Interview with Howard Shelanski, Director, FTC Bureau of Economics

Editor’s Note: In this interview with The Antitrust Source, Dr. Howard Shelanski discusses injunctions for standard essential patents, the role of behavioral economics, contracts that reference rivals, and cooperation across agencies.

Howard Shelanski became Director of the FTC’s Bureau of Economics (BE) on July 1, 2012, replacing Joseph Farrell, who held the position since 2009. Currently, Dr. Shelanski is on leave from Georgetown University Law Center. Previously, he was Deputy Director of the Bureau of Economics from 2009–2011, and was Chief Economist at the Federal Communications Commission from 1999–2000. More recently, he was Of Counsel with the law firm Davis, Polk & Wardwell. Dr. Shelanski holds a Ph.D. in economics and J.D. from the University of California, Berkeley, where he was a member of the law and business faculties from 1997–2011.

Editor Kevin W. Christensen conducted this in-person interview for The Antitrust Source on November 9, 2012.

ANTITRUST SOURCE: You have both a Ph.D. in economics and a law degree. Can you describe for us how your legal training might play a role in your day-to-day duties and responsibilities at the helm of the FTC’s economics staff?

HOWARD SHELANSKI: I think it is helpful because lawyers and economists tend to view things a bit differently and sometimes having both kinds of training helps me to better understand the legal staff’s point of view. On the other side, I sometimes have an ability to understand, not always, but sometimes, what is not getting across from the economics staff to the attorneys because of the different frameworks in which they might be evaluating a case, and can try to tie the Bureau of Economics’ analysis more closely to the framework that the legal staff is using.

So there are definitely some benefits to having the legal perspective in translating between the two Bureaus [BE and the Bureau of Competition] and in making judgments about the relative weights of different kinds of evidence or the extent to which the economic evidence does or does not support the relevant legal standard.

ANTITRUST SOURCE: Is there a specific instance where you think that might have been on display?

SHELANSKI: There have been a couple of instances in the past where there were documents that looked very incriminating in an anticompetitive practices case. For a long time the documents were persuasive to the legal staff because they appeared to show the company was trying hard to monopolize a local distribution market in a particular line of products.

On the other hand, the economics evidence was able to show that the prices for the products at issue were actually going down at the same time the company was apparently trying to do things that should have been pushing prices up. Also, there was additional entry in the market. So despite the documents, the firm we were investigating didn’t appear to be succeeding in its allegedly monopolistic scheme. And so there was a real conflict between what the economic data were showing in terms of price movements and entry and output in the market and what the internal documents were showing about the motives of the target in the investigation.
That was a case where the lawyers had what they thought were very hot documents and the economists thought they had what was very hot evidence. It was very helpful to have the legal perspective to try to work through with the legal staff why they thought there was still a case and to move back and forth between the Bureaus. Eventually, the Bureau staffs worked together to look at each other’s evidence and reach a resolution in the investigation.

**ANTITRUST SOURCE:** Your return to the FTC has coincided with several important matters related to the relationship between intellectual property and competition. These include pay-for-delay agreements in the pharmaceutical industry, International Trade Commission (ITC) injunctions, and hold-up in standard-setting organizations. Do you believe these will be the primary issues of your tenure as Director, or do you anticipate other issues to rise in prominence?

**SHELANSKI:** These issues will certainly stay high on the list. There are cert petitions before the Supreme Court on the pay for delay matters and we’ve got a couple of other pay-for-delay matters that are active at other procedural stages. There is obviously the investigation of Google, which involves some standard essential patent issues, and we are looking at “patent assertion entities” to try to learn more about what they do and how they might affect competition and innovation. But while I think IP and pharma are key areas of the FTC’s focus now, and are likely to remain such over the course of my tenure, you’ve got to keep in mind we still have a much broader docket with many other important issues.

There are important matters on the consumer protection side. There are very important matters in health care markets. And then there are our merger investigations that cover a whole variety of issues and industries, which take up a lot of our time and attention. Some of those investigations are in industries that may look rather old-fashioned and mundane when compared to the newer, high-technology markets, but they are nonetheless vitally important to the economy and to consumers.

**ANTITRUST SOURCE:** Focusing on the injunctions and the ITC, what are the major economic issues and how has BE helped to guide the discussion?

**SHELANSKI:** There are some broad economic issues pertaining to what the harm from delayed or deterred innovation can be. Those are not really the issues that BE focuses on in a very specific way. Those are background issues. It’s well understood that innovation, introduction of new products, and productivity increases are enormously important to economic performance. And there are a lot of results, borne out through many studies, which show that innovation will ultimately move the economy to a much higher and faster growth path and bring better benefits to consumers than will short-term reductions in price and increases in output. So innovation is incredibly important, and BE certainly does things to support the focus generally on innovation because of those economic effects.

More specifically on the injunction issue, the work we have done has focused on how the threat of an injunction might enable a patent holder to get a higher price from the licensee, a price that might perhaps go well out of the FRAND [fair, reasonable, and non-discriminatory] range. And what we’ve been able to show, and this comes out of some fairly standard bargaining models, is that there is a very high likelihood that because an injunction puts not just a marginal amount of a company’s return at stake, but indeed its entire revenue stream on a particular line of products using the IP, that the threat point in the bargaining shifts dramatically. Of course, you have to dis-
count that greatly increased threat by the likelihood that an injunction will be obtained. But, nonetheless, we have found that a rational firm faced with an injunction might be looking at, to paraphrase a popular term these days, a financial cliff whereas before it was looking at a small slide down a hill. And that change shifts one’s behavior in the bargaining process.

**ANTITRUST SOURCE**: Both the FTC and ITC employ economists. Has there been a significant interaction of the economists in these two agencies?

**SHELANSKI**: I do not think so. The FTC economists have done their analyses independently, in the context of the FTC’s own internal investigations and as relevant to the agency’s weighing in at the ITC.

**ANTITRUST SOURCE**: What about other agencies affecting competition in IP, such as the Patent & Trademark Office and the Food and Drug Administration? How does BE work with economists at these agencies?

**SHELANSKI**: For the past couple of years the PTO has had a chief economist, Stuart Graham, who has been a terrific partner in thinking through a lot of the economic issues related to IP. The economic service at the PTO is a very small and nascent operation which hopefully will continue to grow given the importance of IP and the current IP policy challenges the U.S. faces. Stuart has been excellent in trying to build that service up, and we certainly coordinate with him as appropriate on areas of policy and broad policy directions.

We more often work with the economists at the Department of Justice. I’ve worked very closely with my counterpart there, Fiona Scott Morton, on thinking through issues related to standard essential patents, injunctions, SSO [standard-setting organizations] conduct, the meaning of a FRAND commitment. And there’s been, I think, quite a bit of interaction between BE staff and DOJ staff and more generally between the two agencies on these issues.

And I also have been coordinating and discussing these issues with Kai-Uwe Kühn, who is my counterpart at the European Commission. So there has been quite a bit of interaction there.

You mentioned the FDA. We certainly have had discussions with the FDA in specific matters. But I think most of the interaction with the Food and Drug Administration has happened through the Bureau of Competition. I’m sure there has also been some through the Bureau of Consumer Protection. To my knowledge, the economics function at the FDA is very different from what we have here, so while we’ve been involved with discussions, and worked with them on various issues, I wouldn’t say there’s been a terribly deep interaction on the economic side between the two agencies.

**ANTITRUST SOURCE**: What about the Federal Communications Commission? Given the FCC’s strong interest in journalism and media, privacy, mobile applications, and various other online consumer production issues, do you see any opportunities to work with the FCC staff on joint projects?

**SHELANSKI**: We have had discussions with the FCC on numerous issues, for example, relating to network neutrality and things like that, and certainly on privacy. In terms of joint projects, there are limits to what the two agencies can do together, other than to coordinate to make sure that they don’t step on each other’s jurisdictions or have policies that are mutually inconsistent.
**ANTITRUST SOURCE:** You mentioned Fiona Scott Morton, Deputy Assistant Attorney General for Economic Analysis at DOJ’s Antitrust Division. She recently opined on the competitive risks of contracts that reference rivals.¹ In broad strokes, what factors play in BE’s assessment of the pros and cons of CRRs?

**SHELANDSKY:** CRRs are contracts that will have terms that may involve competitors of the buyer, possibly of the seller, but typically of the buyer. And the most common form of CRR is a most favored nation clause, in which the seller usually promises that no other buyer will get a better price. That seems like a very normal kind of thing for a buyer to want, to have the comfort that it has gotten the best price a buyer can get.

There are some potential problems, though, with this kind of constraint. For one thing, the incentive of a seller to cut price diminishes every time there is a most favored nation clause. You can’t cut price to a subsequent buyer without cutting price to all of the previous buyers that had most favored nation clauses. So there’s a real penalty for making a particular bid at a lower price to a particular buyer. Over time, the effect of a contract that references rivals or most favored nation clause can actually be to raise the price floor on the product being sold, which is a concern.

More nefariously, there are ways that a CRR can be used to support a cartel at the buyer level. CRRs can be used to support a cartel at the seller level as well by having everybody put most favored clauses into their sales contracts. A penalty is built in any time a particular seller might want to cut price to a particular buyer. So there are also ways in which contracts that reference rivals can be facilitating practices for horizontal collusion.

The challenge, as Fiona Scott Morton said in her speech, and as has long been recognized, is that there can be good reasons for a contract that references rivals. There can be good reasons for a most favored nations clause. But Fiona’s point was that because of the possible harms from CRRs, there has to be a business justification for an MFN or a CRR where the market context is one in which some harm is plausible.

CRRs are reviewed under the rule of reason, and I think what Fiona Scott Morton was trying to do is to just remind firms that the rule of reason has teeth. And if the agencies see a situation in which there’s no valid business justification for a most favored nation clause or other CRR, and see possible harm, they may investigate and enforce.

The Federal Trade Commission does not take a different view. I think that we do recognize, however, that in the vertical context, putting aside the facilitating practice possibility, CRRs are often innocuous. MFNs or CRRs are being dictated by buyers. And there are cases in which sellers don’t really have a choice if they wish to do business other than to give the buyers the contract that they want. So the challenge is to sort out when an MFN or a CRR is driven by competition compared to when it is actually restraining and limiting competition.

We examine CRRs in the way we examine all vertical practices, recognizing the efficiency possibilities and the procompetitive possibilities, but also attuned to the circumstances under which they can be harmful.

**ANTITRUST SOURCE:** In September, the DOJ and FTC jointly sponsored a workshop on particular

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types of CRRs—MFNs—which we discussed earlier. Will BE become more active in exploring the anticompetitive and procompetitive effects of MFNs? And also, in broad strokes, what factors play into the assessment of those pros and cons?

SHELANSKI: The conference raised awareness on both sides of the arguments about contracts that reference rivals and MFNs and about what the most current thinking is about the problem. Participants discussed lots of good questions. What are the reasons for concern? What are the reasons that firms and industries have these contracts? How do they evolve? I think the conference was useful and Fiona’s paper was useful in bringing the issue back to the forefront, raising awareness, pushing people to rethink and to reexamine the state of our knowledge about these kinds of contracts.

But if one were to ask me, have things fundamentally changed in terms of antitrust law’s perspective on CRRs and MFNs, I would say the answer is no, the agencies will continue to look at the same factors. What is the market context in which MFNs have arisen? Who has dictated them? Are they from the buyer’s side or the seller’s side? How did they arise on the buyer’s side or the seller’s side? What is the market power and the market position of the firm demanding the MFNs or of the firm selling the product? All of these will factor into the likelihood that there is harm, that the likelihood that they are facilitating practice.

My own interpretation of Fiona’s speech was that it took a stronger, harder line than probably had been articulated by antitrust officials in the recent past. She has done original research showing the effects of MFNs. And I think by taking that stronger position on the possible harms of MFNs, she has raised a question that the antitrust agencies will be investigating going forward, which is, how likely is it that there is going to be harm from these kinds of vertical practices? If there is good evidence that there has been harm in a number of industries, should we be looking at CRRs more closely? And I think it likely that antitrust agencies will be looking at CRRs more closely over the next few years.

ANTITRUST SOURCE: Since, as you said, the conference pushed “people to rethink and to reexamine the state of our knowledge” of these contracts, do you think it is time for a revision of the vertical guidelines?

SHELANSKI: I do not think that a new revision of the vertical guidelines is essential. In some sense, there are two reasons for that. I do not think it would be easy to write new vertical guidelines right now because I think that the state of the knowledge about vertical practices is that effects are very case-by-case. And other than setting forth some principles and some economic understanding and some burdens, I’m not sure how useful new guidelines would be.

I am not sure at this point there is something sufficiently systematic that we can capture by guidelines that would really be useful for firms, businesses, or the bar. While I don’t see that there would be a lot of harm in revising the vertical guidelines, I think that a revision of the guidelines now would end up not being terribly useful because it would end up saying, here are a lot of factors that one might consider, but it’s really a very case by case analysis.

ANTITRUST SOURCE: In two recent speeches, DOJ personnel have suggested policy choices for standard-setting organizations that would promote competition and benefit consumers. Do these policy choices sufficiently summarize the FTC’s view, and if not, what is missing?

SHELANSKI: Well, I think I need to be careful about ever saying that I know what the FTC’s view is because we understand the agency’s view based on the votes of the commissioners, by the speeches of the commissioners, and I don’t know to what extent there’s consensus among the commissioners on all of the IP issues that are circulating.

There are certainly some differing views, but on the whole I think it is absolutely correct that the Commission views IP issues as very important to the agency’s mission. And I think there is probably general agreement about the need for better practices at the SSO level, that is to say, during the standard-setting process, to avoid the ex post, and by ex post I mean post adoption of the standard, problems that we very often find ourselves dealing with here at the agency.

If you look at the cases that we have dealt with, successfully or unsuccessfully, the Rambus case, the N-Data case, the recent Bosch/SPX settlement, or the current Google standard essential patent (SEP) investigation, what one sees very quickly is that there are strong allegations of hold-up by firms that have intellectual property embedded in standards. Sometimes, the conduct is pretty clear, and firms behaved in a really poor way, perhaps not disclosing they had IP in a standard or backing off of apparent commitments to license the standard on FRAND terms. But in a lot of cases what we find is that the SSO agreements are quite unclear about what has actually been agreed to. One typically cannot figure out what the FRAND rate is, or what the understanding or agreement was as to the procedure for establishing FRAND, and so on. These are very difficult but important questions.

Now, as a matter of antitrust law, I think there are good reasons to imply certain non-exclusion obligations in the standard-setting agreements among members of an SSO. Standard-setting organizations can obviously do a lot of good, but they also involve cooperation among actual or potential competitors.

So we like the efficiency of standard-setting organizations because they may bring us a better standard sooner, but what we give up through the SSO is the possibility of competing standards, and such competition can reduce the ability of any particular set of standard-essential IP holders to exclude rivals or follow-on innovators from the marketplace. So we trade off efficiency at the front end against the risk of exclusion and monopoly power on the back end, after the standard is adopted.

What allows that trade off to occur, or what should allow that trade off to occur, are commitments by the standard-setting organization to limit that monopoly power, that ability to exclude competitors, innovators, and other future licensees ex post. What the DOJ has been arguing for, what I have been arguing for, is for SSOs to do a better job clarifying what the commitments are by participants in the standard not to exclude once the standard is adopted and once the market power has vested in the standard. That is where the SSOs do not do a good enough job and part of why we have ex post hold-up disputes.

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So the consensus that you’re seeing between the Bureau of Economics at the FTC, the economic analysis group at the DOJ, and the economists at the European Union—I’m referring to the economists because that’s who I’ve been dealing with, but I think this is shared more broadly—is that SSOs should be pushed to adopt clearer and better agreements.

Now, there are challenges in achieving clearer standard-setting agreements. The SSO process is a difficult one. We don’t want to require such specificity that we scare off participation in the SSOs. We all recognize that it’s a delicate balance, but the balance at this point is too far skewed towards vagueness, so that we may in fact not have the confidence we want to have as antitrust enforcers that the procompetitive benefits of these SSOs on the front end, in getting us a better standard sooner, outweigh the exclusionary outcomes ex post through possible abuses of FRAND commitments.

ANTITRUST SOURCE: One of the ways that SSOs have tried to remove the vagueness, as you say, is to require members to publicly announce their most restrictive licensing terms so that the adopted standards could be based not just on the technological merits but also on the cost. This seems to be something that the FTC agrees with. But do you foresee any potential problems if a SSO adopts this policy?

SHELANSKI: You know, I’ve never worked inside an SSO and I think that it’s hard from the outside to appreciate what all of the dynamics are and what all of the problems might be. So anything I say will be something of an abstraction on this point, and I recognize that.

I don’t think that SSOs are trying to do bad things or to be anticompetitive. I mean, if you talk to people in the major standard-setting organizations, they’re trying to get good technological standards out there onto the marketplace. Engineers are not typically trying to be anticompetitive, they’re trying to get good technology into practice. The companies that participate in the standard have their own incentives and obviously they want to maximize the returns on what they’ve done.

