirmed the district court’s determination that a hypothetical monopolist could obtain a SSNIP because payors would not be able to offer a competitive product without a network that included providers in the government’s proposed market area.\(^11\)

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\(^5\) California \textit{v.} Sutter Health Sys., 130 F. Supp. 2d 1109, 1121 (N.D. Cal. 2001).


\(^7\) Id. at 76–77.

\(^8\) Id. at 58, 65, 78.


\(^10\) 778 F.3d 775, 784 n.10 (9th Cir. 2015).

\(^11\) Id. at 784–85.
A decision last year by the Third Circuit was even more emphatic. In FTC v. Penn State Hershey Medical Center, the court of appeals held that “[t]he realities of the healthcare market . . . dictate that we consider payors in our analysis.” The district court had “completely neglected any mention of insurers in the healthcare market” and instead had “utilized patient flow as its primary evidence that [the government’s proposed] market was too narrow.” Although the Third Circuit stated that patients have some relevance to the analysis, it held that the district court had “committed legal error” by failing to properly account for the role of payors when applying the hypothetical monopolist test. The court of appeals went on to find that the proposed market was proper, reasoning that payor networks, to be marketable, needed in-area hospitals.

The Seventh Circuit similarly rejected a district court ruling that the government had failed to prove the geographic market it had alleged. Agreeing with the Ninth Circuit’s Saint Alphonsus opinion, the court stated in FTC v. Advocate Health Care Network that “[t]he geographic market question is . . . most directly about” payors, not patients. The Seventh Circuit opined that the district court had “erred in assuming” that options for patients “translate neatly into options for insurers.” Although the existence of reasonable outside alternatives for many patients might prevent a SSNIP “[i]f patients were the relevant buyers,” the Seventh Circuit reasoned that the likelihood of a SSNIP depends on the degree to which payors need providers within the proposed market, to accommodate those patients for whom outside hospitals are not reasonable alternatives.

Theoretical Application of the Hypothetical Monopolist Test from the Payor Perspective.

In theory, one can take the payor perspective when applying the hypothetical monopolist test. Negotiated prices generally depend on the amount that each side stands to gain by reaching an agreement (or stands to lose by failing to do so). Furthermore, for a payor negotiating with a provider, the benefit of an agreement partly depends on how much less attractive the payor’s health plan would be—to potential enrollees—if the plan’s network excluded the provider.

Under the hypothetical monopolist test, the potential for a SSNIP would arise because all providers in a proposed market are under common control. This means that the payor’s network will not have any in-area providers unless the payor reaches an agreement with the hypothetical monopolist. In comparison, where there is no hypothetical monopolist and providers bargain independently, each set of negotiations determines only whether each independent provider will be included in the payor’s network.

Accordingly, a key issue under the test would be whether a payor could successfully market a network without any providers in the proposed market area. If not (and assuming a network could be marketed successfully with fewer than all providers in the area), then the hypothetical monopolist would have substantially greater bargaining leverage and thus be able to raise prices by a SSNIP. Indeed, the greater the monopolist’s leverage, the greater its ability to negotiate higher prices. If, by contrast, good enough alternatives exist outside the proposed market, the loss of all in-area providers would not affect a health plan’s attractiveness to enrollees. In such a case, the

12 838 F.3d 327, 344 (3d Cir. 2016).
13 Id. at 342.
14 Id. at 343–45.
15 Id. at 345–46.
16 841 F.3d 460, 471 (7th Cir. 2016).
17 Id. at 475.
18 Id. at 475–76.
hypothetical monopolist would lack the additional bargaining leverage needed to negotiate a SSNIP.

**Practical Problems with the Payor Perspective**

Although it is theoretically possible to apply the hypothetical monopolist test from the payor perspective, more attention should be given to whether doing so actually works in practice. In the recent *Penn State Hershey* decision, the Third Circuit did not remand to the district court for a determination of whether the proposed market was valid from the payor perspective. The court instead took the unusual step of deciding this factual question de novo, and devoted just over three pages of its opinion to the issue. 19 Similarly, on remand from the Seventh Circuit in *Advocate*, the district court’s discussion of the proposed market largely focused on the case’s procedural history and the parties’ positions, and offered relatively little explanation of the court’s decision that the proposed market was valid. 20 Closer scrutiny in future health care cases is likely to reveal significant practical problems with applying the hypothetical monopolist test from the payor perspective.

**Bargaining vs. Unilateral Imposition of Prices.** The practical difficulties that arise when applying the hypothetical monopolist test from the payor perspective largely stem from the fact that payors and providers typically bargain over prices, among other terms. That is, a provider does not simply set a price, leaving a payor with no option other than either accepting the price or excluding the provider from its network. By negotiating instead, payors and providers theoretically should reach an agreement so long as there is some price at which both sides would benefit. Usually there is a range of such prices, and the parties’ relative bargaining leverage (and bargaining skill) determines where the agreed-upon price falls within that range. In turn, the agreed-upon price determines how the parties will split the total benefits that they expect to receive from doing business together.

Because payor-provider bargaining does not involve prices set on a unilateral basis, it is not technically accurate to speak of a provider “imposing” a SSNIP and a payor “responding” to a SSNIP by turning to outside providers. There are potential bargaining outcomes other than just agreement to a SSNIP or no agreement at all. Payors and providers are likely to reach agreement, at some price, rather than choosing not to transact together.

Indeed, the FTC has acknowledged that the concept of critical loss does not apply when the hypothetical monopolist test is viewed from the payor perspective. 21 Because providers do not win or lose payors based on prices set unilaterally, it makes no sense to think in terms of a price increase that would be unprofitable due to the number of payors lost. This suggests that the hypothetical monopolist test was not designed for—and does not readily translate to—a situation like payor-provider bargaining.

**Negotiated Price vs. Buyer’s “Walk-Away” Price.** It is especially important to keep the bargaining dynamic in mind when presented with a claim that health care payors would be better off paying a SSNIP than failing to reach an agreement. If those were the only two choices available to a buyer, then one might expect a SSNIP to occur. When prices are negotiated, however,

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a buyer almost always pays less than her maximum or “walk-away” price—that is, the highest price at which she would be better off with an agreement than without one. At the same time, a seller almost always receives more than her minimum price or walk-away price—that is, the lowest price at which she would be better off with an agreement than without one.

Theoretically, whenever the buyer’s maximum price is at least as high as the seller’s minimum price, the parties should agree to a price that is somewhere between these two walk-away prices. When they do, it necessarily is true that, if the alternative were no agreement, the buyer would be better off paying more—and the seller would be better off accepting less—than the agreed price. Any given price between the parties’ respective walk-away prices is a possible bargaining outcome.

Because a negotiated price usually is below—and sometimes well below—the payor’s walk-away price, it is unremarkable when the payor would be better off paying a SSNIP to a hypothetical monopolist, as opposed to walking away. Indeed, this sort of analysis draws a false comparison. It does so by comparing the negotiated price without monopolization (the price that a payor and independent provider would settle upon within their respective ranges) to the payor’s post-monopolization walk-away price (the maximum price that the payor would be willing to pay to a hypothetical monopolist, without regard to the payor’s leverage to negotiate a lower price). Even where the latter exceeds the former, this does not establish that the hypothetical monopolist’s negotiated price would exceed an independent provider’s negotiated price. Nor does it establish that hypothetical monopolization would increase the payor’s walk-away price by a significant amount.

For the same reasons, a payor’s walk-away price without hypothetical monopolization could be well above the negotiated price without hypothetical monopolization. This, again, would simply reflect that the negotiated price is a compromise between the payor’s maximum price and the provider’s minimum price. Accordingly, where a payor would be better off paying a SSNIP than failing to reach an agreement, the same might be true even without hypothetical monopolization of sellers in the proposed market.

To prevent these analytical errors, it is crucial to ensure that one is truly comparing apples to apples. To the extent that one relies on a payor’s walk-away price in negotiations with a hypothetical monopolist, one needs to compare it to the payor’s walk-away price without monopolization. This is the only way to actually assess the impact of monopolization on the payor.

**Effect of Hypothetical Monopolization on a Payor’s Need for Providers.** In payor-provider bargaining, the payor’s maximum price relates closely to the marketability of a health care network that does not include the provider. The more a payor stands to gain from an agreement with a provider, the more the payor should be willing to pay rather than walk away. An important issue, therefore, is whether payors would have difficulty marketing a network without a hypothetical monopolist. If so, then one might think that the payor would have much to gain from an agreement, that the hypothetical monopolist would have substantial leverage, and that the payor’s walk-away price would be relatively high. If not, then one might think the opposite—that the payor’s potential benefit, the hypothetical monopolist’s leverage, and the payor’s walk-away price all would be relatively low.

When considering this issue, however, it is essential to focus on the difference between the scenarios with and without hypothetical monopolization. Substantial bargaining leverage for a hypothetical monopolist does not establish that a SSNIP will result where that leverage, even if substantial, is not much more substantial than the leverage wielded by each separate provider in the proposed market. The opposite also is true: even if a hypothetical monopolist’s leverage would be
low in the abstract, a SSNIP still would be possible if the leverage of independent providers is even lower.