In principle I like the idea of requiring the most restrictive terms to be announced, so that decisions about which technology to use can be based not just on the capability of the technology but on the price and what it’s going to cost investors and innovators and licensees down the road. What would be the harm of this? I don’t really know. It might be that some good technology doesn’t get into some standards because the firms that hold those patents decide, at the end of the day, that they’d be better off pursuing their own standard or licensing separately. And then the question is: would it be better for consumers to run the risk of getting very restrictive terms but to have the better technology? And by consumers, I include the future licensees. Or would it be better to have the price set up front?

ANTITRUST SOURCE: The America Invents Act provides for several changes to the country’s IP landscape, including limitations on litigation and new mechanisms to improve upon patent quality. Going forward, are there specific changes that are of particular interest to the FTC?

SHELANSKI: Well, I think that anything that could improve patent quality is extremely important. And the chance to get post-grant reviews of patents might be very helpful in this regard. Obviously, it is costly for the PTO to engage in these kinds of reviews or take other measures to improve patent quality, but it is a necessary step.

Right now, I think most people acknowledge that the patent system is broken in a number of ways. It can be hard to find out who even owns a patent, who holds the patent, where has it been
transferred, who is the owner of record. So to even discover whether there is particular IP out there and who owns it can be extremely difficult. I can find out who owns virtually any piece of land in the United States, no matter how big or small. I cannot find out who owns a patent with certainty in many cases.

So there are lots of problems with the patent system, and those problems impose costs and risks on moving forward as an inventor, an innovator. So I think that having a patent system that is clearer, more reliable, and easier to navigate would be an extremely useful thing.

There are other aspects of the America Invents Act that I think are difficult and that are obviously very controversial. The first-to-file change is one that has pros and cons, but certainly when we think about people or enterprises that are accumulators of vast numbers of patents, one has to ask where the balance tips with first to file. Companies that have big patenting operations that have their feelers out there in the marketplace for any kind of new technology that is emerging can run in and file now, get the patent, even if they were not the first inventor. And the incentive for small innovators may be to go to the existing large holders of IP with these large patenting operations and to try to cut a deal up front.

Part of the concern here is that market power through accumulation of IP and the amassing of IP will actually be exacerbated by first to file. This is not to say first-to-file is ultimately wrong, but it raises some hard questions. From an antitrust perspective, one question is whether first-to-file will increase the holdings of already large patent holders rather than allowing new entities to develop IP and compete with and offset some of the market power of some of the large IP portfolios.

So this is just one set of concerns that might emerge. But some of the other things in the America Invents Act I think are very helpful and mark a useful step forward in patent reform.

ANTITRUST SOURCE: In August of this year, the FTC issued a notice of proposed rulemaking regarding the issue of whether a transfer of exclusive rights to a pharmaceutical patent would be a reportable asset acquisition under the Hart-Scott-Rodino Act. The public comment period closed in October. Do you have a sense of how BE will look at this issue and what perspective it will bring to help shape the pre-merger notification office’s guidance to parties?

SHELANSKI: We’re still in the process of looking at the comments that are coming in and this is certainly an issue that we’re thinking about.

IP sometimes is really the business that is being transferred. So what might look like a mere IP transfer might really be a future line of business that is being transferred, and that has the same kinds of market power and competitive effect considerations that a merger has. But there are some offsetting considerations. But this is something that we’re still in the process of reviewing, and beyond that I probably don’t have a lot of comment on where we’re likely to come out.

ANTITRUST SOURCE: It has been over two years since the Horizontal Merger Guidelines were revised. Even though they didn’t materially alter the approach of the agencies, have you noticed a change in how merging parties approach the agencies in discussing potential competitive effects?

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SHELANSKI: I have noticed a couple of changes. For one thing, unilateral effects, which became more prominent in the 2010 Guidelines, tend to be part of the early presentation and analysis that we get from merging parties. We often get diversion ratios and upward pricing pressure analyses being submitted early on, when there are differentiated product markets at issue. And this is very helpful to our analysis because it really goes directly to the effects question. And while market definition has remained a very important part of most merger investigations, the very quick and early focus on the likelihood of effects on who the closest competitors are, on what the diversion ratios might be, I think has been very helpful and has actually sharpened the analysis that we do in a number of transactions.

The other area, in section six of the Guidelines, we were much more specific about innovation effects. And so in cases that do involve an acquisition of a firm that is developing technology but might not yet be on the market, or where the incentive to introduce and innovate future products going forward from the transaction is important, we’ve seen a lot more focus on those issues.

So I think the Guidelines very usefully drove people to focus, to the extent possible, directly on effects and not to come in fighting over market boundaries right off the bat if there is more direct effects evidence. And we’ve seen more focus on the innovation aspects and the unilateral aspects. So I do think that it’s been a useful change. Not a 180-degree turn or any kind of particularly radical change, but just a shift in emphasis that actually accords with the way staff internally had been looking at transactions for a long time. Staff didn’t typically get a merger and immediately start calculating HHIs and worrying about market boundaries. What the Bureau of Economics staff typically tried to figure out is: what kinds competitive effects might arise? How do these firms behave toward each other and what might change as a result of the merger?

So I think it has been a useful change and it’s led to a sharper focus on effects from the outset in our merger investigations.

ANTITRUST SOURCE: Have you observed areas where more clarity is needed to supplement the revised Guidelines yet?

SHELANSKI: I think that there is a lot that we’re learning. We are still refining our application of different ways to analyze potential unilateral effects and to interpret the results of those analyses, as well has learning how to make that analysis more dynamic.

Under the coordinated effects section, we have a renewed focus on non-collusive but nonetheless oligopolistic outcomes, parallelism of a kind that might be natural oligopoly behavior but is non-collusive. We ask if a merger is not just going to increase the likelihood of collusion, but is a merger likely to make it easier for firms not to compete as aggressively against one another because of their ability to follow each another in greater transparency in the market?

We now have to sharpen our understanding of the market factors that are likely to lead to such coordinated effects. We will gain that through experience and through continued study of how markets behave. So, yes, there are areas in which we continue to try to fill in and supplement our knowledge and improve our review of mergers and acquisitions.

ANTITRUST SOURCE: I understand that you have been involved with other jurisdictions that have been considering revisions to their guidelines. Do you see the U.S. effort as a harbinger of change in other countries, or does our approach seem to be an outlier?

SHELANSKI: I don’t think our approach is an outlier, but we certainly have differences. There are
jurisdictions that have been engaged in revision of their own guidelines and are very close to us. Certainly, we thought in very similar ways to the folks in the United Kingdom. In the European Union there’s a lot of similarity but there are some differences on coordinated effects, between how we look at them and how the EU looks at them, for example.

In a number of jurisdictions that are putting guidelines in place, like Brazil, which has moved to a pre-notification regime, there are still some differences. We talk to them about how they do things. But I think that, at this point, our emphasis on some of the differentiated product market issues and how to analyze those, our somewhat broader notion of oligopoly effects beyond collusion, and our innovation analysis—I wouldn’t say they’re outliers but I would say we’re running a bit ahead of most other jurisdictions on those.

I do think that glib assertions that the error costs of enforcement in high technology industries likely offset the benefits of enforcement need to be resisted, given some of the new research and the new approaches that economists are developing.

ANTITRUST SOURCE: There have been criticisms that standard antitrust analysis does not apply to innovative industries. In 2005 you wrote that “although a coherent and effective approach to innovation in merger policy will be difficult, the analysis suggests that the goal is achievable.” Do you still feel that way or do you believe that is has been achieved?

SHELANSKI: Innovation is a big issue for antitrust policy and enforcement. Anyone who thinks that competition policy or antitrust policy is the central issue in promoting innovation is missing the boat. But it’s very hard to deny that how markets perform, how competitive markets are, how incumbent firms act, will have an impact on innovation.

It’s just that the impact of conduct or transactions on innovation is likely to be more case-specific and harder to assess. Although there is increasing evidence that tends to support the benefits of competition for innovation, at least up to a point, I think that we’re still working towards a clearer understanding of the relationship between antitrust and innovation. But I think things are promising and improving for the role that antitrust can play in an innovative industry. Does that mean that we always get it right? Not at all. There are risks of making big mistakes because of unforeseen changes to markets. It is very difficult often to understand what the universe of potential innovators is. It can be difficult to understand what the effect of market structure in a particular industry will be on innovation incentives.

That said, I think that we’re starting to do a better, not worse, job in innovative industries. And I would point to a number of specific actions that would show that. To me, a great case is our decision to issue a complaint against the merging parties in Thoratec and HeartWare back in 2009. That was a merger in the medical device industry involving surgically implanted, left ventricular assist devices that keep hearts pumping during end-stage heart failure leading up to a heart replacement operation. In that case we were able to do a very nuanced analysis about the relative economic incentives of the merged firm versus the stand-alone target firm to introduce this new product and bring it to market. And that was a very focused kind of analysis that I think was very compelling.

In many cases you don’t have the level of data that we had in that case. You can’t always do a rigorous analysis of economic incentives to deploy new technology. And in those cases, the analysis remains challenging, but I do think that glib assertions that the error costs of enforcement in high technology industries likely offset the benefits of enforcement need to be resisted, given some of the new research and the new approaches that economists are developing.

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And while we have to be very careful and very modest when we go into digital industries, when we go into biotechnological industries, pharmaceutical industries, any high-technology sectors, information technology, while we have to be certainly modest about what we can and can't know about what the direction of the industry is, we often make good, case-specific decisions about whether a particular course of conduct or a particular transaction is likely or not to be helpful or harmful to that innovative process. Where we can’t tell, we need to stand down. But I think we’re getting better at telling whether or not something is good or bad for innovation.

**ANTITRUST SOURCE:** In a recent interview with *The Antitrust Source*, FTC Commissioner Ohlhausen stated that, in addition to competition policy, “economics ought to play an important role in the consumer protection side as well.”

7 What role does BE currently play in consumer protection issues?

**SHELANSKI:** We have about twenty-five economists who are focused on consumer protection issues. So we play an important role in consumer protection issues. On the policy side, we do a lot of studies to try to determine what the incidence of certain kinds of violations of consumer protection laws there are. We examine various kinds of markets, like debt buyer markets and credit reporting markets, to see how well these markets work for consumers. Are consumers getting harassed to pay debts that they don’t owe in any kind of systematically large way that would go beyond what is an acceptable level of error? Do they get complaints about mistaken credit reports fixed quickly enough?

So we do work on that front. We do tests and analyses to determine the likelihood that consumers were deceived in a harmful way by false advertising or by advertising that does not have sufficient substantiation in the research. We examine the extent to which consumers understand or might be misled by certain kinds of disclosures that firms make.

We also do a lot of work on the consumer protection side in analyzing what the consumer behavior response is to certain things consumers confront in the marketplace in order to figure out whether there is a likelihood of fraud, a likelihood of deception, a likelihood that consumers have been misled and paid for things that were not what they thought they were getting. So BE does a lot of work both in general policy studies and in specific cases across the board.

The Bureau plays a role in assessing the remedies on the consumer protection side. Remedies can be difficult on the consumer protection side. It’s pretty clear that someone who defrauds consumers of their last dollar should be punished to the extent of the law and return the money. You really don’t worry about deterring people engaged in outright fraud like that.

But imagine a case where a firm overstates the benefits of an actually beneficial product. So consumers gain by purchasing the product, but they might have overestimated what they would receive based on the advertising.

A remedy in that kind of case has to be more balanced and nuanced. You don’t want to say the firm may not advertise the benefits at all, or must withdraw the product, or must issue a complete retraction of everything it has said about this product. The question then is not to over-deter the provision of good information by over-punishing the legal violation of putting forward an under-substantiated ad.

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And so we in BE, I think, can play a useful role in trying to help to craft remedies that keep the good information in and benefit consumers while keeping the bad information out. So we play a variety of roles in consumer protection, from policy studies, data analysis and reporting, providing expert support for litigations and support for investigations, and in assessing harm and crafting the remedies.

**I think that consumer protection is going to be the area where behavioral economics plays a larger role sooner, and antitrust is an area in which we will continue to look at behavioral economics, and as systematic predictions develop, as robust results emerge, it may come to play a bigger role.**

**ANTITRUST SOURCE:** There appears to be a significant interest in applying behavioral economics to competition policy. However, some have expressed reservations that it does not yield predictive models on which to base policy. Is there a role for behavioral economics in antitrust? And, if so, what is it?

**SHELANSKI:** I think there is a role, but one needs to be very modest and cautious. There has been a lot written and a lot said about how behavioral economics fundamentally undermines the models on which we do antitrust analysis. And I think most people involved with antitrust enforcement, most people who think about competition issues, would disagree that there is some fundamental new paradigm shift in the works. But behavioral economics does supply insights into how consumers might respond to certain kinds of information, contracting practices, or pricing schemes. This can be very useful to understanding certain kinds of market performance and has led to greater modesty about imputing perfect foresight or rationality to consumers.

But one needs to understand that that is not the sign of a broader behavioral economics revolution in antitrust. That’s something that’s been happening for some time, at least since the Supreme Court’s decision in the *Kodak v. Image Technical Services* case twenty years ago.

I think that consumer protection is going to be the area where behavioral economics plays a larger role sooner, and antitrust is an area in which we will continue to look at behavioral economics, and as systematic predictions develop, as robust results emerge, it may come to play a bigger role.

**ANTITRUST SOURCE:** You mentioned that consumer protection is the area where behavioral economics will play a role sooner. Is there a specific example of where you think that has been the case?

**SHELANSKI:** Well, you know, we had our drip pricing workshop here. Behavioral economics has much to say about the ability of consumers to understand what they are buying, to make calculations about what the total price of a product is when they’re subject to drip pricing. You know, you buy your airline ticket and then you’ve got to pay to get a bag on board, all these little things that occur in a variety of industries where the price that is quoted up front doesn’t actually correspond to the total price you will pay by the time you are done. Behavioral economics can help us to understand the effects on consumers of these kinds of practices.

If consumers actually are misled for reasons that can be systematically discussed and systematically predicted, that would factor into our findings of harm for particular practices out there.

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8 See, e.g., Joshua D. Wright & Judd E. Stone II, *Misbehavioral Economics: The Case Against Behavioral Antitrust*, 33 CaroDozo L. Rev. 1517, 1548 (2012) (“Behavioral economics does not add significant explanatory power concerning the behavior of firms over and above existing theories. . . . Put bluntly, we do not believe that behavioral economics currently offers antitrust policy-relevant insights.”).

in the marketplace and may affect the kinds of regulations we put forward or the kinds of enforcement actions that we bring.

**ANTITRUST SOURCE:** BE, and the economics profession generally, get a lot of attention when quantitative techniques can yield valuable insights into the likely impact of a particular transaction. But I’m sure there are cases in which there’s just not a lot of data out there with which you can work your magic. What’s the role of BE in those cases?

**SHELANSKI:** One role that BE would play would be to look at all of the factors we can know about the market. We can learn a lot about the characteristics of the market. Not just structural characteristics, but historically how the market and its participants have behaved, both on the supply and demand sides of a market. And so we can do a theoretical analysis of whether there is likely to be harm from a particular practice or transaction, given the state of economic knowledge and economic modeling.

The other thing we can do is to be creative in the data sources that we use. There may not be data from these particular firms or even from this particular market, but we may have experience and data from similar or related markets, from similar or related firms.

The other problem that we face, even when there is data, is that there are often multiple sources of data, multiple ways of looking at the data. And so a lot of what we do in BE, even when we have the data, is to slice and dice all the different sources of data every which way to see whether the results we get are robust or are sensitive to small changes in particular observations, particular sources, particular ways of dividing up the data.

In the end, even if we have the data and we can make the data tell a story that goes in a particular direction, we’re not interested in blocking mergers that shouldn’t be blocked. We’re not interested in letting through mergers that should be blocked. We’re interested in good results for competition, for innovation, and for consumers. So what we’re always doing at BE is analyzing and investigating. And the question we’re asking ourselves is, do we believe as an economic matter, using the best available theory and data and taking account of particular market facts, that there is a likelihood of harm in a given case? That will involve data, that will involve theoretical modeling, that will involve our experience with past cases, and it will involve the documentary evidence and testimony that the attorneys and economists here at the FTC obtain through the process of an investigation.
FTC Monetary Remedies Policy and the Limits of Antitrust

Alden F. Abbott

The Federal Trade Commission’s abrupt July 2012 withdrawal of its 2003 Policy Statement on Monetary Equitable Remedies in Competition Cases (MER Statement) marks a change of direction in the FTC’s approach to monetary remedies—and, in particular, disgorgement and restitution—for antitrust violations. This action, which was taken without the benefit of advance notice and public comment, raises troubling questions. By increasing business uncertainty, the withdrawal may substantially chill efficient business practices that are not well understood by enforcers. In addition, it raises the specter of substantial error costs in the FTC’s pursuit of monetary sanctions. In short, it appears to represent a move away from, rather than towards, an economically enlightened antitrust enforcement policy.

Background

Although the FTC Act has been interpreted to explicitly authorize the FTC to seek disgorgement only in consumer protection cases, beginning in 1992 the FTC occasionally has sought such relief in antitrust cases as well. The FTC bases its authority to do so on Section 13(b) of the FTC Act, which provides that the FTC may seek and obtain injunctive relief from federal district courts.

In 1999, in FTC v. Mylan Laboratories, Inc., the FTC sued a pharmaceutical company under Section 13(b) in federal court for over $120 million in restitution and disgorgement for alleged anti-competitive overcharges. Noting that various courts previously had permitted the FTC to seek monetary relief in consumer protection cases under Section 13(b), the district court stated that “monetary relief [also] is a natural extension of the remedial powers authorized under Section 13(b)” in antitrust cases. That court then held for the first time that the FTC had the power to seek monetary relief in consumer protection cases under Section 13(b), despite that section’s lack of specific language authorizing such relief.

2 Section 19 of the FTC Act, 15 U.S.C. § 59, enacted as part of the 1975 Magnuson-Moss Warranty-Federal Trade Commission Improvement Act (two years after the addition of Section 13(b) as part of the Trans-Alaska Pipeline Act), expressly authorizes the FTC to seek monetary relief, but only when fraudulent or deceptive conduct is involved. The courts have also recognized the FTC’s authority to obtain monetary relief in consumer protection cases under Section 13(b), despite that section’s lack of specific language authorizing such relief.
3 The courts have recognized the FTC’s authority to invoke the equitable powers of the court to obtain monetary relief in consumer protection cases under Section 13(b), despite that section’s lack of specific language authorizing such relief. See, e.g., FTC v. U.S. Oil and Gas Corp., 748 F.2d 1431 (11th Cir. 1984). For an overview of the FTC’s use of monetary relief (and, in particular, disgorgement) in consumer protection and antitrust cases through 2001, see David K. Park & Richard Wolfram, The FTC’s Use of Disgorgement in Antitrust Actions Threatens to Undermine the Efficient Enforcement of Federal Antitrust Law, ANTITRUST SOURCE, Sept. 2002, at 1, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/09_02.authcheckdam.pdf [at 23].
5 62 F. Supp. 2d 25 (D.D.C. 1999). This case involved exclusive licensing agreements that allegedly undermined competition in the market for two generic anti-anxiety drugs by preventing competitors from obtaining necessary ingredients for the manufacture of competing products.
6 Id. at 36.
disgorgement in antitrust matters, stressing that the “defendant cite[d] no relevant case law that prohibits the FTC from seeking disgorgement or any other form of ancillary relief.” Even though monetary relief obtained by the FTC in this case could accrue to indirect purchasers, the court did not find Illinois Brick’s prohibition on indirect purchaser recoveries to pose a problem, given that Illinois Brick involved an interpretation of the Clayton Act, not the FTC Act.

Two years later, in FTC v. The Hearst Trust, the FTC entered into a consent order requiring divestiture of an acquired company and the disgorgement of $19 million in profits. The order settled an FTC complaint that Hearst had failed to timely disclose pre-merger documents that would have prompted the FTC to oppose an alleged merger to monopoly in a relevant market comprised of integrable drug data files. Although the Commission approved the settlement 5–0, two Commissioners (Leary and Swindle) suggested that the FTC might have gained greater total relief had it relied on civil penalties rather than disgorgement. Commissioner Leary forcefully stated that disgorgement here was “unnecessary, if not affirmatively harmful.”

The MER Statement and Its Withdrawal
The FTC’s efforts to seek monetary remedies in antitrust matters generated controversy. In December 2001, the FTC issued a notice requesting public comment on the issue, and, after receiving six responsive comments, issued the MER Statement in July 2003.

In the MER Statement, the FTC explained that it would consider three factors in deciding whether to seek disgorgement: (1) it would ordinarily seek monetary relief only where the underlying violation was clear; (2) it would require a reasonable basis for calculating the amount of a remedial payment; and (3) it would consider the value of seeking monetary relief in light of any other remedies available, including private actions and criminal proceedings. Regarding the first factor, the FTC stressed that the value of deterrence is reduced when the violator has no way of knowing in advance that its conduct places in jeopardy its potential gains. The Commission stated that it would assess whether a violation is clear by applying an objective “reasonableness” test. Regarding the second factor, the FTC said it would require “a reasonable means” for calculation when seeking disgorgement, and “a reasonable gauge” of the amount of injury when seeking restitution. A reasonable basis for calculation would not, however, require “undue precision.” With regard to the third factor, the FTC said it would consider monetary remedies when other remedies

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7 Id. at 37. By referring to “other form[s] of ancillary relief,” the court also implied that the FTC had authority to seek restitution.
8 Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977) (standing granted to direct purchasers but denied to indirect purchasers for damages under federal antitrust law).
9 As some commentators have noted, “This literal interpretation of Illinois Brick, leaving open the possibility of recovery by the FTC on behalf of indirect purchasers under the FTC Act, thus opened the way, under the teaching of Arc America, to similar recovery by those states with competition laws based on the FTC Act.” Park & Wolfram, supra note 3, at 7 (citing California v. Arc America Corp., 490 U.S. 93 (1989)).
12 For example, two commentators argued that the policy ran counter to the plain meaning of Section 13(b) and undermined the Supreme Court’s policy against duplicative litigation and damages. They also contended that the FTC’s proposed use of a set-off to deal with these problems was unreliable because set-off’s use and application are discretionary with the courts and short-change indirect purchasers. Park & Wolfram, supra note 3, at 8.
13 Federal Trade Comm’n, MER Statement, supra note 1.
are unlikely to fully accomplish the purpose of the antitrust laws. Thus, disgorgement could be valuable when advantages a violator reaps greatly outweigh the specific penalties prescribed, or when private actions likely would not remove the total unjust enrichment from a violation. When an injured person obtained sufficient damages to erase an injury, however, restitution would not be warranted, according to the FTC.

The FTC sought antitrust monetary relief in two cases following the release of the MER Statement, once successfully and once unsuccessfully. In 2004, generic drug manufacturers Perrigo and Alpharma agreed to disgorge $6.25 million in profits to settle FTC charges that Perrigo had agreed not to enter and compete with Alpharma in the over-the-counter (OTC) store-brand children’s liquid ibuprofen market, in return for an “up front” payment and a share of the resulting monopoly profits. The FTC, had eliminated Ovation’s only competitor for the treatment of a serious congenital heart defect affecting babies. Claiming prices had risen significantly as a result, the FTC sought disgorgement of profits from Ovation’s sales of NeoPren and Indocin, Ovation’s allegedly competing drug. While not addressing disgorgement, the U.S. District Court for the District of Minnesota denied any relief on antitrust grounds after concluding that the two drugs were in different product markets. The Eighth Circuit affirmed.

Without prior notice, the FTC withdrew the MER Statement on July 31, 2012, by a 4–1 vote, stating that the FTC “will rely instead on existing law, which provides sufficient guidance on the use of monetary equitable remedies.” The Commission’s majority statement explaining the withdrawal emphasized that “the practical effect of the [MER] Policy Statement was to create an overly restrictive view of the Commission’s options for equitable remedies,” and “the Policy Statement has chilled the pursuit of monetary remedies in the years since the statement’s issuance.” The Withdrawal Statement focuses on the MER Statement’s first and third factors, noting that the second factor (reasonable basis for calculation) “does no more than restate existing legal standards.” As to the first factor (clarity of the violation), the Withdrawal Statement reasoned that novel conduct can be just as anticompetitive (if not more so) than a “clear violation,” and asserted that courts do not consider the rarity or clarity of a violation in ruling on disgorgement. The Withdrawal Statement added that the third factor (other remedies available) placed an undue burden on the Commission because it could be read to require that the FTC demonstrate the insufficiency of other actions to secure monetary equitable remedies an inappropriate burden.

14 Press Release, Federal Trade Comm’n, Generic Drug Marketers Settle FTC Charges (Aug. 12, 2004), available at http://www.ftc.gov/opa/2004/08/perrigoalpharma.shtm. In addition, the companies agreed to pay the state attorneys general an additional $1.5 million to resolve their claims arising out of the same agreement.


In her dissenting statement, Commissioner Maureen Ohlhausen pointed out that the MER Statement had been adopted by a bipartisan and unanimous Commission vote; had been unanimously endorsed by the Antitrust Modernization Commission (AMC); and had been supported by leading practitioners, including former FTC Chairman Robert Pitofsky. Commissioner Ohlhausen stressed that she had not been presented with any evidence that the MER Statement had inappropriately constrained FTC actions. She also critiqued the Withdrawal Statement’s comment that the FTC would rely henceforth “upon existing law,” noting that this comment could justify a decision to issue no guidance and ran counter to the goal of transparency, “which is an important factor in ensuring ongoing support for the agency’s mission and activities.” Finally, she stressed that she was “troubled” by the lack of internal Commission deliberation and public input prior to withdrawal of the MER Statement.

**Economic Policy Implications of the Withdrawal**

The sudden withdrawal of the MER Statement reduces transparency and increases uncertainty regarding the FTC’s future application of disgorgement and restitution. That added uncertainty threatens to impose substantial economic costs on private actors and to reduce general economic welfare. Although the MER Statement left many questions unanswered, it at least strongly suggested that businesses would not face FTC monetary sanctions unless their behavior fell within well-established antitrust “problem areas” or was shielded from sufficient private damage recoveries. While it is conceivable, of course, that the FTC majority was motivated by a concern that the MER Statement had precluded it from pursuing disgorgement in particular meritorious matters, no such examples (either specific or theoretical) were provided by the majority. Nor did the majority suggest that specific concerns had been raised by third parties or scholars that the MER Statement inappropriately had encouraged anticompetitive behavior—or had cabined the FTC’s discretion to seek monetary relief for consumers. Nor did the majority point to a particular class of harmful conduct that the MER Statement precluded the FTC from pursuing in the future. This lack of specificity is particularly puzzling, not only because the MER Statement had been carefully crafted in light of public notice and comment, but because the FTC is known as a deliberative body that relies heavily on hearings and workshops when contemplating public policy departures.

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21. Admittedly, these costs cannot be precisely quantified, but they threaten to cast a pall over efficient business conduct. A reduction in efficient conduct, even if only at the margin, would tend to slow innovation and the introduction of cost savings that, over time, would benefit consumers. As an agency dedicated to promoting consumer welfare, the FTC should carefully weigh the potential loss of future consumer benefits when considering any policy change, including, of course, the policy change represented by the MER Statement’s withdrawal.

22. The MER Statement was not a serious obstacle to the FTC’s possible pursuit of disgorgement in pharmaceutical “pay for delay” cases. See infra note 30.
Most notably, the MER Statement’s withdrawal suggests that the FTC may feel free to pursue disgorgement for conduct the competitive implications of which are not well understood.\textsuperscript{23} The FTC’s ability to pursue novel theories of competitive harm is well established. Nevertheless, this flexibility must be viewed within the context of an antitrust system where the FTC has not pursued damages or fines—and private rights of action for FTC antitrust violations have not been allowed. Thus, the potential chilling effect on private conduct arising from mistaken prosecutions by the FTC has been rather limited. As one commentator recently explained,

> Since, unlike the Sherman Act, the FTC Act implies no private right of action and Section 5 decisions have no collateral estoppel effect in private follow-on actions, the entity charged with violating Section 5 would face only future consequences through the cease-and-desist order (rather than damages for past action) and would less likely be threatened by costly future private damage actions. This lack of retrospective punishment should mitigate any concerns about expanded antitrust enforcement.\textsuperscript{24}

This limitation on the effects of FTC initiatives, however, will be weakened by the potential broader, more “flexible” initiation of FTC disgorgement actions in light of the MER Statement’s withdrawal.\textsuperscript{25} Specifically, the withdrawal may be expected to raise direct costs on business arising from the FTC’s mistaken prosecution of procompetitive behavior—“false positives” that impose litigation costs and costs due to current changes in beneficial business practices. New indirect costs due to the chilling of future efficient business conduct, and future alteration in efficient business practices, will also follow.

In sum, the withdrawal of the MER Statement may be expected to discourage efficient business conduct, raise litigation costs to the private sector, and increase the burden of mistaken prosecutions, without significant offsetting benefits for consumer welfare. In so doing, the withdrawal also reduces the clarity of FTC antitrust enforcement by rescinding basic principles that provided the private sector guidance on monetary relief. This new FTC approach is at odds with modern antitrust enforcement philosophy, supported by both the Harvard and Chicago Schools, which emphasizes the importance of clear and simple rules in the administration of an antitrust system characterized by imperfect information and inevitable error.\textsuperscript{26} The “simple administrable antitrust rules” philosophy may be seen as an application of the principle, derived from decision theory,\textsuperscript{27}

\begin{itemize}
  \item \textsuperscript{23} The FTC should be wary of using economic theories to condemn and seek monetary relief with respect to “novel” conduct that is not well understood. See Ronald Coase, \textit{Industrial Organization: A Proposal for Research}, in \textit{Policy Issues and Research Opportunities in Industrial Organization} (Victor R. Fuchs ed., 1972) (cautioning against economists’ tendency to ascribe a “monopoly explanation” to business practices that are not well understood).
  \item \textsuperscript{24} Amy Marshak, \textit{The Federal Trade Commission on the Frontier: Suggestions for the Use of Section 5}, 86 N.Y.U. L. Rev. 1121, 1145 (2011) (internal footnote citation omitted) (discussing case for a broad application of Section 5 when the FTC only seeks a cease-and-desist order, a position advanced by former FTC Commissioner Leary).
  \item \textsuperscript{25} Even if the FTC ultimately did not succeed in particular disgorgement actions, the threat of such actions, combined with the costs of defending them, would have to be factored into business planning calculations.
  \item \textsuperscript{26} See generally Frank H. Easterbrook, \textit{The Limits of Antitrust}, 63 Tex. L. Rev. 1 (1984) (false positives more costly than false negatives because market forces mitigate the latter but not the former, and both false positives and false negatives are inevitable due to the difficulty of distinguishing procompetitive from anticompetitive conduct, particularly in the single firm context). See also, e.g., William E. Kovacic, \textit{The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix}, 2007 Colum. Bus. L. Rev. 1, 32–35 (2007) ([B]oth “Chicago” and “Harvard” Schools of antitrust favor reliance on simple administrable rules rather than overly sophisticated economic tests . . . .).
  \item \textsuperscript{27} Decision theory describes a methodology for making factual determinations and decisions when information is imperfect and costly. This methodology is well suited to deriving optimal antitrust rules, given informational constraints. See, e.g., C. Frederick Beckner III & Steven C. Salop, \textit{Decision Theory and Antitrust Rules}, 67 Antitrust L.J. 41, 41–42 (1999).
\end{itemize}
that optimal antitrust rules should minimize the sum of the welfare losses due to: (1) the discouragement of welfare-promoting behavior, (2) false positives, (3) false negatives, and (4) administrative/litigation costs associated with antitrust enforcement. Applying this framework (in particular, points one, two, and four), the FTC’s withdrawal of the MER Statement may discourage novel welfare-promoting business activity (particularly in the realm of single-firm conduct, where welfare implications of particular practices are often ambiguous and false positives are a serious concern),\(^{28}\) raise the incidence of mistaken prosecutions, and increase the weight of administrative and business costs generated by new Commission efforts to obtain monetary relief.

In addition, and similarly, the Commission may now also pursue disgorgement or restitution in some cases when full monetary relief is available in the courts. This implicit threat (whether or not it is realized) will further raise the expected cost \(\text{ex ante}\) of engaging in certain forms of business activity. It will also impose additional and unnecessary administrative and litigation costs \(\text{ex post}\) on firms that must now deal with duplicative lawsuits and multiple monetary exactions.\(^{29}\)

Weighed against these potentially large costs are the theoretical benefits of additional meritorious equitable monetary recoveries by the FTC. As Commissioner Ohlhausen pointed out, the Commission majority had adduced no evidence that the MER Statement had precluded appropriate enforcement initiatives. Absent such evidence, the benefits from cases that could not otherwise have proceeded would appear to be small or nonexistent. If this is not so, and substantial consumer benefits were indeed forgone due to the MER Statement, the FTC should, in the interest of sound policy development, make the case publicly.

Moving from the abstract to the concrete, however, was withdrawal of the MER Statement perhaps required to allow the Commission to pursue disgorgement in pharmaceutical “pay for delay” matters? It was not. Such cases involve allegation that an incumbent patentee drug producer had made a “payment for delay” to a potential generic market entrant in connection with settlement of a patent infringement lawsuit. The FTC could simply have issued a public statement of clarification that it views such cases to be in harmony with the MER Statement because they involve “clear” antitrust violations (analogous to a market division between competitors through a side payment) that may impose costs on consumers that cannot readily be “clawed back” through private litigation. The Commission could have cited the Third Circuit’s recent holding that “pay-for-delay” language in a settlement is prima facie evidence of an antitrust violation in support of such a position.\(^{30}\) Alternatively, given the existing Circuit split on the issue,\(^ {31}\) it could narrowly have amended the MER Statement by providing that the Statement would not apply to pay-for-delay cases, given

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\(^{28}\) For a discussion of decision theory and single firm conduct, see, e.g., Alden F. Abbott, \emph{A Tale of Two Cities: Brussels, Washington, and the Assessment of Unilateral Conduct}, 56 \textsc{Antitrust Bull.} 103 (2011).