Thus, when considering a hypothetical monopolist’s importance for a health care network’s marketability, it is again essential to ensure that one draws the proper comparison, by assessing this against the importance of an independent provider in the proposed market. Without making this comparison, it is too easy to conclude that a hypothetical monopolist’s substantial leverage would be attributable to the monopolization, when in fact that leverage could exist regardless of common control.

The Evanston case provides an example of the sort of comparison that is needed. There, payor testimony “partially support[ed]” the assertion “that the triangle formed by [three hospitals] might constitute a geographic market.” 22 Payors testified that a network lacking all three hospitals in the proposed geographic market would be unmarketable, at least to a significant set of customers. Significantly, payors also opined that a viable or adequate network did not require all three hospitals. 23 This suggested that payors had much more to lose by failing to reach an agreement when all three hospitals were under common control.

A comparison of this sort is necessary whenever claims are made about the effect of certain providers on a network’s attractiveness to enrollees. Although this comparison presents its own difficulties (as discussed below), these difficulties cannot be avoided by abandoning a comparative approach and instead relying entirely on a hypothetical monopolist’s leverage in a vacuum.

**Challenges of Determining Whether a Price Increase Would Be Significant.** A payor lacking an agreement with a hypothetical monopolist often would lose some additional enrollees (compared to the number of enrollees that the payor would lose by failing to reach an agreement with an independent provider). In such cases, hypothetical monopolization would increase provider leverage, would increase a payor’s walk-away price, and—setting aside any price-sensitivity of patients—theoretically would increase negotiated prices to some degree. This is analogous to the upward pricing pressure that theoretically occurs outside the bargaining context: some price increase often would be profitable for a hypothetical monopolist because of its ability to retain some customers that would have been lost by an independent provider imposing the same price.

The more complicated question is whether any such price increase would be at least small but significant (and non-transitory), as required by the hypothetical monopolist test. The size of an increase in a payor’s walk-away price is difficult to describe in measurable terms. In addition, the amount of an increase in negotiated price will not necessarily be the same as the amount of an increase in walk-away price. To apply the hypothetical monopolist test from the payor perspective, one would have to simply assume that a “significant” increase in a payor’s potential loss of enrollees causes a “significant” increase in its walk-away price, which in turn yields a “significant” increase in negotiated price.

This assumption is hard to justify. The number of enrollees a payor stands to lose by failing to reach an agreement is just one factor that goes into negotiated price. One factor is the additional cost to a payor if it agrees to higher prices. Another critical factor is the payor leverage derived from the potential benefits that a provider would lose by failing to reach agreement. As acknowledged above, this payor leverage would not increase as a result of hypothetical monopolization.

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22 Evanston Northwestern, FTC Docket No. 9315, slip op. at 58.

23 Id. at 18–25.
Still, any given increase in provider leverage might have a different impact on negotiated price depending on the amount of counter-leverage wielded by a payor. In Evanston, for example, the Commission noted that “substantial ‘buy-side’ market power” might prevent sellers from obtaining significant price increases even when their own leverage grows.24

Because several different factors influence the negotiated price, it is unclear whether a payor would accept a SSNIP from a hypothetical monopolist. Although the directional effect of each factor might be clear, the way they interact to produce a particular price is not. It therefore is difficult to determine whether negotiated prices would be “significantly” different when a single factor changes “significantly” and the others remain the same.

Moreover, the issue is made even more complicated by the point alluded to above: circumstances might differ by payor, since each one bargains separately. The Commission stated in Evanston:

> The potential for a merger in a bargaining market to have disparate effects on different customers potentially creates sticky and unsettled issues for merger analysis, most significantly, determining the percentage of a merged firm’s revenues that must come from customers who are harmed by the merger for the transaction to violate Section 7.25

Even where it can be established that prices would increase for certain payors, one would need to at least consider the relevance of payor-to-payor differences.

**Evidentiary Limitations When Using the Payor Perspective.** The problems with applying the hypothetical monopolist test from the payor perspective cannot be solved by relying on the statements of payors themselves. It is hard to find much probative value in payor testimony as to the likelihood that a hypothetical monopolist would have sufficient increased leverage to successfully implement a SSNIP. It seems reasonable to believe that a payor could reliably assess the binary question of whether bargaining leverage would shift as a result of hypothetical monopolization—which naturally occurs from any merger of substitutes. It is far less certain, however, that a payor could, with any justifiable confidence, assess the outcome of the bargaining affected by that shift in leverage, given that this outcome would depend on behavior and decision making not only of the payor itself but also of its bargaining counterpart.

In addition to the epistemological difficulties involved with payor predictions as to the effect of hypothetical monopolization, there are questions of skewed incentives. Payors are not disinterested; their views on a merger are sought precisely because they are likely to be affected, one way or another, if the merger occurs. For that very reason, a payor’s testimony as to likely outcomes must be taken with at least a few grains of salt.

A payor that believes it will fare even marginally worse in a postmerger world has an incentive to amplify those concerns when asked by the Commission, which can then be expected to emphasize those payor concerns in arguing against the merger. The converse is also true: if a payor believes that it may benefit from a merger, it may shade its testimony accordingly to help bring about that result—thus providing ammunition to the merging parties. The district court in Advocate Health Care recently found payors’ testimony in support of a merger “not credible,” reasoning that the payors probably had offered this testimony “because they believed the merger would improve their own competitive positions.”26

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24 Id. at 63.
25 Id.
26 Advocate Health Care, 2017 WL 1022015, at *11.
Furthermore, an actual or potential merger challenge can create incentives for buyers to express views that might not reflect their true beliefs. A buyer might hope that by voicing preliminary concerns, it will obtain bargaining concessions meant to remove its purported doubts about a merger; on the other hand, support for a merger might reflect similar concessions already obtained or anticipated. Government litigators also routinely make clear to buyers that a sworn declaration might be accepted in lieu of costly and otherwise burdensome compliance with a subpoena. In fact, a court recently heard a third-party executive’s “very disturbing” testimony that counsel for the Commission had pressured him to sign a declaration containing statements against the merger that he did not believe to be true.27 Even if not taken to this extreme, the potential influences on payor testimony counsel further against assigning it much weight.

None of this is to say that payor testimony is entirely irrelevant. The Sixth Circuit in ProMedica acknowledged the merging hospitals’ argument that payor testimony was “self-serving,” but also thought this argument might be construed “as an implicit admission of the [payors’] point” that the merger would harm them.28 The court found that the record before it offered “no reason to think the [payors’] predictions are wrong . . . [and] plenty of reason[s] to think they are right,” which seemed to assuage any concern the court held as to the payors’ incentives.29

As the Sixth Circuit’s decision reflects, the question to be asked is whether a payor’s views align with other, objective evidence in the record. The Commission in Evanston, for instance, addressed payors’ testimony indicating that they had agreed to higher postmerger prices because a healthcare network without one of the three merged hospitals would have been feasible, whereas a network lacking all three hospitals would have been unmarketable.30 But this “testimony was not precise enough to allow the Commission to draw firm conclusions” about whether the area containing the three hospitals was a proper geographic market.31 The issue thus turned on “whether the Commission [could] define the market based on the econometric evidence.”32 This also points to the conclusion that instead of relying solely or even primarily on payor testimony, one should use econometric evidence to assess the validity of a proposed market.

That said, in most cases it is unclear whether a proposed market’s validity could be demonstrated through econometric evidence that reflects the payor perspective as opposed to the patient perspective. Especially for hospital mergers, there usually will be a relatively small number of relevant payors and providers. In addition, many payors ideally would include most or all hospitals in their networks, if reasonable terms could be negotiated. (More in-network hospitals generally will make a network more attractive to enrollees without increasing the amount or type of hospital services that enrollees will seek and the payor will be charged for.) This means that, for enrollees in a certain area, a payor normally does not choose just one hospital out of several with different prices, locations, and other characteristics.

As a result, it is unlikely that payor-provider agreements would give economists a robust set of data from which to estimate how provider location—distinct from other factors—affects the prices that payors negotiate. This weakness of data from the payor perspective might partially explain the earlier reliance on data, such as flow data, from the patient perspective.

28 ProMedica Health System, 749 F.3d at 571–72.
29 Id. at 572.
30 Evanston Northwestern, FTC Docket No. 9315, slip op. at 18–25.
31 Id. at 58.
32 Id.
At bottom, then, there are serious difficulties inherent in using both payor testimony and econometric evidence to conduct the hypothetical monopolist test. This only further illustrates that the test is not well suited to mergers of health care providers.

Relevance of the Patient Perspective. As the foregoing demonstrates, application of the hypothetical monopolist test from the payor perspective carries an array of significant shortcomings. That is the case even when it is assumed that patients are relevant only to the extent that they affect payors. If that assumption is inaccurate, then there is even more reason to question the propriety of defining markets based on the hypothetical monopolist test as applied from the payor perspective.