\(^{29}\) This concern is reflected in some commentators’ critique that in seeking monetary remedies, the Commission runs afield of the rationale articulated in \emph{Illinois Brick} against duplicative remedies. See Park & Wolfram, supra note 4, at 9–11. This article does not discuss the critique (made by Park and Wolfram, for example) that FTC efforts to obtain monetary relief in antitrust cases lack statutory support. This argument certainly appears to be colorable, however (Section 13(b) makes no explicit reference to monetary recoveries), and, as such, it further cuts against withdrawal of the MER Statement.

\(^{30}\) \emph{In re} K-Dur Antitrust Litig., 686 F.3d 197 (3d Cir. 2012).

\(^{31}\) See Schering-Plough Corp. v. FTC, 402 F.3d 1056, 1072 (11th Cir. 2005) (reverse payment settlement permitting entry before patent expires was a “reasonable implementation” of patent law protections); FTC v. Watson Chems., 677 F. 3d 1298 (11th Cir. 2012) (similar conclusion), \textit{cert.\ granted}; 81 U.S.L.W. 3216 (U.S. Dec. 7, 2012); \textit{In re} Ciprofloxacin, 544 F.3d 1323 (Fed. Cir. 2008) (similar conclusion); \textit{In re} Tamoxifen, 466 F.3d 187 (2d Cir. 2006) (similar conclusion). Presumably, the Supreme Court will resolve the Circuit split in the \textit{Watson} case.
their economic significance for consumers. In short, if the Commission was primarily concerned with pay-for-delay cases, the blanket withdrawal of the Statement, with its attendant uncertainty-based costs for the full spectrum of FTC antitrust investigations, was unnecessary.

Assuming, however, that the Commission’s withdrawal signals an interest in more frequent application of monetary remedies to other sorts of cases involving “less than clear” violations, what might those cases look like? Recent “novel” applications of the FTC Act might include, for example, Intel, a single-firm conduct matter in which Intel agreed to change its intellectual property licensing practices and refrain from certain bundled discounts (among other changes); standard-setting “hold-up” cases such as N-Data, Rambus, and Unocal that may have elevated patent licensing fees and raised costs to ultimate consumers; and “invitation to collude” cases that did not involve actual collusive agreements.

Would cases of this sort be deemed by the Commission to allow for sufficient calculations of consumer harm to justify FTC efforts to obtain disgorgement or restitution? The answer is far from clear. In settling Unocal, the FTC obtained an agreement under which Chevron agreed not to enforce certain Unocal patents that, the FTC asserted, “could have imposed additional costs of over $500 million per year on California consumers.” It is at least conceivable that, given the precision of this statement, the FTC might have sought restitution of well over $500 million in alleged consumer overcharges had it chosen to seek monetary relief in this matter. Alleged standard-setting hold-up cases might give rise to attempted calculations of increases in royalties. Although no damages need be shown in “invitation to collude” cases, it is at least conceivable that some effort might be made to measure in monetary terms the degree of price elevation due to “softening of competition” in a future case of this type. In sum, the FTC might become more aggressive in deriving estimates of harm, as a byproduct of its broader license to seek monetary remedies.

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33 This article does not take a position on the policy merits of pursuing monetary remedies in pay-for-delay cases. The potential consumer benefits of pursuing such remedies would have to be weighed against the potential costs due to “false positives” in particular cases (i.e., the possibility that what had been misdiagnosed as an anticompetitive “payment for delay” in a particular matter actually involved an efficient side payment that was key to reaching a consumer-beneficial settlement that allowed entry to occur earlier than otherwise).


37 Although the Withdrawal Statement did provide that the FTC “do[es] not intend to use monetary equitable remedies in stand-alone Section 5 matters,” Withdrawal Statement, supra note 17, at 2, n. 6, this is not necessarily a significant constraint on Commission actions. For example, bundled discounts, deceptive actions that may increase market power (through “hold-up,” for example), and patentees’ payments to delay entry, among other practices, might readily be characterized as Sherman Act as well as stand-alone Section 5 violations. Even invitations to collude might be deemed to raise Sherman Act issues to the extent they were viewed as a “plus factor” that greatly strengthened “mutual independence recognized” and facilitated tacit collusion. For a discussion of plus factors, see, e.g., HERBERT HOVENKAMP, FEDERAL ANTI.TRUST POLICY 188 n.15 (4th ed. 2011); William E. Kovacic, The Identification and Proof of Horizontal Agreements Under the Antitrust Laws, 38 ANTI.TRUST BULL. 5 (1995).

Absent FTC clarification in these and other “cutting edge” antitrust matters, business uncertainty may be expected to rise.

Finally, at a time when U.S. agencies are attempting to promote beneficial convergence among antitrust authorities toward sound enforcement principles (for example, through the work of the International Competition Network39), injecting new uncertainty into U.S. antitrust monetary remedies by withdrawal of the MER Statement has international ramifications. Some jurisdictions could cite the U.S. decision to support financial sanctions directed at “novel” anticompetitive conduct—much of which may actually be procompetitive.40 This could (at least marginally) increase uncertainty and reduce multinational businesses’ incentive to engage in novel profit-seeking business conduct, to the detriment of innovation and welfare. It might also deflect competition authorities’ attention away from a focus on clearly anticompetitive conduct in favor of more “glamorous” yet “novel” behavior, causing a welfare-inimical reallocation of scarce enforcement resources.

Conclusion
The FTC’s recent withdrawal of the MER Statement is a move away from reliance on sound and cost-beneficial antitrust enforcement norms. The increased uncertainty, higher error costs, and disincentive to efficient business behavior that stem from the withdrawal will tend to reduce welfare and may have a negative “demonstration” effect on the policies of foreign competition authorities. Moreover, the withdrawal was not needed to facilitate FTC pursuit of monetary relief in pharmaceutical “reverse payment” cases. Given these factors, the FTC may wish to consider reinstating the MER Statement. At the very least, to reduce harmful uncertainty, the FTC should provide additional guidance regarding the precise conditions under which it will seek monetary relief in antitrust cases.

39 The activities of this “virtual” network comprised of national competition agencies and “non-governmental advisors” are delineated at http://www.internationalcompetitionnetwork.org.

40 Technically, of course, FTC monetary remedies (primarily disgorgement and restitution) are compensatory rather than punitive in nature, but some authorities might not appreciate that distinction—or could mischaracterize punitive financial exactions as “compensatory.” The author believes that the practice of some major non-U.S. enforcers, such as the European Commission, of imposing fines for non-per se offenses, may tend to discourage innovation-producing but aggressive business conduct. That question, however, is beyond the scope of this article.
How This Cookie Crumbled: Deciphering the Compliance Obligations Around the EU’s Cookie Directive

Saira Nayak

In the past few years, online advertising practices have increasingly come under the regulatory microscope on both sides of the Atlantic. Much of this attention has been centered on the use of technology by online advertisers—particularly the use of “cookies”1 and similar tracking technologies in advertising online. In recent years, advertisers have configured cookies and similar technologies to track a user’s online activity over time and then serve the user ads based on such activity. Different names apply to this type of advertising. The Federal Trade Commission has labeled and defined this as “behavioral advertising.”2 The industry refers to it as interest-based advertising—to highlight that as a result of being tracked, the user almost always receives an ad that is relevant or “of interest.”3 Regardless of the label, the use of technology to track a specific user’s online activity continues to raise privacy concerns—particularly as cookie and tracking technology evolves.4

In the United States, the regulatory response to behavioral or interest-based advertising has been framed largely by FTC staff in their 2009 report, Self Regulatory Principles for Online Behavioral Advertising (FTC Principles).5 The FTC Principles identify two types of tracking: (1) by the website or “first party,” and (2) by third parties (advertising networks, analytics companies, etc.), which place ads on the first party’s site and which may also be tracking the user’s activity (both on the first party site or on other sites within the advertiser’s network).6 The FTC Principles specifically exclude instances of “first party” advertising (where no data is shared with third parties) from its definition of behavioral advertising.7 The FTC Principles also exclude “contextual

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1 Cookies are small pieces of code that an advertiser (or its network) places on a user’s computer, so that it can recognize that user on future visits to the website. See Adam Barth, Internet Eng’g Task Force (IETF), Request for Comments 6265, HTTP State Management Mechanism 6 (2011), http://tools.ietf.org/pdf/rfc6265.pdf.
2 Under the FTC’s Self-Regulatory Principles for Online Behavioral Advertising, “online behavioral advertising” is defined as “the tracking of a consumer’s online activities over time—including the searches the consumer has conducted, the web pages visited, and the content viewed—in order to deliver advertising targeted to the individual consumer’s interests.” FTC STAFF REPORT: SELF-REGULATORY PRINCIPLES FOR ONLINE BEHAVIORAL ADVERTISING 46 (2009) [hereinafter FTC PRINCIPLES], available at http://www.ftc.gov/os/2009/02/P085400 behavadreport.pdf.
5 FTC PRINCIPLES, supra note 2.
6 Id. at 2–3, 26.
7 Id. at 26–28.
advertising”—where an ad is based on tracking a user’s activity during a single visit to a web page or during a single search query. Industry associations, such as the Digital Advertising Alliance (DAA), have built on this FTC guidance to create the Self Regulatory Principles for Online Behavioral Advertising.

In contrast, the European Union response to targeted advertising has been to include an amendment in existing law that covers all online activity that involves accessing or storing information on a user’s computer (not just advertising). The amendment, which often is referred to as the “Cookie Directive” because of its focus on cookies and other tracking technologies, has become one of the most controversial provisions of EU data protection law, and it continues to be a lightning rod for discussions about what constitutes appropriate consent in the online context.

This article explores the legal basis for the EU’s Cookie Directive and analyzes the various consent standards that the EU Member States use through their respective Cookie Directive laws. In addition, the article identifies the legal and technical challenges with Cookie Directive compliance and provides some practical pointers for compliance.

Background

In November 2009, the European Parliament passed a number of updates to Directive 2002/58/EC, known as the e-Privacy Directive, which applies specifically to the processing of personal data and the protection of privacy in the electronic communications sector. Most of the 2009 reforms to the e-Privacy Directive focused on important updates to Europe’s online and telecommunications laws, including number portability and cheaper phone and data plans for European consumers, the creation of a new telecommunications regulator, and new data breach notification requirements for EU businesses. But one change, recital 66 of Directive 2009/136/EC, attempted to address the privacy concerns about tracking users for advertising purposes, by requiring that entities give users “clear and comprehensive” notice before accessing or storing any information on users’ computers or other devices.

Understanding the unique aspects and interaction of EU law provides a greater appreciation for the impact of these amendments.

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8 Id. at 29–30.
14 Id. recital 66, 2009 O.J. (L 337) at 20.
First, there are two EU data protection laws. Directive 95/46/EC, known commonly as the “Data Protection Directive,” is founded on the premise that privacy is a fundamental human right, in accordance with the EU Constitution. Passed by the European Parliament in 1995, it establishes a framework to regulate the “processing” of online and offline personal data in the EU. Directive 2002/58/EC, known as the e-Privacy Directive, applies specifically to data processing and privacy in the “electronic communications sector.”

Second, the EU has a distinctive legislative procedure. All EU laws are proposed by the European Commission, approved by the EU Council, and voted on by the European Parliament. Furthermore, the European Commission only proposes legislation in those areas where it “shares” competences with the Member States. To determine whether an issue falls within a shared competence or not, two factors must be considered:

- **Subsidiarity.** Actions taken by the EU must be more effective than action taken at the national or local level.
- **Conferred Powers.** The EU does not extend its competence at the expense of a Member State, without that Member State’s prior agreement.

Data protection is a subset of consumer protection, which falls within the category of shared competences and it is therefore within the legislative purview of the European Commission, EU Council, and European Parliament.

Third, all EU laws are either “Directives” or “Regulations.” Regulations are similar to U.S. laws and take effect when passed, without the need for additional implementing legislation. In contrast, Directives have no practical effect until they are transposed into a Member State’s law through additional, implementing legislation. Once the national law transposing a Directive is passed, it is enforced by the respective data protection authority, or “DPA,” of the Member State. Directives protect a Member State’s sovereign rights. In particular, they give Member States the flexibility to implement a Directive’s framework in a way that also preserves the unique characteristics of that Member State’s national laws.

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17 “Processing of personal data” is defined as “any operation or set of operations which is performed upon personal data, whether or not by automatic means.” Directive 95/46/EC art. 2(b), 1995 O.J. (L 281) at 38.


19 However, such flexibility is not always welcome by national governments. For instance, the European Commission has proposed that the next version of the EU’s data protection laws should be in the form of a Regulation (for commercial uses of personal data) and a Directive (for law enforcement—a division that was recently discussed before the UK Parliament). See 1 JUSTICE COMMITTEE, THE COMMITTEE’S OPINION ON THE EUROPEAN UNION DATA PROTECTION FRAMEWORK PROPOSALS, THIRD REPORT 2012–13, H.C. 572 ¶¶ 9–10, at 7–8 (U.K.) (statements of Christopher Graham, U.K. Information Commissioner, and David Smith, Deputy Commissioner and Director of Data Protection, U.K. Information Commissioner’s Office, and Francoise Le Bail, Director-General, Directorate-General Justice, European Commission), available at http://www.publications.parliament.uk/pa/cm201213/cmselect/cmjust/572/572.pdf.
As indicated by their titles, the EU’s 1995 and 2002 data protection laws (and subsequent amendments) are Directives. As a result, the practice of imposing data protection requirements through Directives has led to varying standards of data protection among EU Member States. This has been exemplified most recently by the varying standards of consent reflected in the different Cookie Laws enacted in response to the Cookie Directive. Interestingly, the European Commission’s current proposals attempt to address this patchwork of data protection requirements by incorporating commercial data protection requirements into a Regulation, not a Directive.20

The EU Cookie Directive—Requirements

Article 5(3) of the ePrivacy Directive was amended in 2009 as follows: “[T]he storing of information or the gaining of access to information already stored, in the terminal equipment of a subscriber or user is only allowed on condition that the subscriber or user concerned has given his or her consent, having been provided with clear and comprehensive information . . . .”21 Member States were required to implement the provisions of the ePrivacy Directive in national law by May 2011.

To clarify the Cookie Directive’s requirements and the standard for “informed consent,” the Article 29 Data Protection Working Party (Working Party),22 composed of the lead DPA officials from each EU Member State, issued their Opinion on Online Behavioural Advertising in February 2010.23 This was followed by an opinion on what constitutes appropriate consent,24 a separate opinion outlining exceptions to the Cookie Directive,25 as well as opinions on the self-regulatory mechanisms provided by industry to comply with the Cookie Directive.26

Based on the Working Party’s analysis, the “informed consent” needed to comply with the Cookie Directive’s requirements must take place before the data on the user’s “equipment” is


processed—i.e., before any tracking activity occurs. The Working Party reasoned that in order for users to have informed consent about being targeted online for advertisements, they must know they are being tracked before the tracking activity. The Working Party refers to this form of consent as “prior informed consent.” Additionally, the user’s consent must be expressed through an affirmative action by the user—clicking yes, or ticking a box (express consent), and not implied from the user’s current activity (implied consent). Under the Working Party’s interpretation, consent could also be expressed by the user’s browser settings, if the browser rejects all third-party cookies by default (which no commercially available browser currently does).

In addition to notice and consent, the Working Party found that when targeting users online for advertising purposes, online providers must offer users choice and control, including the ability to “opt-out” of tracking and data collection altogether.

In their opinion on exceptions to the “informed consent” requirement of the Cookie Directive, the Working Party found two broad exceptions:

**CRITERION A:** the cookie is used “for the sole purpose of carrying out the transmission of a communication over an electronic communications network.”

**CRITERION B:** the cookie is “strictly necessary in order for the provider of an information society service explicitly requested by the subscriber or user to provide the service.”

Using this classification, the Working Party found that first party analytics cookies, particularly those limited to aggregated statistical reporting on behalf of that first party, do not pose a significant privacy risk. So long as such analytics cookies are referenced in the privacy policy, there should be no need for the first party to obtain informed consent before dropping these types of cookies on the user’s machine.

The Working Party also discussed the privacy risk of certain cookies vis-à-vis others. For instance, session cookies, which expire at the end of each web browsing session, have less privacy risk than persistent cookies, which do not expire and can remain on the user’s machine or other equipment indefinitely.

**Why One Can Never Truly Comply with the EU’s Cookie Directive**

Today, almost every single action taken online involves either accessing or storing information on a user’s computer, which is why, as websites are currently configured, compliance with the requirements of the Cookie Directive is practically impossible. Each time the web browser does its job—retrieving information and providing it to the user in a viewable format—it places a cookie or sim-
ilar tracker on the user’s computer so that it can identify the user on future visits to that website. Much of this “tagging” process is invisible and seamless to the user.

Cookies also are used to determine prior browsing activity, advertising analytics, and other information. They are also the simplest, most cost-effective way for an advertiser to implement a user’s preferences about whether or not to be tracked. The most common example of this is the opt-out cookie used by most online ad networks to record a user’s preference not to be tracked by that network.33

Because cookies are a ubiquitous feature of the online ecosystem, it is impossible to expunge all online cookies and start from a point at which no cookies exist. And yet the very language of the Cookie Directive—requiring informed consent even before information is accessed or shared on the user’s computer—assumes that a state exists where the user’s computer does not contain any cookies or trackers, something that is not technically possible unless the user works on a computer that has never accessed the Internet. This practicality means that true compliance with the Cookie Directive is almost impossible from a technical perspective.

Working Party Opinions on the EU Cookie Directive

The Working Party’s opinions on online behavioral advertising, consent, exceptions, and self-regulatory compliance mechanisms are all important sources of guidance on how to interpret the requirements of the Cookie Directive. Based on these opinions, we can draw four important conclusions:

1. Prior Informed Consent Is Key. The Working Party concluded that in order for a user to be informed about tracking, she must have known about the tracking beforehand and have received clear and comprehensive information before data is “processed” from her computer or other device. In subsequent opinions, the Working Party clarified this position further, finding that “implied” or “implicit” consent was not sufficient to satisfy the requirements of the Cookie Directive.34

In addition, the Working Party laid out requirements for the notice that should precede consent, finding highly visible information as a “precondition” for valid consent (it also encourages the use of icons, layered notices and links to consumer education to meet the “informed consent” standard). Specifically, the following information must be included in a privacy policy or notice that aims to be compliant with the Cookie Directive:

- The entity responsible for serving the cookie (or other tracker) and collecting the related information and/or personal data of the user.
- A statement about whether the cookie will be used to create profiles, specifically (a) what type of information will be collected to build such profiles; (b) the fact that the profiles will be used to deliver targeted advertising; and (c) the fact that the cookie will enable the user’s identification across multiple web sites.35

33 The Digital Advertising Alliance’s (DAA) Self-Regulatory Program for Online Behavioral Advertising is currently beta testing a choice mechanism that allows the user to opt out of some or all 117 participating companies with a few clicks. See Digital Advertising Alliance, Self-Regulatory Program for Online Behavioral Advertising, Opt Out From Online Behavioral Advertising (Beta), http://www.aboutads.info/choices/ (last visited Dec. 13, 2012).


2. **The 1995 Data Protection Directive May Also Apply.** The Working Party found that in instances where personal data is being accessed or collected, additional compliance requirements under the 1995 Data Protection Directive\(^{36}\) will also apply. The 1995 Directive incorporates such important data protection principles as access, data retention, data security, and purpose limitation, along with enhanced obligations for sensitive data collection. In addition, DPAs must be notified about personal data processing and comply with onward transfer obligations.\(^{37}\)

Furthermore, the Working Party concluded that since behavioral advertising almost always involves the collection of IP addresses (which the Working Party classified as personal data because of its ability to identify the device if not the individual), the requirements of the Data Protection Directive would almost always apply to data collected for targeted advertising purposes.\(^{38}\) This presumption—that all online behavioral advertising involves personal data—is a controversial position that is currently not supported under FTC guidance or U.S. law.

3. **Browser Consent.** The Working Party also identified three key requirements for browser consent to provide informed consent under the Cookie Directive. First, the browser must reject all third-party cookies by default (something that no commercially available browser does today). Second, the browser must “require the data subject to engage in an affirmative action” to accept setting and transmission of the cookie. Finally, the browser must “convey clear, comprehensive and fully visible information” about the data collection.\(^{39}\)

4. **Advertiser and Publisher Duties.** Finally, the Working Party laid out specific requirements for compliance based on whether the entity is an online publisher (website) or advertiser. Generally, the Working Party viewed both Ad Networks and Publishers that engage in targeted advertising as “Data Controllers” under EU law, because of the presumption that all online behavioral advertising involves personal data.\(^{40}\) However, in their Opinion on Online Behavioral Advertising, the Working Party highlighted specific separate responsibilities depending on whether the company is an Ad Network\(^{41}\) or a Publisher:\(^{42}\)

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\(^{36}\) Directive 95/46/EC, supra note 15.

\(^{37}\) See Opinion 2/2010 on Online Behavioural Advertising, supra note 23, at 9, 19–21. If “data controllers” (see below) transfer data outside the EU, they must ensure compliance with the provisions on transfers of personal data to third countries (e.g., ad networks transferring data to a server located in a third country should make sure the third country’s laws are adequate with the EU for data transfers). \(\text{id.}\) at 21.

\(^{38}\) \(\text{id.}\) at 9 & n.23.

\(^{39}\) \(\text{id.}\) at 14–15.

\(^{40}\) See \(\text{id.}\) at 9–10, 12, 22–23.

\(^{41}\) \(\text{id.}\) at 10–11, 22–24.

\(^{42}\) \(\text{id.}\) at 11–12, 23, 24.
**Ad Networks**

- Ad Networks may be viewed as Data Controllers if personal data is collected and used (because they have “complete control over purposes and means of processing”); and, if so, requirements of Directive 95/46/EC, including access, apply (see below).⁴³

  - To be compliant, ad-network administered consent mechanisms should:
    - Limit in time the scope of consent
    - Offer easy revocation and create visible tools for users
    - Inform individuals periodically that monitoring is taking place.⁴⁴

- Ad Networks that target children for online advertising are specifically required to provide notice and obtain consent from the child’s parent/legal representative, and they cannot target children based on “interest categories.”⁴⁵

**Publishers**

Publishers may be deemed “joint” Controllers with an ad network if:

- They are set up in a way to “trigger” the transfer of a user’s IP address to an ad network (site is set up so that user is “automatically redirected to the ad network provider web site”).⁴⁶

- They collect and transmit personal data regarding their visitors, such as name, address, age, location, etc. to the ad network provider.⁴⁷

- Publishers should work with advertisers and ad networks to contractually assign responsibility for providing notice and informed consent around tracking.⁴⁸

- Publishers who directly collect or “trigger” the collection of personal data must also comply with the requirements under the 1995 Data Protection Directive.⁴⁹

**The Cookie Laws—Implemented**

Since 2009, all but two EU Member Countries have passed their own Cookie Laws implementing the Cookie Directive. However, these Cookie Laws are not uniform, and they vary in the standard of consent required, reflecting the differences between each Member country’s data protections laws.⁵⁰ This in turn has resulted in a confusing patchwork of compliance obligations for companies doing business in the EU when it comes to cookies and similar tracking technologies.

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⁴³ Id. at 10.
⁴⁴ Id. at 23.
⁴⁵ Id. at 17.
⁴⁶ Id. at 11.
⁴⁷ Id. at 12.
⁴⁸ See id.
⁴⁹ Id. at 11.
⁵⁰ Data protection concepts are interpreted differently in the national laws of different EU Member Countries. For instance, “consent” is a concept that is not defined under French law but was developed through the opinions and subsequent actions taken by France’s Data Protection Authority, the CNIL. In contrast, the UK’s view of consent is shaped by its common law. See Opinion 15/2011 on the Definition of Consent, supra note 24, at 6.
Included below is a map of EU member countries by the consent standard transposed into their respective Cookie Laws. Countries have implemented laws that require either prior express consent (France) or implied consent (Finland), or both, depending on the context of the transaction (UK).

Of the EU Member Countries that have adopted a Cookie Law, twelve countries, including the larger economies of France, Germany, and the Netherlands, have incorporated a clear express consent standard into their law. Two additional EU Member Countries (Cyprus and Norway) are considering a law with an express consent requirement.

Six other countries have incorporated an implied consent standard. It is interesting to note that most of these countries adopted their laws before the adoption by the Working Party of its Opinion 2/2010 on Online Behavioural Advertising (which clearly found implied consent not compliant with the Cookie Directive). Since then, most Cookie Laws that have been passed or are being considered incorporate an express consent standard; no EU Member State is currently considering a Cookie law that incorporates an implied consent standard.

Belgium, the UK, and Denmark have adopted what can be seen as a “contextual standard”—express or implied consent will be required depending on the context and privacy expectations of the transaction. The UK Information Commissioner’s Office (UK ICO), is one of the few data protection authorities that has published guidance for businesses seeking to comply with the UK’s Cookie Law. Under the UK Cookie Law, information on a user’s computer or other device cannot be accessed or stored unless the user has been provided “clear and comprehensive information about the purposes of the storage of, or access to” the user’s information, and been

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52 The UK ICO has published three sets of guidance of compliance with the UK’s cookie law. The most recent version was published in May 2012. See UK ICO GUIDANCE, supra note 28.
“given the opportunity to refuse the storage of, or access to, that information.” However, and unlike the Cookie laws in express consent jurisdictions, the UK law does not specify that consent must be either express or implied consent.

In addition, it appears that at least in some cases, implied consent could be sufficient to satisfy the UK’s cookie law requirements. In their May 2012 guidance, the UK ICO opined that since the standard is “informed consent,” implied consent may be sufficient in instances where the user is specifically aware, not only that he is receiving a service from the entity dropping the cookie, but that the entity is also accessing or storing information on the user’s device. To do this, the UK ICO encourages website owners to supplement implied consent with education pieces that help users close the “information gap” that users have around online tracking, and technology like analytics cookies.

The UK’s approach to consent is similar to the contextual approach that has already been endorsed by U.S. regulators under the FTC’s final privacy report and the Obama Administration’s Consumer Privacy Bill of Rights.

In contrast, both France and the Netherlands have passed Cookie Laws that require express consent before any tracking occurs on the user’s computer or other device. Under guidance provided by France’s data protection authority, the CNIL, this consent must be provided before the tracking occurs, and the website publisher has the ultimate responsibility for cookie compliance (although this responsibility can be contractually assigned to the advertiser to prevent duplicate notice). Similarly, consent under the Netherlands Cookie law must be obtained before any tracking occurs and is the responsibility of the website or publisher.

In addition to consent obligations, the Cookie Laws also contain requirements around the type of notice that may be required, as well as additional, specific exceptions (e.g., France exempts first party analytics from Cookie obligations, but will require the company to update its privacy policy to reflect all data collection on the site, whether by a first or third party).

Included below is a matrix that outlines the obligations identified by the Working Party (under the Cookie Directive), as well as specific requirements identified by the UK ICO, France’s CNIL, and the Netherlands OPTA regarding their respective Cookie laws:

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54 See UK ICO GUIDANCE, supra note 28, at 7–10.

55 See id. at 9–10.

56 See FED. TRADE COMM’N, PROTECTING CONSUMER PRIVACY IN AN ERA OF RAPID CHANGE: RECOMMENDATIONS FOR BUSINESSES AND POLICYMAKERS 60 (2012), available at http://www.ftc.gov/os/2012/03/120326privacyreport.pdf (“For practices requiring choice, companies should offer the choice at a time and in a context in which the consumer is making a decision about his or her data.”); THE WHITE HOUSE, CONSUMER DATA PRIVACY IN A NETWORKED WORLD: A FRAMEWORK FOR PROTECTING PRIVACY AND PROMOTING INNOVATION IN THE GLOBAL DIGITAL ECONOMY 15 (2012), available at http://www.whitehouse.gov/sites/default/files/privacy-final.pdf (“Respect for Context: Consumers have a right to expect that companies will collect, use, and disclose personal data in ways that are consistent with the context in which consumers provide the data.”).


<table>
<thead>
<tr>
<th>Required Feature</th>
<th>Compliance Obligations</th>
</tr>
</thead>
</table>
| Responsibility for Notice and Consent | Working Party  
Entity dropping the cookie or tracker  
UK ICO  
Operator of online service  
France CNIL  
Publisher or assignee  
Netherlands OPTA  
Publisher |
| Timing and Type of Consent | Working Party  
• Must occur before tracking first occurs, so that user is aware that they are being tracked.\(^\text{60}\)  
• Prior express consent is the best way to achieve compliance.\(^\text{61}\)  
• Opt-out mechanisms that require the user to navigate to another site, such as those presently used under the DAA’s “i” icon program, are not compliant because they:  
• Do not provide the user prior notice that tracking is taking place—no affirmative action indicating user knowledge of tracking  
• Rely on user knowledge of where, i.e. which website, to opt-out from.\(^\text{62}\)  

Note: Under Working Party guidance, behavioral advertising almost always triggers compliance obligations under the 1995 Data Protection Directive because of IP address collection.\(^\text{63}\) |

UK ICO  
Express Consent  
• Required for highly tracked sites with third party partners  
• Required for collection of sensitive data  
Implied Consent  
• Permissible for publishers with first party tracking  
• Permissible for brand or informational sites  
• Must include other education on the page to close the user’s “knowledge gap”  
continued

\(^\text{63}\) Opinion 2/2010 on Online Behavioural Advertising, supra note 23, at 9 & n.23.
<table>
<thead>
<tr>
<th>Required Feature</th>
<th>Compliance Obligations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Timing and Type of Consent</strong></td>
<td><strong>France CNIL</strong></td>
</tr>
<tr>
<td>● Standard is prior express consent.</td>
<td></td>
</tr>
<tr>
<td>● Consent must occur before tracking occurs.</td>
<td></td>
</tr>
<tr>
<td><strong>Netherlands OPTA</strong></td>
<td></td>
</tr>
<tr>
<td>● Consent must be obtained before tracking occurs.</td>
<td></td>
</tr>
<tr>
<td><strong>Browser Consent OK?</strong></td>
<td><strong>Working Party</strong></td>
</tr>
<tr>
<td>● To be compliant, the browser must reject third-party cookies by default.</td>
<td></td>
</tr>
<tr>
<td>● The browser must also require the data subject to engage in an “affirmative action” to accept setting and transmission of cookie.</td>
<td></td>
</tr>
<tr>
<td>● Finally, the browser must “convey clear, comprehensive, and fully visible information” about the data collection.64</td>
<td></td>
</tr>
<tr>
<td><strong>UK ICO</strong></td>
<td></td>
</tr>
<tr>
<td>Currently, no browser satisfies standard because none rejects third party cookies by default.</td>
<td></td>
</tr>
<tr>
<td><strong>CNIL</strong></td>
<td></td>
</tr>
<tr>
<td>● To meet the requirements of France’s Cookie law, browsers must provide notice, an easy mechanism for both consent, and a way to express their preferences. While no such browser currently exists, the CNIL is aware of technological developments, including new browser features that will allow “users to express their preferences regarding privacy.”65</td>
<td></td>
</tr>
<tr>
<td><strong>Netherlands</strong></td>
<td></td>
</tr>
<tr>
<td>No current browser is compliant with the Netherlands Cookie law, as they all accept cookies by default and do not give users a way to express their privacy preferences.</td>
<td></td>
</tr>
<tr>
<td><strong>Exceptions</strong></td>
<td><strong>Working Party</strong></td>
</tr>
<tr>
<td>There is no “informed consent” requirement for cookies that are:</td>
<td></td>
</tr>
<tr>
<td>● Used “for the sole purpose of carrying out the transmission of a communication” over an electronic communications network (test: the transmission can’t happen without the cookie).66</td>
<td></td>
</tr>
</tbody>
</table>

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64 Id. at 14–15.
### Required Feature Compliance Obligations

#### Exceptions continued

- Are “strictly necessary for the legitimate purpose of enabling a specific service explicitly requested by the subscriber or user.” There is a three factor test to determine whether a cookie is “strictly necessary” (the cookie must have at least one of these properties to get the exemption).\(^{67}\)
  - Ability to route information
  - Ability to exchange data items in intended order
  - Ability to detect transmission errors or data loss

The UK, France and Netherlands cookie laws all include language including these two exceptions.

<table>
<thead>
<tr>
<th>Analytics</th>
<th>Working Party</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempts first party analytics as long as it is appropriately noticed in the privacy policy.</td>
<td></td>
</tr>
</tbody>
</table>

**UK ICO**

Unclear. Recognizes that express consent may not be workable for analytics cookies (regardless of whether they are first or third party), but acknowledges that there is an information gap among users when it comes to website analytics activity. As the ICO states: “[T]he key to the validity of implied consent in this context is the narrowing of this gap.”\(^{68}\)

**France CNIL**

First party analytics cookies are exempted so long as there is notification of their use in the privacy policy.

**Netherlands**

No exception for analytics cookies. According to the OPTA, a cookie used for web analytics is not “strictly necessary” for communication or to provide a service at the user’s request.

<table>
<thead>
<tr>
<th>Update Privacy Policy &amp; Notices</th>
<th>France CNIL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Requires online operators to update their privacy policies and related notices based on implementation of cookie notice and consent.</td>
<td></td>
</tr>
</tbody>
</table>

### Practice Tips

Given the patchwork of compliance standards under the various EU cookie laws, it is important that practitioners follow some important steps while advising clients in this area.

1. Identify the countries in which the client primarily does business, and, based on the map provided above, identify which consent standard should be applied.

\(^{67}\) Id.