The Commission itself has refused to endorse the view that evidence about patients is irrelevant to merger analysis. In *Evanston*, it stated that “there is some merit to [the] argument that the [administrative law judge] erred in holding that patient flow data are always irrelevant to determining the relevant geographic market.”\(^{33}\) As the Commission explained, “[payor] demand for hospital services is partially a derived demand based on patient preferences, and the percentage of patients in a given area who use a hospital can, in certain circumstances, provide some rough indication of [payor] preferences when they form a network.”\(^{34}\) The Commission’s attorneys frequently assert that a large percentage of patients living in an area also choose providers in that same area, suggesting that a payor would stand to lose many enrollees in the area if its network included no provider there.

Even if this logic is sound, the reliance on indirect evidence—that is, the use of patient preferences as a sort of proxy for payor preferences—highlights the absence of direct statistical evidence about payors’ need for certain providers. The logic says nothing about the other problems noted above, including the difficulty of determining the significance of a negotiated price increase when a payor is at risk of losing more enrollees. Furthermore, there are ways in which patients themselves might directly affect the proper definition of a market.

First, payors are trying to control costs by making patients more price-sensitive. Payors thus are expanding their use of mechanisms that include deductibles (requiring the patient to pay most or all of charges up to an annual limit), co-insurance (requiring the patient to pay a percentage of charges), tiering (requiring the patient to pay a greater share of charges for certain providers), and transparency tools (allowing the patient to compare costs across providers). If these tools are successful, patient price-sensitivity might prevent a SSNIP from occurring, even if one were able to conclude that a hypothetical monopolist otherwise would obtain a SSNIP in bargaining with payors.

Second, patients directly bear the effects of differences in health care quality, even when they do not directly pay provider charges. Thus, fear of losing patients to providers outside of a proposed market might constrain quality declines, regardless of whether the presence of those same outside providers is sufficient to constrain prices negotiated with payors. This is potentially significant because many merger challenges purport to allege quality reductions separate and apart from price increases. If a challenger is serious about treating quality as an independent concern, then the patient perspective would be important—much more important than the payor perspective—as to the quality issue. In fact, a market that purportedly passes the “SSNIP” test based on the payor perspective might be proper for analyzing competitive effects only as to price, not quality.

Thus, it is far from clear that courts have gotten it right to the extent they have held that health

\(^{33}\) *Id.* at 77.

\(^{34}\) *Id.*
care markets should be defined by the hypothetical monopolist test applied from the payor perspective. As the ultimate consumers of health care services, patients animate the entire bargaining process that is central to the payor perspective, and they provide the statistical evidence upon which the Commission continues to rely. Even apart from that bargaining, patients remain autonomous actors whose choices could affect the degree to which outside providers are reasonable alternatives. All of this only further underscores the difficulties with attempting to apply the hypothetical monopolist test in the health care context.

Jorge L. Contreras

The recent UK High Court decision in Unwired Planet v. Huawei1 raises several questions regarding the manner in which national courts will assess the conduct of parties that operate in global product markets. In Unwired Planet, Mister Justice Colin Birss (UK High Court of Justice, Patents) assesses the royalties due on standard-essential patents (SEPs) subject to a FRAND (fair, reasonable and non-discriminatory) licensing commitment made to the European Telecommunications Standards Institute (ETSI). The ruling is important because it addresses, for the first time, several key issues arising from the international nature of SEP licensing transactions and the manner in which national court decisions can impact global business and litigation strategies. These issues have risen to prominence in recent years with the increasing assertion of SEPs by patent assertion entities (PAEs)2 and the transfer of SEPs by producing firms to PAEs (a phenomenon sometimes referred to as privateering).3

In Unwired Planet, Justice Birss views the parties’ dispute primarily through the lens of competition law, rather than as an exercise in contractual interpretation. In doing so, he holds that (1) there is but a single FRAND royalty rate applicable to any given set of SEPs and circumstances, (2) FRAND licenses for global market players are necessarily global licenses and should not be limited to a single jurisdiction, (3) neither a breach of contract nor a European competition law claim for abuse of dominance will succeed unless a SEP holder’s offer is significantly above this FRAND rate, and (4) the “non-discrimination” (ND) prong of a FRAND commitment does not imply a “hard-edged” test in which a licensee may challenge a FRAND license solely on the basis that another similarly situated licensee has been granted a lower rate, so long as the difference does not distort competition between the two licensees. Justice Birss also develops two alternative methodologies for determining the applicable FRAND royalty rate: one based on comparable licenses and one based on a top-down allocation approach. This article analyzes and assesses the implications of Unwired Planet on firms operating in global markets today.

Background

The case arose in 2014 when Unwired Planet, a U.S.-based patent assertion entity, sued Google, Samsung, and Huawei for infringement of six UK patents. Unwired Planet claimed that five of the asserted patents, which it acquired from Ericsson in 2013 as part of a portfolio of more than 2000 patents and patent applications, were essential to the 2G, 3G, and 4G wireless telecommunications standards developed under the auspices of ETSI. Because Ericsson participated in development of the standards at ETSI, any patents shown to be SEPs would necessarily be encumbered by Ericsson’s FRAND commitment to ETSI.

The UK proceedings called for five “technical trials,” which would determine whether each of the asserted patents was valid, infringed, and essential to the ETSI standards. After three technical trials were held, the parties agreed to suspend further technical proceedings. In October 2016 a “non-technical” trial began regarding issues of competition law, FRAND, injunction, and damages. Hearings were concluded in December 2016, and the court’s opinion and judgment were issued on April 5, 2017. A further decision by the court imposing an injunction against Huawei (stayed pending appeal) was rendered on May 19, 2017.

The principal questions before the court in its April 2017 decision were: (1) the level of the FRAND royalty for Unwired Planet’s SEPs, (2) whether Unwired Planet abused a dominant position in violation of Article 102 of the Treaty on the Functioning of the European Union (TFEU) by failing to adhere to the procedural requirements for FRAND negotiations outlined by the European Court of Justice (CJEU) in Huawei v. ZTE, and (3) whether an injunction should be issued in the case.

Two overarching themes emerge from the Court’s analysis: (a) the tension between the contract-based origins of the FRAND commitment and an analysis that is rooted primarily in competition law, and (b) the impact of a national court decision on the inherently international business relationship of the parties. I discuss the major holdings of the case in terms of these two themes below.

Contract versus Competition Paradigms for FRAND Analysis

A Single FRAND Rate. In an earlier case, Vringo v. ZTE, Justice Birss considered the possibility that a SEP holder and a standard implementer could each make the other a FRAND licensing offer, resulting in two competing FRAND offers or, alternatively, a range of possible royalty rates that...
could qualify as FRAND. In *Unwired Planet*, Justice Birss reconsiders this possibility, reasoning that it is better to maintain, as a matter of law, that there is but a single royalty rate that qualifies as FRAND for any given set of SEPs and products.\(^{11}\) This conclusion also appears to have been supported by the economic experts in the case.\(^{12}\)

From a practical standpoint, the single-rate approach solves several problems, including how to evaluate the conduct of the parties from a competition law standpoint. In rejecting the parties’ objections to this approach, Justice Birss makes two additional observations. First, if there is but a single value for the FRAND royalty, it is likely that parties, in private bilateral negotiations over SEP licenses, will agree on a royalty rate that *differs* from this precise value. This difference does not, however, open up every negotiated agreement to a FRAND-based challenge, as the parties are free to agree on any royalty they wish, within the constraints of competition law.\(^{13}\)

In essence, the court holds that while the FRAND rate is precise, the conditions under which it may be enforced are fuzzy. For example, it is likely that the parties will usually “miss” the single FRAND rate when making offers and counteroffers to one another. Thus, the relevant question is when a party should be penalized for missing this rate. Would it be acceptable for a SEP holder to miss the rate by 0.5 percent? By 5 percent? By 25 percent or 50 percent? Justice Birss tells us very little about the margin of error by which missing the single FRAND rate could or should result in some penalty. The single-rate approach results in a number of additional logical hurdles with respect to the SEP holder’s initial offer to the implementer and how to assess the SEP holder’s compliance with competition law.

For example, it has long been a point of debate whether a FRAND commitment requires a SEP holder to *offer* FRAND licensing terms to a potential licensee or actually to *enter* into a license agreement on FRAND terms.\(^{14}\) Under the single-rate approach, there is only one answer to this question: the FRAND constraint must apply to the final, negotiated rate, not to either party’s initial offer (unless no negotiation is allowed at all).\(^{15}\) Otherwise, Justice Birss reasons, a SEP holder making an initial offer that actually is FRAND would be condemned, given the normal process of negotiation, “to always end up with negotiated rates below a FRAND rate.”\(^{16}\) Under this reasoning, it would seem that a SEP holder would be justified in making an initial offer above the FRAND rate, so that the final negotiated rate ended up being FRAND. This approach seems a risky one, as SEP holders may not always negotiate a rate downward, particularly when they use a standard set of rates (which is advisable given the non-discrimination commitment that also makes up part of a FRAND commitment, as discussed below). Thus, ironically, the single-rate approach, which does not constrain a SEP holder’s initial offer, could ultimately result in higher (and supra-FRAND) SEP licenses.