\(^{68}\) UK ICO GUIDANCE, supra note 28, at 10.
2. Understand the client’s business model and the type of tracking activity used:

- Companies with modestly sized websites with a low number of trackers that are used to enable the website's functionalities, or with lightweight tracking for analytics purposes, may consider using implied consent, coupled with appropriate notice in their privacy policies.
- Big retailers/publishers in the e-commerce sector attracting wider audiences and using trackers (including third party trackers) for analytical and optimization purposes, will probably need more robust consent mechanisms. One recommendation is to have an express consent event at least once, supplemented by implied consent that is proportional to the intensity of tracking involved (i.e., larger volume of cookies will require notice, consent and prominent access to the consent manager in multiple parts of the website).
- Publishers, social media, and free content websites that rely heavily on first and third party trackers should adopt an express consent mechanism. Depending on the jurisdiction (e.g., UK), this consent can be supplemented with subsequent implied consent events, so long as once again, it is proportional to the intensity of tracking involved, and noticed appropriately in the privacy policy.

What’s Next?

It is unclear what the future of the EU Cookie Directive will be. To date, there has been little enforcement of Cookie laws by any data protection authority in Europe. France, with a statutory penalty of €300,000 per violation, has yet to enforce its law against a single company (even though France’s CNIL is one of the few EU data protection authorities that currently has enforcement powers for data protection). Countries like Italy and Spain, which often trend towards heavy fines for data protection violations, and which have express consent laws, have also remained silent on enforcement of their respective Cookie laws.

In fact, the primary EU Member country to enforce its Cookie law right now is the UK, but it is unclear whether the UK ICO has the appetite to pursue serious enforcement. So far, enforcement by the UK ICO has been minimal—warning letters (sent by the UK ICO) to its list of top websites that were not in compliance with the UK’s Cookie Law. The UK ICO has said it will start to enforce more aggressively in the coming months against those entities that are doing nothing to comply, but it is unclear whether the ICO will also turn its attention to the many companies that are, in fact, “under-complying” with the law.

We can also expect to see some enforcement in the Netherlands, which has two regulators—the OPTA and the Dutch Data Protection Authority headed by the current Working Party Chair, Jakob Kohnstamm. Under the Dutch Cookie law, the OPTA is responsible for regulation notice and consent, while the DPA will be in charge of enforcing the personal data obligations that arise under the law. The OPTA has signaled that it intends to enforce the Dutch Cookie law aggressively.

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70 There are several ways that companies are currently attempting to comply with the UK’s cookie law. These range from sophisticated notice and consent mechanisms that allow the user to change her tracking preferences, to a single page on a site directing the user to change her cookie settings. TRUSTe Privacy Index: UK Compliance & Tracking Edition (2012), http://www.truste.com/uk-compliance-tracking-index.

While the enforcement direction of the Cookie Directive remains unclear, the disruptive effect of its provisions is not. Mandating express consent for all online transactions will clearly impact the flow of online advertising across the web. In contrast, implied consent preserves the fluidity of the user’s online experience by not requiring a consent notification each time an advertisement is served; that consent is implied, unless the user indicates otherwise. In addition, implied consent does not require that a user take an affirmative action each time she needs to signal consent; that consent is presumed until the user has indicated otherwise. Requiring that a user affirmatively indicate her consent each time an ad is served—through an interstitial or “pop-up” window, for example—will also result in a negative user experience. The situation could become particularly tiresome (and potentially dangerous) for users accessing services on their mobile devices.

When you transpose these outcomes against the billions of online advertisements that are served daily, you get a sense of how disruptive a prior express consent requirement would be to the flow of personal data through the online and mobile ecosystems. Imposing an express consent event may hinder online advertising, an important source of revenue for many online operators, including smaller websites and web services, which depend on the revenue they derive by allowing the placement of advertisements by third parties on their pages. However, it is not clear how long that disruption would last, and whether it would diminish as users become more informed about consent and the ways they can “manage” being tracked on computers and other devices. Recent research by TRUSTe shows that consumers in France, Germany, the Netherlands, and the UK are not only aware of the Cookie Directive and its requirements, but also hold companies responsible for compliance. A significant percentage of these consumers have opted to do business only with companies that comply with the Cookie Directive.

Consumer education about cookies and the directive remains important. Since the standard of the Cookie Directive is “informed consent,” the more consumers are educated and aware of cookies and how they are being tracked, the stronger the argument industry will have against the enforcement of a strict, express, or opt-in standard. In the coming months, as companies seek to comply with the Cookie Directive, it is important to provide not the required notice and consent, but also the education materials that (to paraphrase the UK ICO) will close the “information gap” that so many consumers today have around cookies and online tracking for advertising purposes.

So at least for now, this cookie continues to crumble.

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72 Consumer awareness of the Cookie Directive is high in France (56%), and significantly higher in Germany (78%), UK (81%), and the Netherlands (86%). See EU Cookie Compliance, Tracking, and Consumer Awareness Index, TRUSTe, http://www.truste.com/eu-compliance-tracking-awareness-index/ (last visited Dec. 13, 2012).

73 It is worth noting the number of consumers who say they will only do business with companies that comply with the Cookie Directive: France (44%), Germany (49%), UK (33%), and the Netherlands (37%). Id.
Maximizing Efficiencies: Getting Credit Where Credit Is Due

Efficiencies are frequently a significant part of the business rationale for a transaction. However, receiving credit for the efficiency-enhancing aspects of a combination in a merger review is often difficult. By the Federal Trade Commission and Department of Justice’s own account, “the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers” and “efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great.”

Recent transactions, such as H&R Block/Tax Act, AT&T/T-Mobile, and OSF Healthcare/Rockford, continue to confirm that receiving credit for efficiencies is no easy task.

Either because the agencies and courts have tended to set the bar very high or because efficiencies are notoriously difficult to quantify, some rightfully may ask whether merging parties should save the time and effort required to prepare a robust efficiencies argument in favor of focusing on the potentially dispositive issue of market definition and attacking theories of competitive harm. Efficiencies, however, should not be abandoned despite the challenges in demonstrating them. Indeed, a 2009 FTC study demonstrated that the agencies do examine efficiencies—the FTC’s Bureau of Competition staff memoranda analyzed efficiencies in 37 of the 48 closed investigations and in 61 of the 121 consent decree cases over a ten-year period. Similarly, efficiencies are touted as a rationale in many closing statements and thus can help the agencies justify clearance decisions. Thus, forgoing an efficiencies argument when one exists can be costly. But given the burdens of developing substantiated efficiencies, it is critical for the parties to focus their efforts in the right areas.

The Role of Efficiencies in Merger Analysis

The “principal analytical techniques, practices, and the enforcement policy” of the U.S. antitrust authorities regarding horizontal mergers under the antitrust law are outlined in the 2010 Merger Guidelines. These guidelines replaced the 1992/1997 Guidelines and were intended to increase “the transparency of the analytical process underlying the Agencies’ enforcement decisions” and “assist the courts in developing an appropriate framework for interpreting and applying the

2. Malcolm B. Coate & Andrew J. Heimert, Federal Trade Commission, Merger Efficiencies at the Federal Trade Commission 1997–2007 at 14 n.31 (2009) [hereinafter 2009 FTC Efficiencies Study]. The presence of efficiencies, however, does not mean such arguments are a cure-all. Indeed, efficiencies were claimed in all 17 of the cases where the agency sought a preliminary injunction.
antitrust laws in the horizontal merger context." The agencies, however, did not make any substantive changes to the analysis of efficiencies from the prior Guidelines, but rather expanded the efficiencies discussion to provide more clarity on their view regarding efficiencies. Interestingly, elsewhere in the 2010 Merger Guidelines, revisions were made that increased the ranges of Herfindal-Hirschman Index (HHI) concentration levels linked to certain presumptions about the potential for anticompetitive harm from mergers in highly concentrated markets. As a result, these revisions may have potentially opened the door for a successful efficiencies argument where a merger now falls below the range and is no longer presumed to enhance market power.

Under the 2010 Merger Guidelines, the agencies only credit those efficiencies that are “merger specific.” In other words, the only efficiencies that count are those “accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.” In terms of whether another avenue is available for the same benefits, the agencies consider only “practical” alternatives and “do not insist upon a less restrictive alternative that is merely theoretical.”

Moreover, in addition to being merger specific, efficiencies must be substantiated or verifiable with quantifiable measurements derived—to the maximum extent possible—from information relied on by the parties in the ordinary course of business. As some courts have stated, one “must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those ‘efficiencies’ represent more than mere speculation and promises about post-merger behavior.” According to the 2010 Merger Guidelines, “[V]ague, speculative, or [other efficiencies that] cannot be verified by reasonable means” will not be sufficient to receive credit. Projections developed specifically for the transaction will be viewed with particular skepticism. Rather, the agencies are most likely to credit “efficiency claims substantiated by analogous past experience.”

Additionally, the agencies will not credit efficiencies if there is reason to believe that benefits will not be passed on to consumers. Although some have posited that consumer benefit can be presumed once efficiencies are established as cognizable (i.e., merger specific and verifiable), the agencies do not accept any such presumption. According to the 2009 FTC study, staff frequently failed to credit efficiencies in their recommendation memoranda because they concluded that the savings from the efficiencies would not be passed on to consumers.

Once cognizable efficiencies are established, the agencies consider whether such efficiencies likely would be sufficient to reverse a merger’s potential to harm customers in the relevant market. The burden remains on the parties to make the required demonstration. The agencies will not

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4 2010 Merger Guidelines, supra note 1, § 1.
5 See id. § 5.3.
7 2010 Merger Guidelines, supra note 1, § 10.
8 Id.
10 2101 Merger Guidelines, supra note 1, § 10
11 Id.
13 2009 FTC Efficiencies Study, supra note 2, at 8.
conduct a linear comparison of the magnitude of the cognizable efficiencies and the magnitude of the likely harm to competition absent the efficiencies. Instead, a greater potential for adverse competitive effects requires not only a greater showing of offsetting cognizable efficiencies, but also greater pass-through of the benefits to customers in order for the agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, parties must show *extraordinarily* great efficiencies.\footnote{14}{2010 Merger Guidelines, *supra* note 1, \S\ 10.}

While some courts consider efficiencies an affirmative defense, most courts have considered efficiencies a means to rebut the government’s prima facie case.\footnote{15}{See, e.g., FTC v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991); *Heinz*, 246 F.3d at 720; see also FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 124 (D.D.C. 2004) (”[W]here the HHI calculation potentially . . . indicates a merger to be presumptively illegal, the factors set forth in the [Horizontal Merger Guidelines] become relevant in undertaking a more comprehensive and holistic assessment . . . [that] include: the potential competitive effects of a merger, entry analysis, efficiencies and failure and exiting assets.”) (emphasis added). Although the D.C. Circuit in *Staples* used the phrase “affirmative defense,” when considering efficiencies, the court actually considered efficiencies when assessing the competitive effects of the transaction—as opposed to after the court found that the transaction was likely to substantially lessen competition. FTC v. Staples, Inc., 970 F. Supp. 1066, 1088–90 (D.D.C. 1997).}

Accordingly, courts will consider first whether an acquisition would result in anticompetitive harm in the relevant market and then whether the efficiencies can overcome the structural and statistical presumptions presented in the government’s prima facie case.\footnote{16}{Some courts, however, apply a more flexible framework. Because, in practice, the evidence is presented all at once such that the government’s prima facie case anticipate and addresses the rebuttal evidence presented by defendants, some courts analyze the government’s burden and the defense’s burden together. See, e.g., Chi. Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410 (5th Cir. 2008); Olin Corp. v. FTC, 986 F.2d 1295 (9th Cir. 1993). While not employing the burden shifting framework, these courts still appear to consider the efficiencies when assessing whether defendant’s evidence rebuts the government’s case that the transaction will substantially lessen competition.}

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The D.C. Circuit in *Baker Hughes* set forth the basic framework for efficiencies analysis in merger litigation:

By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition. The burden of producing evidence to rebut this presumption then shifts to the defendant. If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion.\footnote{17}{United States v. Baker Hughes Inc., 908 F.2d 981, 983–84 (D.C. Cir. 1990) (internal citations omitted).}

### Receiving Credit Is Not Always Easy

Despite the potential for efficiencies to matter in litigation, in most merger cases the courts have applied stringent standards and found that the parties failed to carry their burden of demonstrating cognizable efficiencies. For example, in *Heinz*, the merging parties argued that their combination of the second and third largest competitors would result in a new entity better positioned to compete with the largest competitor. The D.C. Circuit reversed the district court’s analysis under which it refused to block the transaction, finding that the efficiencies were overstated and not merger specific. For one, the variable cost savings advanced were only a small percentage of overall variable costs and so did “not necessarily translate into a significant cost advantage.”\footnote{18}{*Heinz*, 246 F.3d at 721.}

Moreover, the court found the claimed efficiencies of manufacturing the target’s “better recipes”...
at the acquirer’s more efficient plant were not shown to be merger specific because the acquirer might have invested in better recipes itself. 19

Similarly, in CCC Holdings, the defendants claimed that significant cost savings would result from consolidating the parties’ software on a single platform. However, the merging parties acknowledged that the integration could take as long as ten years, with ultimate success remaining uncertain. And, two financial consultants hired by one of the merging parties had calculated the merger would still result in a net loss (costs versus synergies) three years out. Thus, the court found that while efficiencies might exist, “the record [was] far from clear” and they were too “speculative and supported by little more than lawyer argument,” which was insufficient to overcome the “strong presumption of anticompetitive effects created by large HHIs and high barriers to entry in the relevant market.” 20

In Staples,21 the court detailed numerous shortcomings with the acquirer’s efficiencies estimates, including:

- Efficiencies claims offered in court significantly exceeded earlier figures shown to the board and made in securities filings;
- Cost savings were not properly documented (Staples’ VP of Integration admitted that backup, source, and calculations for some of the savings were entirely omitted from the analysis submitted);
- The analysis used questionable methodologies; 22
- When testifying, Staples’ VP of Integration was unable to explain the methods used to calculate many of the cost savings;
- The analysis failed to deduct certain stand-alone benefits from the efficiencies figures, thereby rendering aspects of the total calculation non-merger specific; and
- The efficiencies estimates included savings from more favorable negotiations with vendors, but failed to consider any stand-alone discounts Staples might have obtained in the ordinary course of business as it had been able to do in the past.

In Oracle, despite refusing to enjoin the transaction, the court found the defendant’s efficiencies claims “too vague and unreliable to rebut a showing of anticompetitive effect.” 23 The court emphasized that the parties’ expert was unable to provide a factual basis for the various inputs in spreadsheets that detailed the cost savings and no documents explained the personal judgments on the inputs, thereby rendering the claims as “too speculative to be afforded credibility.” 24

Even when courts credit efficiencies, those efficiencies might nevertheless be insufficient to overcome the government’s evidence of potential anticompetitive harm. In FTC v. Libbey,25 the court found that the evidence was not sufficient to rebut the government’s prima facie case, given the potential harm stemming from the already highly concentrated market for food service glass-

21 Staples, 970 F. Supp. at 1090.
22 The court noted that in calculating vendor cost savings, Staples used a sample of vendors and then extrapolated the savings across all products. However, the sample group omitted Hewlett Packard, Staples’s largest vendor. Moreover, “the evidence show[ed] that Staples was not confident that it could improve its buying from Hewlett Packard” yet Hewlett Packard products received the extrapolated discount in the efficiencies analysis. Staples, 970 F. Supp. at 1090.
24 Id.
ware. The parties argued that the transaction would lower prices and improve product innovation, which would allow the merged firm to compete better against foreign competition. Although these efficiencies were acknowledged by the court, they were insufficient to outweigh the potential harm.26

More recently, efficiencies played a significant role in H&R Block/Tax Act,27 where the merging parties presented evidence of cost savings in ten different areas (e.g., online information technology, a debit card, the corporate website, and software information technology). Applying the 2010 Merger Guidelines in evaluating the claimed efficiencies, the court questioned why the cost savings and certain IT efficiencies could not be obtained absent the merger. The court also found that the efficiencies were not verifiable because they were only based on the “experiential judgment” of managers in the business without specific facts or figures to support the claims.28

It is also worth noting that the court in H&R Block was skeptical of claimed efficiencies because of H&R Block’s past integration failures. The court pointed to a smaller 2006 acquisition of another tax software company where H&R Block had estimated more conservative efficiencies over a three year horizon but failed to achieve them. Instead of crediting the company with having learned from those shortcomings, the court found that “this history only underscores the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government’s presumption of anticompetitive effects.”29 Thus, courts seem to accept the agencies’ position that “[t]he best way to substantiate an efficiency claim is to demonstrate that similar efficiencies were achieved in the recent past from similar actions.”30

Similarly, AT&T’s abandoned acquisition of T-Mobile illustrates the uphill battle to demonstrate merger-specific and verifiable efficiencies with the agencies. Public papers filed in connection with the transaction highlighted that the parties did significant work and provided the agencies with detailed information and studies regarding the network enhancing efficiencies the parties believed would be achieved with the merger. The parties presented a set of complimentary models: one showing cost savings from network integrations and another showing an economic analysis of the resulting consumer welfare benefit.31 But, in seeking injunctive relief, the DOJ stated that while it “gave serious consideration to the efficiencies that the merging parties claim would result from the transaction,” the merging parties “had not demonstrated that the proposed transaction promised any efficiencies that would be sufficient to outweigh the transaction’s substantial adverse impact on competition and consumers.”32 Further, the DOJ took the position that “AT&T could obtain substantially the same network enhancements that it claims will come from the trans-

26 Similarly, in Swedish Match, the court found that the claimed efficiencies of lowered fixed costs from consolidating operations and better capacity management, and lowered variable costs from more automation, were insufficient to rebut the increased concentration—and likely competitive harm—that would result from combining the largest producer of loose leaf tobacco manufacturer in the United States with the third largest producer. FTC v. Swedish Match, 131 F. Supp. 2d 151, 171–72 (D.D.C. 2000).