The single-rate FRAND approach adopted in *Unwired Planet* is conceptually different than the approach developed by Judge James Robart in *Microsoft Corp. v. Motorola, Inc.*\(^{17}\) There, the court

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12. *Id.* ¶ 148.
13. *Id.* ¶ 155.
15. In some situations, such as licensing by patent pools, patent holders may not entertain any negotiation of their offered license rates.
determined a FRAND *range* to assess whether the SEP holder complied with its duty of good faith and fair dealing under applicable law. Then, in setting a final royalty, the court picked a specific rate within the allowable range. At the end of the day, picking a single rate with an allowable margin of error could yield the same result as picking a royalty range. My discomfort with the single-rate approach is rooted in the contractual origin of the FRAND commitment. Could one really say that standards-development organization (SDO) participants, in committing to license their SEPs at FRAND rates, envisioned that only a single, precise rate would qualify as FRAND? The very notions of fairness and reasonableness imply some degree of flexibility, rather than arithmetic precision. The single-rate construct thus seems removed from the reality of private negotiation. After all, no SDO policy of which I am aware states that a SEP holder must grant a license at a rate that is FRAND or somewhat close to FRAND. Rather, such policies state that rates must be FRAND, implying that some allowable range is contemplated. Thus, while the single-rate approach may make the court's job easier, it appears to depart from the conceptual underpinnings giving rise to FRAND commitments.

It is notable that Justice Birss, in developing his reasoning around the single-rate approach, does not really dwell on the intent or expectations of ETSI participants. Rather than contract, his approach is grounded largely in competition law. That is, the SEP holder will not be faulted for deviating from the FRAND rate unless that deviation contravenes competition law.\(^\text{18}\) In fact, he goes so far as to say that “there is no reason why the [FRAND] undertaking should entitle either party subsequently to challenge agreed terms as being non-FRAND absent competition law considerations.”\(^\text{19}\) He thus eliminates, for all practical purposes, any contractual interpretive element from his analysis. This approach may make sense in this case, given that Unwired Planet itself never participated in the ETSI standards development process. Yet unmooring the FRAND commitment from its contractual origins has other potentially problematic effects throughout the decision, as discussed below.

**The FRAND Negotiation Process.** In *Huawei v. ZTE*, the CJEU established a set of procedures that a SEP holder must comply with when negotiating a FRAND license in order to avoid a finding that it abused its dominant position under TFEU Article 102, among which, an important one is that, a SEP holder must make an initial FRAND offer to a potential licensee. However, under Justice Birss’s reasoning that there is only a single FRAND rate in a given transaction, requiring the SEP holder to offer this rate at the outset would not be reasonable. Thus, Justice Birss concludes that it would *not* be an abuse of dominance under TFEU Article 102 or the CJEU’s holding in *Huawei v. ZTE* for a SEP holder to offer a rate that is different from the precise FRAND rate, so long as it is *not excessively so.*\(^\text{20}\) That is, an abuse of dominance will not be found unless an offer “is so far above FRAND as to act to disrupt or prejudice the negotiations themselves.”\(^\text{21}\) While this standard, rooted in competition law principles, has the ring of fairness to it, the standard is not easy for parties to apply. In fact, the only way to know, definitively, whether an offer is excessively high is to go to court. The uncertainty introduced by subjective standards such as these emerges again in the context of the non-discrimination prong of FRAND, discussed below.

\(^{18}\) *Unwired Planet*, [2017] EWHC 711 (Pat) ¶ 155.
\(^{19}\) *Id.*
\(^{20}\) *Id.* ¶ 153.
\(^{21}\) *Id.* ¶ 765.
In *Unwired Planet*, Justice Birss also addresses the potential implementer’s behavior in the negotiation over a FRAND license. He reasons that even though potential implementers are not necessarily bound by the undertakings required by SDOs (assuming that they are not SDO members), implementers must still negotiate fairly if they wish to take advantage of the SEP-holder’s SDO-imposed commitment to grant them a license on FRAND terms.\textsuperscript{22} Thus, if an implementer engages in deliberate delay tactics or other unreasonable behavior to avoid entering into a license and thus paying royalties (behavior often referred to as hold-out or reverse hold-up), a SEP holder might be within its rights to stop offering a license to the implementer and instead assert its SEPs (including by seeking an injunction).\textsuperscript{23} Moreover, Justice Birss views holdout behavior by an implementer as relevant in determining whether, from a competition law standpoint, the SEP holder possesses a dominant position, thereby permitting the SEP holder to seek an injunction to prevent infringement.\textsuperscript{24} Interestingly, however, Justice Birss reasons that evidence of implementer holdout is really only relevant before pricing discussions begin. “Once prices are discussed a delay may just be due to a licensor asking for too much money.”\textsuperscript{25}

**Non-Discrimination (ND).** The ND prong of the FRAND commitment is important but has received far less attention from courts and commentators than other issues. Justice Birss devotes substantial attention to the non-discrimination arguments made by the parties, and develops some novel theories in doing so.

There is general consensus (including among the experts in this case) that in order to comply with the non-discrimination prong of the FRAND commitment, a SEP holder must treat “similarly situated” licensees in a similar manner.\textsuperscript{26} Several commentators have understood this constraint to allow a SEP holder to charge different royalty rates to implementers based on their size or market share (often with the understanding that larger players are likely to sell more licensed products and thus pay higher levels of royalties). Justice Birss, however, reasons that a FRAND royalty rate should be set based on the value of the licensed patents, not on the size or other characteristics of the licensee.\textsuperscript{27} Thus, “all licensees who need the same kind of licence will be charged the same kind of rate” and “[s]mall new entrants are entitled to pay a royalty based on the same benchmark as established large entities.”\textsuperscript{28} This analysis, even though presumably based on a contractual/textual interpretation of the ETSI policy establishing the FRAND commitment, seems to rely primarily on competition law considerations. This is particularly striking with respect to Justice Birss’s emphasis on creating a level playing field for small market entrants, a concern of competition law and competition regulators but not necessarily of SDOs.

Nevertheless, after bolstering the SEP holder’s ND commitment by prohibiting size-based discrimination, Justice Birss weakens it in a surprising turn of logic. He asks what happens if, after the FRAND rate is agreed between a SEP holder and an implementer, the implementer discovers that the SEP holder has granted more favorable terms to other “similarly situated” implementers.

\textsuperscript{22} *Id.* ¶ 160.

\textsuperscript{23} *Id.*

\textsuperscript{24} *Id.* ¶ 806(12).

\textsuperscript{25} *Id.* ¶ 667.

\textsuperscript{26} *Id.* ¶ 485; see generally Richard J. Gilbert, *Deal or No Deal? Licensing Negotiations in Standard-Setting Organizations*, 77 *Antitrust L. J.* 855 (2011); Dennis W. Carlton & Allan L. Shampine, *An Economic Interpretation of FRAND*, 9 *J. Competition L. & Econ.* 531 (2013).

\textsuperscript{27} *Unwired Planet*, [2017] EWHC 711 (Pat) ¶ 175.

\textsuperscript{28} *Id.* ¶¶ 175, 806(8).
Has the SEP holder violated its commitment of nondiscrimination? May the aggrieved implementer sue to reform its license and thereby obtain a lower royalty rate? Justice Birss, surprisingly, answers all of these questions in the negative. In the court’s view, a SEP licensee cannot challenge a license granted on FRAND terms if it later discovers that a similarly-situated licensee is paying a lower royalty rate for the same patents unless the difference would “distort competition” between the two licensees.\(^\text{29}\) In reaching this conclusion, Justice Birss rejects the notion that the ND prong of FRAND implies a “hard-edged” obligation that places an absolute ceiling on the rate that a SEP holder may charge.\(^\text{30}\) He justifies this conclusion under a competition law rationale, noting that a competition law violation would not occur without a competitive distortion.\(^\text{31}\) This reasoning, however, seems to conflate the competition law effects of violating a FRAND commitment and the private “contractual” meaning of the FRAND commitment itself.

From a contractual standpoint, it is not clear how allowing a licensor to discriminate among its licensees could be said to comply with a non-discrimination requirement. That is, if an SDO’s participants commit not to discriminate in granting licenses, then, other than de minimis differences in royalty rates, discrimination ought not to be allowed. This being said, many FRAND commitments do not impose unmitigated non-discrimination obligations. For example, the American National Standards Institute (ANSI) requires ANSI-accredited SDOs to require their participants to grant licenses on reasonable terms and conditions that are “demonstrably free of any unfair discrimination.”\(^\text{32}\) In these cases, discrimination among licensees is permitted, so long as it is not unfair. And while the meaning of “unfair” in this context is far from settled, it is at least clear that some flexibility is allowed to licensors to vary the terms of their licenses, even among similarly situated licensees.

But ETSI, whose policy is at issue in Unwired Planet, does not allow such flexibility in its non-discrimination covenant. Rather, ETSI requires that its participants grant licenses on “fair, reasonable and non-discriminatory” terms and conditions.\(^\text{33}\) The requirement of non-discrimination is not mitigated by fairness or materiality. It is an absolute requirement. Therefore, while a competition law violation might not arise absent some distortion to competition, the underlying contractual meaning of FRAND, at least in the context of the ETSI policy at issue in Unwired Planet, seems to impose a stricter definition of non-discrimination than that determined by the court. Accordingly, it is hard to reconcile the court’s conclusion that non-discrimination here lacks a “hard edge,” at least when considering the contractual nature of this particular commitment. This step seems to take the competition framework too far, as it would allow individual competitors to be disadvantaged (i.e., by paying higher royalties) so long as competition itself is not distorted. Again, there

\(^\text{29}\) Unwired Planet, [2017] EWHC 711 (Pat) ¶ 501.

\(^\text{30}\) The court denied Huawei permission to appeal this aspect of the ruling. [2017] EWHC 1304 (Pat) ¶ 64 (June 7, 2017).

\(^\text{31}\) Mark Patterson closely examines the economic assumptions underlying the court’s finding that no competitive harm likely resulted from the lower royalties enjoyed by Samsung as compared to Huawei. He notes that “if Samsung’s rate were half of Huawei’s, the difference would be about one-half or more of Huawei’s profits. Surely one could infer competitive harm from that difference.” Mark R. Patterson, Teasing Through a Single FRAND Rate, PATENTLY-O (Apr. 20, 2017), https://patentlyo.com/patent/2017/04/patterson-teasing-through.html.

\(^\text{32}\) AM. NAT’L STANDARDS INST., ANSI ESSENTIAL REQUIREMENTS: DUE PROCESS REQUIREMENTS FOR AMERICAN NATIONAL STANDARDS § 3.1.1(b), at 11 (2017) (emphasis added).

are systemic reasons that this result may be desirable, but one must ask how closely it reflects the intentions of the parties that implemented the FRAND policy in question.34

National Law and Global Business

**Enforceability of FRAND Commitments.** FRAND commitments in standard setting arise from voluntary undertakings made by participants in the standards-development process, largely in response to written policies adopted by SDOs. There is considerable academic debate regarding the legal treatment of these commitments, and whether they can and should be enforceable as contractual commitments—not by the SDO, but by third party implementers of the SDO’s standards.35 ETSI, one of the principal global SDOs, is chartered under French law, and French legal principles govern its membership and policy documentation.36 However, it is not clear whether or how this fact should affect cases in other countries. For example, in recent cases involving ETSI standards, several non-French courts, particularly in the United States, have studiously avoided any deep engagement with French law in considering these questions. The most notable instance of such evasion occurred in *Apple, Inc. v. Motorola Mobility, Inc.*,37 in which the trial judge concluded that French law “requires the same general elements” as Wisconsin law, and made little effort to apply anything other than local law to the case.38

Justice Birss, by contrast, undertakes a thorough analysis of French statutory law as applied to ETSI’s FRAND commitments, thoughtfully probing the arguments of both parties’ experts.39 However, while he concedes that, as a theoretical matter, “the enforceability of the FRAND undertaking in French law is not a clear cut question,”40 he adopts the pragmatic view that FRAND commitments should in any event be viewed as “public, irrevocable and enforceable” on grounds of public policy, if nothing else.41 This view supports the international nature of the standard-setting marketplace. While every SDO must, by necessity, be situated in a particular physical location, the national laws governing the SDO’s operations should not undermine the expectations and commitments of the SDO’s participants. Where, as here, the participants in ETSI intended their public licensing commitments to be binding, these commitments should be taken seriously, notwithstanding potential loopholes in national law.

**FRAND Royalty Methodology.** Perhaps the most significant aspect of Justice Birss’s opinion in *Unwired Planet* is his painstaking calculation of a “benchmark” FRAND royalty applicable to the parties’ transaction. He offers two possible methods of calculating this royalty, one based on an

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34 But see Peter Picht, *Unwired Planet/Huawei: A Seminal SEP/FRAND Decision from the UK*, (Max Planck Inst. for Innovation & Comp. Research Paper No. 17-07 at 21 (2017)) (arguing that Justice Birss favors a contractual approach, at least more than his judicial counterparts, for example, in Germany).


36 EUROPEAN TELECOM. STANDARDS INST., ETSI RULES OF PROCEDURE, Sec. 12—Law and Regulation (“The POLICY shall be governed by the laws of France.”).

37 886 F. Supp. 2d 1061 (W.D. Wis. 2012).

38 Id. at 1083.


40 Id. ¶ 146.

In addition to Georgia-Pacific, Justice Birss rejects another touchstone of U.S. FRAND analysis: the notion that a FRAND royalty should reflect the *ex ante* value of the patented technology, without considering any value attributable to the adoption of the technology in a standard. This theoretical construct, which has its basis in economic analysis, has been adopted by scholars, regulatory agencies, and courts in the United States. This position has, however, come under increasing criticism by commentators, who advocate awarding at least part of the value of standardization to the SEP holder. In rejecting the *ex ante* valuation approach, Justice Birss acknowledges that he is departing from the decisions of U.S. courts in cases such as *Innovatio* and *Ericsson v. D-Link*. In the end, however, he notes that the point is moot, as neither party pressed the use of this approach.

Joining several judges in the United States, Justice Birss relies heavily on comparable license agreements to determine a FRAND royalty. While the use of comparable licenses has been criticized on the basis that most licenses are not really comparable at all, the fact that Unwired Planet obtained each of the asserted patents from Ericsson was convincing proof that at least Ericsson’s licenses would be sufficiently comparable to what Unwired Planet would have negotiated.

Indeed, Justice Birss finds that most other licenses (i.e., those not involving Ericsson) were not

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44 U.S. courts are generally in agreement that this “incremental” value should form the basis for the FRAND royalty. See *Microsoft Corp. v. Motorola, Inc.*, 963 F. Supp. 2d 1176 (W.D. Wash. 2013), *aff’d*, 795 F.3d 1024 (9th Cir. 2015); *Ericsson*, 773 F.3d 1201.


46 *Fed. Trade Comm'n, The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 22–23 (2011) (“A definition of RAND based on the *ex ante* value of the patented technology at the time the standard is chosen is necessary for consumers to benefit from competition among technologies to be incorporated into the standard”).

47 *Ericsson v. D-Link*, 773 F.3d at 1232.


49 *Unwired Planet*, [2017] EWHC 711 (Pat) ¶ 97.


51 *Unwired Planet*, [2017] EWHC 711 (Pat) ¶ 180.
suitable comparables. These observations may provide useful guidance for other courts evaluating FRAND licenses in privateering transactions where parts of a portfolio are sold or given to new entities in an attempt to increase monetization of a portfolio. Specifically, it may be that the best (and only) comparable licenses are those entered into by the original SEP holder.

Another important implication is that if a SEP holder enters into licenses and then sells the SEPs, the SEPs remain subject to the FRAND commitment itself, and the terms of the prior holder’s licenses are relevant for purposes of analyzing non-discrimination. This is particularly relevant for cases involving patent transfers. Accordingly, after identifying an appropriate set of comparable Ericsson licenses, Justice Birss reasons that the appropriate FRAND royalty rate for Unwired Planet’s 2G/3G/4G SEP portfolio should be the rate charged by Ericsson for its 2G/3G/4G SEP portfolio, scaled down to represent the relative strength of Unwired Planet’s smaller portfolio. Using these inputs, he calculates the benchmark FRAND rates for Unwired Planet’s portfolio in Major Markets as follows:

a) 4G/LTE: 0.062% for handsets, and 0.072% for infrastructure;

b) 3G/UMTS: 0.032% for handsets, and 0.016% for infrastructure;

c) 2G/GSM: 0.064% for handsets, and 0.064% for infrastructure.

While this calculation results (as shown below) in a FRAND rate that is validated through other methods, it is questionable whether this methodology (which is dependent on having a comparable license under which the asserted SEPs were previously licensed) has significant applicability to cases that do not involve privateered SEPs. That is, FRAND rates in cases such as Microsoft v. Motorola and Ericsson v. D-Link could not have been calculated as simply or reliably as the rate in Unwired Planet because there did not exist an original SEP owner that sold a subset of its SEPs to the licensor in the case. Unwired Planet is a rare case with a focus on non-discrimination and a clear comparable. The straightforward apportionment of a fraction of the overall Ericsson portfolio to Unwired Planet would not have worked when Motorola or Ericsson itself was the asserting SEP holder. As such, the court in Unwired Planet may simply have been the beneficiary of good luck in having at hand such a clear set of comparable licenses.

But even if the court’s reasoning in Unwired Planet is useful primarily in privateering cases, it may still offer some valuable general lessons. First, privateering appears to be a significant trend in certain SEP-intensive industries, as an increasing number of operating companies that were or are active in standards development are transferring SEPs to PAEs for enforcement. One recent study found that 77 percent of all U.S. assertions of SEPs covering seven widely-adopted interoperability standards between 2000 and 2015 were made by non-practicing entities. A similar

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52 See supra note 4 and accompanying text.

53 Unwired Planet, ¶ 807(4), (7).

54 The court held that Major Markets are those in which Unwired Planet held more than two or three SEPs covering a particular standard. Based on this analysis, the following countries were found to constitute Major Markets for at least one of the standards at issue: France, Germany, India, Japan, UK, United States, Canada, Italy, Spain, Taiwan, Ireland, Netherlands, New Zealand, Switzerland, Argentina, Australia, and South Korea. Unwired Planet, [2017] EWHC 711 (Pat) ¶ 587.