28 Id. at 91.

29 Id. at 91–92.


action if it simply invested in its own network without eliminating a close competitor.”33 This case illustrates that it can be particularly difficult for innovation efficiencies to prevail because, despite the agencies’ recognition that mergers can result in more effective research and development or “may spur innovation,” true innovation is difficult to quantify and verify, and, therefore, the agencies may remain skeptical of such claims.

Recent litigation against the FTC is not any more promising concerning the burden of establishing efficiencies, especially in light of the Whole Foods34 preliminary injunction standard. In FTC v. OSF Healthcare, the court was “mindful of its limited role in [the injunction] proceedings and express[ed] no opinion on the ultimate merits of the proposed merger.”35 Despite the parties’ identification of specific areas of cost savings from the consolidation, the court considered the potential for such efficiencies “that made business sense” as no guarantee of actual implementation and relied on conflicting expert testimony, ultimately finding no “confidence” that the efficiencies rebutted the strong structural presumption of anticompetitive effect.36 The court granted the injunction allowing the matter to be further considered in the FTC administrative proceedings.

While these recent cases demonstrate efficiencies arguments still play a role in merger analysis, they strongly suggest that any calculations or models must survive close and rigorous testing before being accepted.

Efficiencies Still Matter

Given this backdrop, it would be difficult to claim that efficiencies alone can save an otherwise anticompetitive merger. But while no cases have been won based on efficiencies alone,37 there are numerous examples where efficiencies tipped the scale in favor of clearing the merger. For instance, in Long Island Jewish Medical Center, the parties claimed significant efficiencies across fifty different products and supported this claim with expert testimony.38 The court found that while some of the claimed efficiencies were unlikely to be realized, the transaction in its totality would result in annual operating savings of approximately $25 to $30 million.39 Even in Arch Coal, although $100 million of between $130 and $140 million in purported savings were found by the

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33 Press Release, Justice Dep’t Files Antitrust Lawsuit to Block AT&T’s Acquisition of T-Mobile (Aug. 31, 2011), available at http://www.justice.gov/atr/public/press_releases/2011/274615.htm. The transaction was also subject to FCC approval. The FCC staff report suggested that FCC staff also conducted a number of sensitivity tests to the models and found the results varied too much based on the assumptions which themselves were subject to debate. As such, the staff could not credit the efficiencies claimed.

34 FTC v. Whole Foods Mkts., Inc., 548 F.3d 1028 (D.C. Cir. 2008). Under the holding in Whole Foods, it appears that the parties’ efficiencies arguments may not receive much consideration because a district court need only “balance the likelihood of the FTC’s success against the equities, under a sliding scale” and in its analysis a “district court should bear in mind the FTC will be entitled to a presumption against the merger on the merits . . . and therefore does not need detailed evidence of anticompetitive effect at this preliminary phase.” Id. Accordingly, the FTC need not make any showing of irreparable harm, and “‘private equities’ alone cannot override the FTC’s showing of likelihood of success.” Id. at 1035. Whole Foods also made clear that at this preliminary stage the FTC does not “necessarily need to settle on a market definition” and can put forth alternate theories of anticompetitive harm without committing to one because “it just has to raise substantial doubts about a transaction.” Id. at 1036.


36 Id. at 1087-93.

37 See, e.g., Robert Pitofsky, Efficiency Consideration and Merger Enforcement: Comparison of U.S. and EU Approaches, 30 FORDHAM INT’L L.J., 1413, 1418 (2006) (“There is no recorded instance in the United States where an otherwise illegal merger was found by a court not to violate the antitrust laws because of the presence of efficiencies.”).


39 Id. at 148–49.
court to be questionable or overstated, the efficiencies in general were found “relevant to an assessment of the post-merger market and the potential benefits to consumers from cost reductions and increased competition,” and supported the conclusion that there would not be a substantial lessening of competition. 40

Similarly, in FTC v. Butterworth Health Corp., 41 the district court recognized the importance of efficiencies, but only after considering detailed estimates of the capital investment savings and other operating efficiencies. While the FTC’s expert criticized the degree of the projected savings, the court sided with the hospitals because they had done their homework. The court pointed out a “striking disparity in quality” between the experts:

Defendants’ experts were part of multi-disciplinary teams who spent as much as four months in Grand Rapids inspecting the hospital facilities and conducting hundreds of interviews. The FTC’s expert admitted he had not been to Grand Rapids in over 20 years. He did not conduct independent capital avoidance and efficiencies studies, but merely critiqued those done by defendants’ experts. 42

The 2006 Commentary on the 1992/1997 Merger Guidelines 43 specifically identified a number of matters where the efficiencies arguments were central to the agencies’ decision not to challenge the merger:

● In Toppan/DuPont, the DOJ analyzed a three-to-two merger in the market for high technology photomasks from which integrated circuits were made. It applied an auction model that predicted only small potential price increases. The DOJ concluded no net harm to competition would result from the transaction, taking into account a conservative estimate of the efficiencies.

● In Genzyme/Ilex, the FTC approved the transaction in large part because of “out-of-market” efficiencies. Although, the FTC found the transaction would reduce direct competition between the two firms, the merger promised substantial efficiencies in another use for the drugs. Instead of rejecting the merger in its entirety, the FTC cleared the deal with a remedy tailored to alleviate competitive concerns while still preserving the potential to achieve the efficiencies.

● Similarly, in Genzyme/Novazyme, the FTC cleared what it claimed to be a merger to monopoly in part because the combined firm would be able to develop a potential treatment for a rare disease faster than the companies could independently. But, it is important to note that the agencies typically view more skeptically combinations where innovation is central to competition between the merging firms. 44

● In 2005, two separate telecommunications transactions, Verizon/MCI and SBC/AT&T, were approved in significant part because of the efficiencies. Central to the DOJ’s decision not to challenge the mergers was its conclusion that the combinations provided the ability to sell

40 Arch Coal, 329 F. Supp. 2d at 153.


42 Id. at 1301.

43 2006 Commentary, supra note 30.

44 Richard G. Parker, Prepared Remarks before the Annual Briefing for Corporate Counsel (Sept. 16, 1998) (“That argument is not likely to succeed where innovation is a driving force behind competition. . . . We recognize that the reduction of R&D expenses may sometimes be a cognizable efficiency, but it is not when the result may be reduced competition.”), available at http://www.ftc.gov/speeches/other/parker.shtm.
services across regions at lower costs by combining complimentary inputs.\textsuperscript{45}

Moreover, it is not uncommon for the agencies to highlight efficiencies in their closing statements when clearing transactions. For example, in the DOJ’s closing statement in the merger of Delta Air Lines and Northwest Airlines, efficiencies appeared to be one of the main reasons for allowing the transaction to proceed. The letter noted that “the merger will result in efficiencies such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization that will benefit consumers.”\textsuperscript{46}

While one might be able to glean the impact of efficiencies from a closing statement, the confidential nature of agency review makes it difficult to understand precisely how the parties positioned an efficiencies defense and how it might have influenced the outcome. As a result, it is entirely possible that efficiencies play an even greater role in the close cases than can be detected.

Maximizing Credit for Efficiencies

In developing an efficiencies argument, parties must recognize that what they consider to be efficiencies from a business perspective may be very different from the kinds of efficiencies that will count for purposes of the antitrust analysis. Before signing a deal, parties often conduct significant quantitative analyses and hire consultants and bankers to assist in valuing the transaction and projecting the prospects for the combined firm. Many of these analyses include predicted efficiencies, including significant cost savings, benefits from more productive assets, access to more efficient or broader distribution networks, and the potential for collaboration on new products. But many of these business efficiencies might not be counted in an antitrust analysis because they are not merger specific or verifiable.

Typically, during the commercial negotiations phase of a deal, such issues are not of primary concern, and gun-jumping concerns—i.e., the prohibition of sharing competitively sensitive information before close—may add other practical difficulties to the parties’ obtaining the level of detail necessary to make efficiencies estimates substantiated at the level the agencies would want. Nevertheless, starting to develop these arguments at an early stage is critical for efficiencies to be given any weight—and guidelines for clean teams, or independent third-party expert teams (which are inherently clean) can be established to resolve gun-jumping concerns related to more detailed information necessary to develop support for the efficiencies claims.

Therefore, in preparing to make the most persuasive efficiencies argument possible, the parties should consider the following:

- **Acknowledge the bar is set high for efficiencies evidence.** The parties bear the burden of presenting a well-supported and verifiable quantification of efficiencies. The agencies and the courts are going to put significant effort into reviewing the information submitted, including testing the assumptions and models the parties are using. Any doubts about quantification or ability to achieve the efficiencies are not likely to be resolved in favor of the merging parties.

- **Start early and be consistent.** Developing the strengths of an efficiencies argument early lets the parties use efficiencies affirmatively, not just defensively to counter a structural case against the merging parties. One of the lessons learned from *Staples* is that being consis-


\textsuperscript{46} See 2010 Merger Guidelines, supra note 1, § 10.
tent from the beginning will make the existence of efficiencies appear less like a post-hoc rationalization. Identifying the limits of what can be substantiated from ordinary course-of-business documents and models is key to developing a strategy for presenting efficiencies arguments. For those transactions where the efficiencies are important to the deal rationale, the parties should take the time early in the process to substantiate the estimates. While clearing a deal based on efficiencies is an uphill battle given the high standards, efficiencies remain an important piece of the puzzle and may turn the tide in merger review. Thus, presenting a coherent and readily supported efficiencies argument at the outset is critical to the success of an efficiencies argument.

- **Explain in detail why the efficiencies are “merger specific.”** As previous cases have demonstrated, antitrust analysis will not credit all efficiencies identified by the business. Only merger-specific efficiencies—those that could not practically be achieved without the merger—will be credited in the antitrust analysis. For example, cost savings that could be obtained independent of the merger by investment in more efficient production technology would be considered benefits that could be obtained via a “less restrictive alternative,” i.e., without the merger, which raises no risk of the potential anticompetitive harm concerning the agencies. There are no rigid bounds for what alternatives are practically available, but arguments that a non-merger strategy to obtain similar benefits is not viable merely because it would cost more and take longer are not likely to be persuasive. The agencies and courts have tended to resolve any uncertainty against crediting the efficiencies. The agencies have found that certain efficiencies, such as those related to procurement, management, or capital cost, may be less likely to be merger specific or substantial. Thus, when making efficiencies arguments, the parties should take great care to explain why the efficiencies would not be achievable absent the transaction, highlighting impossibilities more than mere inconveniences associated with the potential alternatives where possible.

- **Do not overlook low-hanging fruit.** The agencies have found that certain types of efficiencies, such as shifting production between facilities to reduce the merged firms’ incremental costs, are more likely to be verifiable and substantial than others. Parties, therefore, should be sure to highlight these types of efficiencies where they can.

- **Use experts as appropriate.** As seen in H&R Block, Oracle, and Staples, courts are reluctant to rely on efficiencies analysis by subject matter experts within the company. The efficiencies in Oracle were predicated on the best projections of a senior executive, but were rejected because the court still found them to be mere speculation. At the same time, the 2010 Merger Guidelines state that “projections of efficiencies may be viewed with skepticism . . . when generated outside of the usual business planning process.” Thus, experts must be used appropriately and, to the extent possible, incorporate materials and data the parties rely on in the ordinary course of business as the basis for their analysis. Experts developing and presenting efficiencies-related models should anticipate that any input assumptions of their models that are not based on such ordinary course information will be subjected to rigorous testing.

By taking into account these practical considerations, parties with significant efficiencies enhancing transactions can work to develop and present their efficiencies arguments in a way that maximizes the potential credit with the agencies. While efficiencies are not likely to compensate for severe structural concerns, in closer cases they can be a very effective tool to establish a positive frame of reference for the agency staff’s review of the transaction. Proving efficiencies remains a challenging endeavor, but it remains clear that efficiencies can still be a persuasive factor in merger review analysis.
An Overview of the FTC’s New and Improved Green Guides

Randal Shaheen and Amy Ralph Mudge

The Federal Trade Commission released the final version of its revised Guides for the Use of Environmental Marketing Claims (2012 Green Guides) on October 11, 2012—almost two years to the day from when the FTC proposed them, and some twenty years after its prior Green Guides were first issued in 1992. The Prior Green Guides themselves followed on the heels of various regulatory enforcement efforts undertaken by the FTC and state attorneys general, as well as increasing (and often inconsistent) state efforts to regulate specific claims—such as a product’s being “biodegradable” or “recycled” properties—that prompted many companies to call upon the FTC to provide a consistent set of trade regulation rules or guidance.

In the last few years, advertisers have responded to consumer interest in a growing list of environmental matters through a new generation of green marketing claims, including claims relating to carbon emissions and use of renewable energy and materials. Regulatory interest in these new claims intensified when, in July 2007, then-Chairman Edward Markey of the House Select Committee on Energy Independence and Global Warming held a hearing on the (potentially fraudulent) marketing of carbon offsets. After the hearing, Congressman Markey sent the FTC a letter urging it to “undertake a public process designed to update the Commission’s Guides for the use of Environmental Marketing Claims.” In reply, FTC Chairman Deborah Platt Majoras sent Congressman Markey a letter noting that the Agency planned to conduct a review of its Prior Green Guides and update as appropriate.

Thus began an FTC-led process to issue revised Green Guides that lasted more than five years, including workshops in early 2008, receipt of numerous comments, conducting of the Commission’s own consumer surveys, release of the proposed Guides in October 2010, and receipt and evaluation of more than 300 non-duplicative comments on the proposed Guides.

The 2012 Green Guides show some significant changes from the Prior Green Guides—key differences include (1) clarifying or revising provisions that were in the Prior Green Guides; (2) elevating claims that were discussed briefly in footnotes or examples in the Prior Green Guides to...

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their own specific sections, and; (3) adding claims that were not addressed in the Prior Green Guides and, in most instances, were not part of green marketing at that time. Yet the 2012 Green Guides leave lingering questions as to how the Commission will treat key claims for which it has stated it will not provide guidance at this time.

Our analysis mainly addresses the text of the 2012 Green Guides—but the Commission has also provided a 302-page analysis that contains additional insight into several issues that many might miss if they look only at the 2012 Green Guides themselves.7

The 2012 Green Guides provide a carefully thought-through, important step forward in the regulation of green claims, and give clear guidance for those who wish to avoid any entanglement with the Commission. They also continue, and arguably expand, the Commission’s practice of providing numerous easy to understand examples of how their industry guides may be applied. Although some questions are left for another day, there is clearly much here to applaud.

Revisions to Existing Guidance

The 2012 Green Guides make minor changes to some provisions in the Prior Green Guides, by providing additional clarification and more specific guidance as to the use of three of the most frequently encountered green claims—that products are “environmentally friendly,” “biodegradable,” or “recyclable.”

“Environmentally Friendly.” The Prior Green Guides discouraged the use of general environmental-benefit claims like “environmentally friendly” because they could imply the product offered both far-reaching environmental benefits and no adverse environmental effects.8 The 2012 Green Guides clarify it is “highly unlikely” that such general claims can be substantiated and marketers should not make them.9 Nevertheless, a claim that a product is “environmentally friendly” can be made if coupled with the specific green attribute or attributes; for example, “environmentally friendly: 20% less packaging.”10

“Biodegradable.” Similarly, the Prior Green Guides discouraged making claims that products disposed of in landfills are “biodegradable,” and said that any such claims should be substantiated by evidence that the product or package will completely break down within a reasonably short period of time after customary disposal.11 The 2012 Green Guides state much more definitively that biodegradable claims should not be made for products typically disposed of in landfills because a “reasonably short period of time” is a year or less, and items will not biodegrade in a landfill in a year or less.12

The FTC’s separate Analysis also addresses claims by some companies that they have developed technologies that accelerate biodegradability in landfills, as substantiated by ASTM D 5511,13 and comments suggesting that the Commission should adopt ASTM D 5511 as a “safe har-
The Commission declined to endorse the ASTM standard in the 2012 Green Guides, stating that it is not aware of any standard, including ASTM D 5511, that adequately mimics actual landfill conditions. Some efforts are underway to create landfills with conditions that are more hospitable to degradation. Should such landfills become widely available to consumers, then perhaps the Commission may be open to revisiting its guidance on biodegradability claims.

“Recyclable.” The 2012 Green Guides also slightly revise and clarify how the FTC views use of the term “recyclable.” The Prior Green Guides had permitted sellers to make an unqualified “recyclable” claim when all elements of a product are capable of being recycled in facilities available to a “substantial majority” of consumers or communities. If necessary facilities were only available to a “significant percentage” of consumers or communities, then the Prior Green Guides provided that the materials could be claimed to be “recyclable” when accompanied by the disclaimer that “this product may not be recyclable in your area.” (The Prior Green Guides required even more explicit disclaimers if the percentage dropped below a “significant” percentage.