55 Id. ¶ 807(8).

56 That being said, the individual circumstances of a case are always key to resolving it, and similar good fortune (the availability of patent pools covering the standards at issue) played a significant role in establishing comparable license rates in Microsoft Corp. v. Motorola, Inc., 963 F. Supp. 2d 1176 (W.D. Wash. 2013), aff’d, 795 F.3d 1024 (9th Cir. 2015). See Jorge L. Contreras, That’s What RAND Means? A Brief Report on the Findings of Fact and Conclusions of Law in Microsoft v. Motorola, PATENTLY-O (Apr. 27, 2013).

57 Contreras, Stranger, supra note 2, at 528.
study found significant levels of SEP assertion by non-practicing entities in Germany and the United Kingdom.\(^5\) Given this trend, there has been concern that privateering transactions could result in an inflation of the overall royalty burden associated with large SEP portfolios.\(^5\) In 2016, Apple alleged that Nokia, the holder of a large SEP portfolio covering wireless telecommunications standards, conspired with Acacia and other PAEs to divide Nokia’s SEP portfolio so as to inflate Apple’s (and other licensees’) overall royalty burden in violation of both Nokia’s applicable FRAND commitment and U.S. antitrust law.\(^6\) But if courts followed the reasoning of Justice Birss in *Unwired Planet* and benchmarked the royalty due to a privateer on the licenses granted by the original SEP holder, this risk would be reduced.

In addition to the comparables method, Justice Birss uses a second FRAND calculation methodology as a “cross-check.”\(^6\) It is a “top down” or “aggregate royalty burden” approach, in which the aggregate royalty attributable to a standard under all SEPs is computed and then allocated to the SEP holder asserting patents in the suit. This approach has been advocated by some commentators\(^6\) and has been attempted in cases including *Innovatio*,\(^6\) as well as the Japanese IP High Court’s decision in *Apple Japan v. Samsung*.\(^6\)

Under the top down method defined by Justice Birss, the benchmark FRAND royalty equals $T \times S$, where $T$ is the total aggregate SEP royalty burden of a particular standard on a product (i.e., the percentage of a smartphone’s price that should be charged for all patents covering 4G), and $S$ is the share of that aggregate royalty that is allocable to the SEP holder (*Unwired Planet*).\(^6\) The greatest difficulty with such an approach is figuring out what $T$ should be. To calculate “$T$,” Justice Birss considered public statements made by Ericsson and other holders of SEPs covering the rel-

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58 Conteras et al., supra note 2.

59 For example, suppose that Firm A holds 500 SEPs and charges a royalty rate of $0.10 per unit on products implementing the relevant standard. A manufacturer of 100,000 standardized products would then pay a total royalty of $10,000 with respect to that portfolio. However, if Firm A split its portfolio into 10 equal portions of 50 patents each and sold 9 of those portions to PAEs, it is possible that at least some of those PAEs would successfully argue, based on factors such as the relative value of the SEPs they held, that they were entitled to a royalty greater than 10% of Firm A’s royalty. Accordingly, after the privateering transactions, the same manufacturer of 100,000 standardized products could pay significantly more than $10,000 for the same 500 patents. For an example of a U.S. FRAND royalty calculation with respect to a SEP privateer, see *In re Innovatio IP Ventures, LLC Patent Litigation*, No. 1:11CV-09308, 2013 U.S. Dist. LEXIS 144061 (N.D. Ill. Oct. 3, 2013) (SEPs acquired from Broadcom covering the IEEE 802.11 standard).

60 Complaint at 2, 4, Apple Inc. v. Acacia Research Corp., No. 16-CV-7266 (N.D. Cal. filed Dec. 20, 2016) (alleging that Nokia and several PAEs entered into a scheme to “diffuse and abuse” Nokia’s SEP portfolio by forcing manufacturers to defend multiple suits by different plaintiffs and “demanding far more in royalties than [Nokia] could have sought on its own”).

61 *Unwired Planet*, [2017] EWHC 711 (Pat) ¶ 476.


63 *In re Innovatio*, 2013 U.S. Dist. LEXIS 144061, at *84.


relevant standards. He then calculated “S,” Unwired Planet’s share of the relevant SEPs, using a variety of counting and filtering methodologies proposed by the parties’ experts, including a filter for the likely essentiality of the patents in the asserted portfolio. The resulting FRAND rates served as validating cross-checks for the rates obtained using the comparables methodology.

I have argued previously that whenever multiple patents held by multiple owners cover the same product, top-down royalty allocation methodologies should yield more accurate results than plaintiff-by-plaintiff, patent-by-patent “bottom-up” analyses. Nevertheless, in order for top-down approaches to be useful, the top-level aggregate royalty used by the court must be determined in a reliable manner. Unfortunately, the basis on which Justice Birss determined the aggregate royalty to be apportioned in Unwired Planet is far from scientific. To determine the aggregate royalty for the different standards at issue, he references eight different press releases and public statements in which industry participants estimated either the total royalty burden for ETSI’s 3G and 4G standards or their share of SEPs covering those standards. In some cases, these rates appeared to be mere ballpark estimates. For example, in one public statement by “wireless industry leaders,” the maximum reasonable aggregate royalty level for the 4G LTE standard was estimated to be a “single-digit percentage of the sales price.” In a press release, Huawei anticipated “a low single-digit percentage of sales prices as a reasonable maximum aggregate royalty rate applicable to end-user devices.” In several cases, the court noted that these statements were “obviously self-serving.” Thus, while the top-down methodology employed by the court is sound, it is not clear that the inputs to that methodology were entirely robust. It may be for this reason that Justice Birss relied on the top-down methodology solely as a cross-check against the royalty rates calculated using the comparables methodology.

**FRAND Means Worldwide—an Invitation to Forum Shopping?** Unwired Planet offered Huawei a worldwide license under the asserted SEPs. Huawei argued that it only wanted a license under Unwired Planet’s UK patents and that Unwired Planet’s insistence on a worldwide license was unreasonable. In evaluating the reasonableness of Unwired Planet’s license offer, Justice Birss first observes that the “vast majority” of SEP licenses in the trial, including all of the comparable licenses introduced at trial, were granted on a worldwide basis, with occasional exclusions. He then observes that Unwired Planet’s patents were issued in 42 countries, while Huawei’s

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66 Id. ¶¶ 264–272. The statements in question were likely made between 2008 and 2010. Id. ¶ 264. The LTE standard was finalized in December 2008. 3GPP, LTE, http://www.3gpp.org/technologies/keywords-acronyms/98-lte. Carlton and Shampine observe that “if (i) a patent holder announces non-discriminatory license terms for its patents prior to the adoption of a standard and therefore prior to anyone having sunk investments relying on the standard, and (ii) the SSO then includes those patents in the standard, that is evidence that the SSO regards the terms as reasonable given the value created by the patented invention.” Dennis W. Carlton & Allan L. Shampine, Identifying Benchmarks for Applying Non-Discrimination in FRAND, CPI ANTITRUST CHRON. 1, 3, 6-7 (Aug. 2014). For a general discussion of the usefulness and enforcement of such public patent “pledges,” see Contreras, Market Reliance, supra note 14.

67 Unwired Planet, [2017] EWHC 711 (Pat) ¶ 324 et seq.


69 Unwired Planet, [2017] EWHC 711 (Pat) ¶ 264.

70 Id. ¶ 264(i).

71 Id. ¶ 264(iii).

72 Id. ¶ 269.

73 Id. ¶ 524.

74 Id. ¶ 534. Some comparable licenses, for example, excluded China.
operations extended to 51 countries.\textsuperscript{75} In effect, both are global companies. Against this backdrop, he concludes that “a licensor and licensee acting reasonably and on a willing basis would agree on a worldwide licence.”\textsuperscript{76} In contrast, he regards the possibility of country-by-country licensing as highly inefficient.\textsuperscript{77} The prospect of two large multinational companies agreeing to country-by-country licensing, he concludes, would be “madness.”\textsuperscript{78} and Huawei’s insistence on a UK-only license was not reasonable.\textsuperscript{79} He likewise dismisses Huawei’s arguments that including unwanted patents in the license amounts to illegal tying in violation of competition law.\textsuperscript{80} Accordingly, the court ruled that, in this case, a FRAND license is necessarily a \textit{worldwide} license.\textsuperscript{81}

Nevertheless, Justice Birss does not apply the benchmark rate that he calculated to every country in the world. As noted above, the benchmark rate was calculated for 17 “major market” countries.\textsuperscript{82} Justice Birss recognizes that both the number of SEPs held in a country, as well as commercial and market realities, will affect the FRAND rate in that country. This is especially true of China, Huawei’s home jurisdiction. But despite Huawei’s objection to the UK court setting a FRAND rate for China with respect to Unwired Planet’s Chinese patents (which were, of course, not at issue in the UK case), Justice Birss reasons “The appropriate rate for China is not complicated to arrive at. The comparable licences show that rates are often lower in China than for the rest of the world. The relative factor varies. I find that a FRAND licence would use a factor of 50%.\textsuperscript{83}

Though the court’s reasoning quoted above sounds almost cavalier, Justice Birss spends a significant amount of time discussing royalty rates in China, including those found in comparable licenses. However, in the final analysis, he simply cuts the Major Market rate in half to arrive at the benchmark rate for China.

Then he turns to the appropriate benchmark rate for countries other than the Major Markets and China (Other Markets). He concludes, with little evidentiary backing, that “the rate of [Other Market] countries would be the China rate on the basis that the products are made in China under license.”\textsuperscript{84} This rationale makes little commercial sense. First, it assumes that patentees price license rights based on cost rather than the pricing level that a particular market will bear. Second, it ignores the reality that products manufactured in China will be sold in both Other Markets and Major Markets. Thus, establishing Other Market pricing on the basis that products sold in those

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\textsuperscript{75} Id. ¶ 538.

\textsuperscript{76} Id. ¶ 543.

\textsuperscript{77} Id. ¶ 544.

\textsuperscript{78} Id. ¶ 543.

\textsuperscript{79} Id. ¶ 572.

\textsuperscript{80} Id. ¶¶ 544–572.

\textsuperscript{81} Huawei has been granted leave to appeal this aspect of the ruling. [2017] EWHC 1304 (Pat) ¶¶ 62–63 (June 7, 2017). A similar result was reached by the Landgericht Düsseldorf in \textit{Saint Lawrence Communications v. Vodafone}, Landgericht Düsseldorf 4a O 73/14, 4a O 126/14, 4a O 127/14, 4a O 128/14, 4a O 129/14, 4a O 130/14, 31 March 2016. In \textit{Vodafone}, the SEP holder also offered a worldwide license, which the potential licensee resisted. In assessing the SEP holder’s conduct under \textit{Huawei v. ZTE}, the court held that the offer for a worldwide license was FRAND compliant. \textit{See} Robin Jacob & Alexander Milner, \textit{Lessons from Huawei v. ZTE 10}, 4IP Council research report (Oct. 2016), http://www.4ipcouncil.com/news/latest-research-4ip-council-lessons-huawei-v-zte.

\textsuperscript{82} See supra note 54.

\textsuperscript{83} Unwired Planet, [2017] EWHC 711 (Pat) ¶ 583.

\textsuperscript{84} Id. ¶ 589.
countries are manufactured in China is inapposite. Products manufactured in China are sold everywhere, yet sales in Major Markets bear a royalty that is twice that of sales in Other Markets.

Despite these issues, my greatest concern is not with the particular rates determined by Justice Birss in this case, but with the very real possibility that national courts will now feel emboldened to set royalty rates for patents across the globe. The implications of this prospect are sobering, as high stakes patent litigation today is a global enterprise with parallel actions brought in a dozen or more jurisdictions.85

Justice Birss ruled that Huawei must enter into a global license agreement on the FRAND terms that he dictated or risk the entry of an injunction in the UK.86 When Huawei enters into that license agreement, it will be licensed across the entire world at the rates set by the UK court. No further licenses will be needed; thus proceedings in other jurisdictions will, to a large degree, be mooted. A separate question is whether the FRAND rates set by the UK court (or whichever court gets to judgment first) will be respected by courts in other jurisdictions evaluating damages claims for past infringement, or whether each national court will feel compelled to conduct its own FRAND royalty calculation.

It is possible that the willingness of judges in particular jurisdictions to set favorable (high) worldwide FRAND rates will begin to attract SEP holders to those jurisdictions, much as U.S. patent holders were once attracted to the patent-friendly District Court for the Eastern District of Texas.87 By the same token, jurisdictions that gain reputations for setting unfavorable (low) FRAND rates may become attractive venues for implementers claiming that SEP holders have breached their FRAND commitments. Will a new “race to the bottom” (or top) thus emerge, in which litigants will seek out the national courts most likely to produce globe-spanning judgments in their favor?88

But why should a UK (or any other) court be able to establish royalty rates for patents that are not before the court? Certainly, the availability of a global license from any court might make the job of SEP holders easier and reduce the need to bring suit against implementers in every country in which they operate. But such global solutions would shortchange national adjudication of patent validity and infringement, which are inherently national questions. Moreover, what if commercial parties wished to negotiate finer-grained royalty structures than the 50 percent discount for China/Other Markets that was established in *Unwired Planet*?89 What if a quick but lazy court in a particular country did not bother to conduct the detailed analysis undertaken by Justice Birss and simply established a single global FRAND royalty rate for all countries, large and small? Would such a ruling be subject to challenge in other jurisdictions?

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86 As of this writing, Huawei had not accepted the license, and the court entered the injunction but stayed its enforcement pending appeal. [2017] EWHC 1304 (Pat) (June 7, 2017).


Before the decision in *Unwired Planet*, courts in the U.S. appeared the most willing to give extraterritorial reach to their decisions. In *Microsoft v. Motorola*, the U.S. District Court for the Western District of Washington entered an injunction prohibiting Motorola from enforcing an injunction against Microsoft in Germany pending the resolution of the U.S. litigation regarding Motorola’s compliance with its FRAND commitment. At least two other U.S. courts have issued similar anti-suit injunctions in cases involving FRAND disputes. Will courts in the UK now vie with those in the U.S. to be the first to prohibit parties from prosecuting actions in other jurisdictions? Will the U.S. and UK be joined by Germany, Japan, China, and other countries? If so, a true race to the courthouse may emerge in cases involving FRAND and other global commitments.

These possibilities have important ramifications not only for FRAND disputes, but also for licensing negotiations in global markets, which are often conducted in the shadow of litigation. At the end of the day, the systemic impact of these changes is hard to predict. On one hand, a race to the courthouse could lead to gamesmanship and opportunism by litigants, inappropriate competition and lowering of standards among courts, and unpredictable results for the market. On the other hand, such a volatile litigation system could pressure parties to settle their disputes without resorting to litigation. What's more, a true race to the courthouse in which the first court enjoins the parties from prosecuting suit elsewhere could, perversely, reduce the extent of duplicative national litigation and reduce litigation costs across the globe. What might be lost in terms of fairness and justice could, to some degree, be made up by increased efficiency and reduced costs.

**Conclusion**

In *Unwired Planet v. Huawei*, the UK court addresses a complex set of licensing and royalty questions to develop a novel approach to FRAND royalties. Its analysis is deeply rooted in competition law principles, often at the expense of the contractual underpinnings of the FRAND commitment. Most importantly, a willingness to establish global license terms covering patents outside the UK has serious implications for international commercial litigation and licensing transactions. If this approach is adopted by courts around the world, FRAND litigation could devolve to a race to the courthouse, with unpredictable effects on outcomes and efficiency.

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90 Microsoft Corp. v. Motorola, Inc., 871 F. Supp. 2d 1089 (W.D. Wash. 2012), aff’d, 696 F.3d 872 (9th Cir. 2012).

Paper Trail: Working Paper and Recent Scholarship

Editors’ Note: This edition reviews a paper by Castanheira et al. that describes theoretical and empirical research which attempts to model and measure the effects of a situation that the authors refer to as an “asymmetric competition shock” by looking to pharmaceutical markets and the effects of generic product launches in those markets.

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

—William H. Page and John R. Woodbury

Recent Papers


This paper by Micael Castanheira, Carmine Ornaghi, Georges Siotis, and Marie-Angeles de Frutos describes theoretical and empirical research that attempts to model and measure the effects of a situation that the authors refer to as an “asymmetric competition shock.” In this context, the authors consider an asymmetric competition shock to be an event that differentially affects existing competitors.

To help motivate and empirically test a theoretical model of an asymmetric competition shock that the authors develop, they look to pharmaceutical markets and the effects of generic product launches in those markets. In recent years, many antitrust cases have been brought for which the alleged competitive harm stems from alleged delay or foreclosure of the launch of generic versions of a branded pharmaceutical product. At the heart of these cases are several different mechanisms through which generics are alleged to have been delayed or foreclosed. Mechanisms that are accused of having this effect include so-called reverse payment patent settlements that are alleged to be engineered to delay generic entry and the development of new drug formulations that are alleged to frustrate the launch of generic products by inhibiting their ability to take advantage of institutional structures that facilitate their being dispensed by pharmacies. Accordingly, this research may be of interest to antitrust practitioners.

The authors describe pharmaceutical markets as being “oligopolistic and differentiated” with advertising and promotion used as key competitive strategies by some market participants.1 As such, they recognize the substitutability of products that are used to treat the same medical condition.2

2 Id. at 3.
The authors also recognize that generic versions of branded drugs are typically launched at the time that the branded versions lose patent protection. They consider the first entry of a generic version of a branded drug to be an asymmetric competition shock because it can differentially affect the products within a particular therapeutic class of drugs. In this context, a therapeutic class of drugs generally means a set of products that are used to treat the same medical condition. The authors observe that, following the launch of the first generic versions of a drug, typically (1) a substantial portion of the sales that, but for the launch of the generic versions, would have gone to the branded version are converted to the generic versions and (2) the advertising and promotional efforts for the branded version are stopped.

Under these circumstances, the authors have observed that, although the prices of generic drugs tend to be lower than their branded reference products (and often by a substantial margin), there are cases for which, following the launch of low-priced generic products, the total branded plus generic unit sales of the product decline, while the sales of other products within the same therapeutic class increase. The authors attribute this effect to changes in the relative promotional efforts for the products—in particular, because the branded products without generic versions continue to engage in promotion, the demand-building effects of those efforts dominate the low price of the new generic entrants. Based on that result, they conclude “that generics display two different faces: while they are fierce competitors for the branded drug that lost exclusivity, they appear to be toothless challengers with respect to the remaining patent-protected drugs.”

Theoretical Model

To formalize these anecdotal observations, the authors build a simple model of a market with two different products (A and B) that experiences entry of a new product that is a perfect substitute for one of the incumbent products. In their model, (1) firms compete through price and non-price (specifically, persuasive advertising) instruments; (2) purchasing behavior is made through an intermediary who can be persuaded; (3) one of the incumbent products (A) faces the entry of a new product that is assumed to be a perfect substitute (G).

The authors suggest that competition between A and G implies that the price of A will drop and, because G can “free-ride” off of the advertising efforts of A, the level of promotion for A will also fall. However, the authors indicate that the effect of the entry of G on B’s sales is ambiguous: the lower price of A may have a negative effect on B’s sales, but the reduced promotional efforts by A may have a positive effect. The model that the authors construct suggests how various factors, such as patient price sensitivity and the degree of horizontal differentiation between A and B, may affect the post-entry change in the market share of B.

The model assumes (1) that a patient/physician pair (PPP) gains an “intrinsic utility” from using each product that can be affected by the level of advertising and the PPP’s sensitivity to price and (2) the PPPs are heterogeneous. PPPs choose the product that maximizes their utility, which yields the demand curve for each product. Manufacturers are allowed to choose the prices of their products, as well as a level of promotional activity. Promotional activity is modeled as a cost that increases demand for the product by increasing its utility.

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3 Id.
4 Id. at 1–3.
5 Id. at 8.
6 Id. at 10–17.
In the end, the model predicts that when G enters, all else equal, B should realize larger gains in market share (1) the less price sensitivity among the PPPs; (2) the less differentiation between A and B; and (3) the larger the overall market defined by A and B. Based on these findings, the authors conclude:

It is striking that it is precisely when A and B are closer substitutes . . . that stiffer price competition by the generic versions of A allows B to increase its market share. Conversely, only if the two molecules are sufficiently distant substitutes or if market size . . . is small, will price competition have the (a priori expected) effect of boosting the sales of molecule A.7

**Empirical Analyses**

To test these predictions, the authors perform several regression analyses using data on historical pharmaceutical sales and promotional efforts.8 Specifically, for these analyses they use quarterly data from IMS Health on dollar sales revenues and quantities sold for hundreds of branded and generic prescription drugs sold in the United States from 1994 through 2003. As discussed below, from these data they are able to observe sales in two separate channels: hospitals and pharmacies.9 The authors also use data from IMS Health that report expenditures on efforts to promote drugs to doctors, including for physician detailing, providing free samples to physicians to give to their patients, and advertising in professional journals.

First, the authors analyze pharmaceutical demand without the effects of within-molecule generic entry.10 To that end, they look at drug prices, quantities, and promotion during the time periods before a drug loses exclusivity (i.e., generic versions are launched and sold). The authors make several empirical observations based on this analysis: (1) elasticity of demand with respect to prices is higher for hospitals than for pharmacies; (2) promotional efforts affect a drug’s own sales positively and competitors’ sales negatively; and (3) generic entry does not have a meaningful effect on branded sales. To obtain these results, the authors use a regression analysis that attempts to assess the relationship between a drug’s market share (where the market is as defined by ATC311 therapeutic categories) and the drug’s own price, the prices of competing drugs, measures of promotional efforts for the drug, and measures of promotional efforts for competing drugs, along with controls for the time remaining until patent expiration and likely entry of generic versions of the drug. This regression was performed separately for the hospital and pharmacy channels.12

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7 Id. at 16.
8 Id. at 18–21.
9 The authors do not explain whether they are measuring sales (and prices) into these channels or the sales being dispensed out of these channels.
10 Id. at 23–30.
11 ATC is an acronym for Anatomical Therapeutic Chemical. The ATC system is a classification system for drugs. The authors state that “[t]he ATC3 level’ corresponds to a market: it groups the drugs that target a given condition.” Id. at 20. They also indicate that “the ATC3 class is associated with a pathology, while each of the ATC4 therapeutic sub-groups within the same ATC3 corresponds to different modes of action to treat that pathology.” Id. at 33.
12 To attempt to address endogeneity and measurement error in the price and promotion variables, which will cause the regression coefficients to be biased, the authors use an instrumental variables approach with the following instruments: the number of packages; the number of packages squared; the average price of drugs sold by the manufacturer in other ATC3 markets (for hospitals) and price of drug sold in hospitals (for pharmacy); and an indicator variable for a successful Paragraph IV challenge. They provide very little intuition as to why these are valid instruments.
As previously mentioned, the authors find that the own-price elasticity of demand (measuring the change in the quantity demanded of a product in response to a change in its price) at hospitals is higher than at pharmacies.\textsuperscript{13} They attribute this result to circumstances that may make “consumers” of pharmacy-dispensed drugs less price sensitive compared to hospitals. Specifically, they cite the agency problem caused by physicians not having the direct financial incentive to account for drug prices in their prescribing decisions, as well as the fact that patients generally tend not to bear the entire cost of a prescription drug because of insurance benefits.

Additional inquiry would be useful to test if these results are robust. For example, the data used by the authors to measure drug prices do not account for rebates that are paid by drug manufacturers as a result of contracts that they enter with managed care organizations. Because of the strategic and competitively significant nature of these rebates, they are typically confidential and thus difficult for researchers to obtain. That said, it would be interesting to consider and, if possible, test how the results of these analyses are sensitive to the price constraints imposed by managed care contracting.

In this analysis, the authors also find that cross-price elasticities (measuring the change in the quantity demanded of a product in response to a change in the price of another product) are very small in magnitude and not statistically distinguishable from zero between the branded drugs in this analysis and competing generic drugs (which are not therapeutically equivalent but in the same therapeutic class), but are much larger (especially for hospital buyers) between the branded drugs analyzed and competing branded drugs.

In their second set of empirical analyses, the authors look at the effect on generic drugs of the loss of brand exclusivity by regressing generic market shares following the loss of brand exclusivity on the prices of other generic products (with the same and different branded reference products), the branded version’s price, the prices of other branded competitors, as well as the measures of promotional efforts described above.\textsuperscript{14} From this regression, the authors estimate large own-price elasticities for generics and significant positive cross-price elasticities between other generic versions of the same drug. They also find little influence of other competing drugs’ (brand or generic) prices on generic share, but some negative effect by competing brands’ promotional efforts.

The authors conclude that their results from these two analyses suggest that “competition is inter-molecular while drugs are on patent” and it “shifts to chiefly intra-molecular after” loss of exclusivity.\textsuperscript{15}

Finally, the authors perform empirical tests of some of the implications of their theoretical model.\textsuperscript{16} As discussed above, the model predicts that the “negative cross-price” elasticity effect should be amplified (i.e., competitors to the drug going off-patent for which generic versions are launched should gain more share) when (1) the price elasticity is smaller in magnitude; (2) the products in the market exhibit less differentiation; and (3) when the market is larger. They find empirical results that are consistent with these predictions. Specifically, they find empirical models that show the “negative cross-price” elasticity effect and that the effect is diminished in the

\textsuperscript{13} Again, as noted above, it is not clear if the data used by the authors is measuring drug purchases by these entities or drug dispensing in which they engage.
\textsuperscript{14} Id. at 30–33.
\textsuperscript{15} Id. at 33.
\textsuperscript{16} Id. at 35–39.
hospital channel (which they found to be more price sensitive), diminished with each additional mode of action defined by the ATC4 classification (which they conclude is a proxy for more product differentiation), and diminished in smaller markets.

**Conclusion**

In sum, this paper raises some interesting theoretical and empirical observations about how pharmaceutical markets may respond to generic drug entry. Of particular note, the authors’ findings implicate output effects from the launch of lower-priced generics and competition among therapeutic alternatives. As with any analysis of pharmaceutical markets, this analysis must contend with idiosyncratic features of those markets, including institutional structures that affect dispensing decisions and multiple layers of pricing and decision-making that affect prescribing and purchasing decisions. Among other issues, these features make measuring prices and price changes problematic. The authors recognize some of these hurdles and attempt to address them with certain econometric techniques. To what extent those efforts are successful deserves further research and analysis.

—Monica Lu and Bryan Ray are economists at NERA Economic Consulting

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17 These features include, e.g., the effects of managed care practices, such as manufacturer rebates and patient pharmacy benefit copays, which can promote competitive outcomes.