The 2012 Green Guides clarify that a “substantial” majority means at least 60 percent of consumers and eliminates the Prior Green Guides’ three-tier approach. Instead, if recycling facilities are not available for at least 60 percent of consumers or communities, then any “recyclable” claim must be qualified. The smaller the percentage of consumers who have access to recycling facilities, the stronger the qualification must be. Alternatively, an advertiser can disclose the actual percentage of consumers or communities who have access to recycling programs.

In the accompanying analysis, the Commission also clarified how to calculate “community.” A “community” is defined as an “area within a reasonable distance of where the consumers to whom the product is advertised live, work, and shop.” Effectively, communities may be much smaller in an urban area, where consumers typically travel shorter distances, than in a rural area.

The Commission also cited the American Forestry and Paper Association and American Beverage Association’s Community surveys utilizing U.S. Census Bureau data surveys as reasonable means of defining communities.

Elevation of Previously Discussed Claims

In addition, a few claims that did not merit their own section in the Prior Green Guides were “promoted” and given their own separate discussion and guidance by the 2012 Green Guides—in particular, claims that a product has received an organization’s “seal” or “certification,” is “free of” particular materials, is “non-toxic,” or has undergone a “life cycle assessment.”

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14 Analysis, supra note 7, at 119.
15 Id. at 123.
17 In that case, the Commission could adopt an analysis of how landfill biodegradability claims might be made similar to those currently used regarding compostable claims and the limited availability of municipal compost facilities. 77 Fed. Reg. 62,128 (to be codified at 16 C.F.R. § 260.7 (d)).
18 Analysis, supra note 7, at 155.
19 77 Fed. Reg. 62,129 (to be codified at 16 C.F.R. § 260.12 (b)(c)).
20 Analysis, supra note 7, at 172–73. “Communities [in these surveys] were defined as: (1) incorporated municipalities with their own governing bodies typically responsible for recycling; (2) unincorporated “Census Designated Places” with no local governing body that falls under the domain of the county in which they reside; (3) “remaining areas” that do not fall under (1) or (2). Id.
Seals and Certification. The 2012 Green Guides add a new section on environmental certifications and seals of approval. The Guides state that a seal or certification that uses broad, general environmental terms can falsely imply far-reaching environmental benefits. To combat this, seals should convey, through their names, the environmental benefit(s) they certify (e.g., “Certified Carbon Emissions Offset”). Alternatively, the advertiser can disclose the basis for the certification in close proximity to the seal. Reference on product packaging to a website is generally not acceptable unless the attributes evaluated are too numerous to mention. In that case, advertisers may make a statement to the effect that “[v]irtually all products impact the environment. For details on which attributes we evaluated, go to [a website that discusses this product].”

The 2012 Green Guides also make clear that, consistent with the Commission’s Endorsement Guides, any material connection between the advertiser and the certifying organization must be disclosed. Yet, in doing so, the 2012 Green Guides retract a statement in the Proposed Guides that a trade association’s certification of a member’s product was a “material connection” that was relevant to consumers’ purchase decisions and should be disclosed.

The Commission’s Endorsement Guides consider the payment for an endorsement to be a “material connection” that should be disclosed, and the Commission reasoned in the Proposed Guides that the dues paid by members to their trade associations constituted “payment” for the certification. Numerous commentators questioned use of “payment” as the basis for a determination that disclosure is required because all third-party certifiers, even wholly independent ones, require payment. They argued the issue should be whether there is potential for bias or subjectivity in the trade association certification. In its Analysis of the 2012 Green Guides as ultimately released, the Commission agreed that the critical issue is not payment but rather the credibility of the certification. Thus, disclosure is not required with respect to trade association certifications when the standards are “voluntary consensus standards” objectively applied by an independent auditor.

Free-of and Non-Toxic. “Free-of” claims were also promoted to their own section in the Proposed Guides, and then further subdivided into “free-of” and “non-toxic” claims in the final 2012 Green Guides.

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21 The Prior Green Guides had an example in the General Environmental Benefit Claims section that addressed seals and said they could imply environmental superiority: Former 16 C.F.R. § 260.7(a), Example 5 (2012).
22 77 Fed. Reg. 62,126–27 (to be codified at 16 C.F.R. § 260.6 (d), (e), Example 7).
24 77 Fed. Reg. 62,126 (to be codified at 16 C.F.R. § 260.6 (b)).
27 Analysis, supra note 7, at 86–88.
29 The Prior Green Guides had three examples touching upon “free-of” claims: former 16 C.F.R. § 260.6(c), Example 4 (2012) (“chlorine-free” coffee filters); former 16 C.F.R. § 260.7(a), Example 4 (2012) (“essentially non-toxic” lawn care pesticide); and former 16 C.F.R. § 260.7(h), Example 3 (2012) (“CFC-free” aerosol product.).
A company can make “free-of” claims even when a trace amount of the substance is present, if three conditions are satisfied. First, the substance must not have been intentionally added. (The Guides do not explicitly address substances used in the manufacturing process but not “added” to the product—for example, if a product is bathed or washed in a liquid. Nevertheless, at one point in the accompanying Analysis, the Commission discusses the use of a substance “in the manufacturing process,” which may suggest that use of a substance in this manner may trigger the “intentionally added” test.) Second, the amount of the substance in the product must not be more than what would be considered a “trace contaminant” or background levels at which the substance is commonly found in the environment. Third, the amount of the substance present must be so low as not to cause whatever harm has been associated with the substance. This last factor, of course, can vary widely. Some substances are harmful even at very low levels while others require a much higher degree of exposure. The risk of harm may also vary depending upon who is exposed to the substance.

In its Proposed Guides, the Commission also raised a question regarding products claiming to be free of a substance that they had never contained in the first place. The Commission noted that such a claim could deceptively imply that the product used to contain the substance, which had now been eliminated, but could also potentially present a legitimate comparison to other types of products that contain the substance. In the 2012 Green Guides, the Commission ultimately decided to permit such claims as long as the substance is associated with that product category. For example, a water bottle that does not, and has never, contained BPA nevertheless would be able to make the claim “BPA-free” because other products in that category contain BPA.

With respect to claims that a product is “non-toxic,” the Commission reiterated its prior view that the claim implies non-toxicity to humans and the environment, including pets. In its analysis the Commission refused to create a similar “trace” exception for toxic substances, but emphasized that although trace amounts of a toxic substance cannot be labeled “non-toxic,” a product that contains trace elements of a toxic substance could be so labeled assuming that the trace amount present was not harmful. However, despite urging from EPA, the Commission declined to take a position on whether a “non-toxic” claim implies that a product is “non-toxic” under all circumstances or only when used as directed.

**Life Cycle Assessment.** The Prior Green Guides specifically declined to address specific “life cycle assessment” (LCA) claims because the Commission lacked sufficient information about them. LCA is essentially a cradle-to-grave analysis of a product’s impact on the environment, from manufacture to use through disposal. The 2012 Green Guides reaffirm the FTC’s reluctance.
to provide specific guidance for LCA claim substantiation. However, the Guides do address under what circumstances a LCA might be required to substantiate other green claims.

As noted, the 2012 Green Guides permit a general environmental claim, when coupled with the specific green attribute or attributes; for example, “environmentally friendly: 20% less packaging.” However, combining a general environmental claim with a specific green benefit may also imply that the specific benefit resulted in an overall benefit to the environment and so could require an LCA. Compare two situations: in the first, the manufacturer used the same packaging as before but simply used less of it; in the second, the packaging reduction was brought about in whole or in part by substituting one type of packaging material for another. In the first case, the FTC’s Analysis indicates that no LCA should be required because there are no environmental tradeoffs to assess; in the second case, there may be tradeoffs that could lead the FTC to require some type of LCA. However, the Commission declined to endorse a particular LCA methodology.

Guidance on New Types of Green Claims

The 2012 Green Guides also include several green claims for which guidance has not previously been provided—claims involving “carbon offsets” and claims that a product involves “renewable energy” or “renewable materials.”

Claims Regarding Carbon Offsets. Carbon offset claims were the initial focus of the 2007 House hearings and one of the primary drivers behind the FTC’s decision to revisit the Prior Green Guides. The 2012 Green Guides respond by providing some guidance as to how carbon offset claims may and may not be made.

The House hearings evidenced concerns about double counting of offsets (whether the same offsets have been sold to multiple parties), additionality (whether the activity offsetting the carbon emissions would have occurred regardless), and legitimacy (whether, e.g., seeding the ocean to promote kelp blooms achieves a demonstrable offset).

In the 2012 Green Guides, the Commission declined to address issues it deemed outside its consumer protection mission, such as the soundness of particular offset methods or additionality, as those issues are more appropriate for scientific or public policy debate. However, the 2012 Green Guides provide limited guidance in four areas where the Commission felt there could clearly be consumer deception.

First, any offset should not be sold more than once. Second, claims that an offset occurred must be substantiated by competent and reliable scientific and accounting evidence. Third, any offset directed toward current or soon-to-occur emissions must be qualified if the offset will not occur for two or more years. (What is not clear, however, is whether the entire offset must occur

39 Analysis, supra note 7, at 37.
40 See supra note 10 and accompanying text.
41 Analysis, supra note 7, at 33–34.
42 Id.
43 Carbon Offset Hearing, supra note 4, Testimony of Russ George, President & CEO Planktos, Inc. at 92; Statements of Reps. Mackey & Sensenbrenner, id. at 2, 6.
44 Analysis, supra note 7, at 70.
45 77 Fed. Reg. 62,126 (to be codifed at 16 C.F.R. § 260.5 (a)).
46 Id.
47 77 Fed. Reg. 62,126 (to be codifed at 16 C.F.R. § 260.5(a)(b)).
within the two-year period. For example, if one or more trees are planted as a form of offset, the trees will begin to convert carbon dioxide immediately but the offset claim may be tied to the cumulative effect of that conversion over a much longer period of time. Further, does it matter if only a small amount of the offset occurs within the two-year period versus a substantial majority?)

Fourth, although the Commission largely declined to address issues of additionality, its Analysis notes that activities required by law cannot be claimed as an offset. (The 2012 Green Guides give the example of mandatory methane capture at a landfill.)

Claims Regarding Use of Renewable Energy or Renewable Materials. The 2012 Green Guides also address “renewable energy” and “renewable materials.” In both instances, the Commission declined to define these terms, “finding their meaning was more within the province of scientists.” During the process of finalizing the 2012 Green Guides, the Commission learned that consumers lacked a clear understanding of both terms. In the case of “renewable energy,” many consumers equated that term with “renewable materials” or “recycled content.” With regard to “renewable materials,” many consumers confused the term with “recycled,” “recyclable,” or “biodegradable.”

To combat these consumer misperceptions, the 2012 Green Guides call for disclosures. For “renewable energy” claims, the 2012 Green Guides recommend disclosing the source or sources of the energy. Presumably the Commission believed that a claim of “made with renewable solar energy” would not be misunderstood by consumers to relate to recycled content. In the case of mixed sources, all sources can be disclosed or the advertiser can disclose that it is a mix and specify the source that makes up the greatest percentage, calculated on an annual basis.

For “renewable materials” claims, the recommended form of disclosure involves setting forth both the type of renewable material and why the seller characterizes it as renewable (e.g., “bamboo, which grows at the same rate or faster than we use it”). In both instances, the Commission’s analysis stresses that it did not test consumer perceptions of its recommended disclosures because it had not anticipated finding consumer confusion and that therefore the Commission was particularly open to further evidence and testing on this issue.

The 2012 Green Guides also state that it is misleading to make a “renewable” energy or materials claim unless the claim is true for all or virtually all of the manufacturing process and product. Otherwise, an appropriate qualification must be used, such as stating the relevant percentage, or specifying to which part of the manufacturing process or product the claim applies. The 2012 Green Guides leave open the possibility that a company that largely assembles products might be able to make a “made with renewable energy” claim even though the components it purchases are made with fossil fuels, while a competitor that manufactures most of its own components may not be able to make such a claim even though it uses an equivalent amount of renewable

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48 77 Fed. Reg. 62,126 (to be codified at 16 C.F.R. § 260.5(c)).
49 Analysis, supra note 7, at 218, 240.
50 Id. at 220. According to the Commission 28% of consumers took away a meaning of “renewable materials” and 21% “recycled content.”
51 Id. at 241. Thirty-one percent of respondents interpreted the claim as made from recycled materials and 17% believed it meant these materials can be recycled.
52 77 Fed. Reg. 62,131 (to be codified at 16 C.F.R. § 260.15(b)).
53 Id. Example 2.
55 Analysis, supra note 7, at 221, 242.
56 77 Fed. Reg. 62,131 and 62,132 (to be codified at 16 C.F.R. § 260.15(c) and § 260.16(c)).
energy. However, were such a claim made by a company that largely engages in assembly, it could potentially be misleading to the extent it implies significant manufacturing activity.

Finally, the Commission declined to require companies to disclose the geographic location where they use the renewable energy. However, it held out the possibility that a renewable energy claim could imply a local benefit—for example, showing clean skies over a city and discussing a company’s use of clean solar energy at a plant thousands of miles away—and cautioned that those claims must not be misleading. For example, if the local facility serving St. Louis, Missouri, is in fact using coal, then the claim of a local St. Louis impact from the company’s use of solar energy in Los Angeles, California, may be deceptive.

**Claims for Which No Guidance Was Provided**

Although the Commission carried out an extensive review and revision of the Prior Green Guides, it declined to provide guidance on the use of two common claims—“sustainable” and “natural.”

The Commission in its survey found that the term “sustainable” meant many different things to consumers, including that a product was “strong/durable” or “long-lasting.” Given the wide range of possible meanings, the Commission declined to provide guidance. What is less clear, however, is why the Commission felt it could not offer guidance when the term is used in a context that is clearly environmental. Instead, the Commission simply cautioned that any green “sustainability” claim must be appropriately substantiated and that substantiation could be a “challenge” if consumers interpret the claim to mean that the product does not have any significant adverse environmental consequences.

As was the case with “sustainable,” the FTC found that “natural” can have many different meanings depending upon context and therefore it was unable to provide general guidance. The Commission’s decision to not provide guidance on use of the term “natural” has deep roots. Both the FDA and FTC have previously declined to define the term.

The issue with “natural,” however, is both more and less pressing than with “sustainable”—more pressing because numerous class action lawsuits have been filed challenging “natural” claims where products contain processed ingredients like high-fructose corn syrup or GMO (Genetically Modified Organism) ingredients—and less pressing because the courts may define the term in the absence of guidance from the Commission.

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57 Analysis, supra note 7, at 226.
58 Id. at 226–27.
59 Id. at 258. Nineteen percent of the study participants stated that “sustainable” means “strong/durable,” while 16% stated it means “long-lasting.”
60 Id.
61 Id. at 258.
62 Id. at 264.
64 See, e.g., Complaint, Ries v. Hornell Brewing Co., No. 3:10-cv-01139-RS (N.D. Cal.) (challenging claim of natural when beverage contained high fructose corn syrup); Complaint, Frito-Lay N. Am., Inc. “All Natural” Litig., No. 12-cv-408-RM-RLM (E.D.N.Y.) (challenging genetically modified ingredients as natural); Complaint, Astiana v. Dreyer’s Grand Ice Cream, Inc., No. 3:11-cv-012910-EMC (N.D. Cal.) (challenging alcalized cocoa powder as natural); Complaint, In re Tropicana Orange Juice Mktg. and Sales Practices Litig., MDL No. 2353 (D.N.J.) (challenging claim that “not from concentrate” orange juice is natural due to processing); Complaint, Jernigan v. Beam Global Spirits & Wine, Inc., No. 3:11-00842 (S.D. Ill.) (challenging claim that cocktails are natural due to preservative sodium benzoate); Complaint, Trevin v. Church & Dwight, Inc., No. 3:12-cv-01475-FLW-DEA (D.N.J.) (“natural” claims for a deodorant false and misleading because the deodorant contains dipropylene glycol, propylene glycol, triclosan, and tetrasodium EDTA).
Absent guidance from some regulatory authority or court, companies may find themselves in the position of finding it too risky to make the claim at all. In that case, there may be no easy way for consumers to distinguish between foods that contain highly-processed or artificial ingredients and those that have GMO ingredients or ingredients with only very minimal processing. In any event, with respect to both “sustainable” and “natural” claims, the Commission indicated that it is open to receiving additional evidence relating to consumer perception of these claims.65

Other Issues
Finally, the 2012 Green Guides and the accompanying analysis touch upon two additional topics of general interest—business-to-business transactions and the role of international standards. Reasserting that the Commission has general Section 5 jurisdiction over business-to-business claims,66 the 2012 Green Guides specifically state that they apply to business-to-business transactions,67 and even include an example of such a transaction.68 Indeed, the first post-Guides environmental claims’ case brought by the Commission included a claim by a manufacturer to its distributors.69

The Commission also has stated it recognizes the value of harmonizing its revised Guides with international standards, but cautions that this was not fully possible because the final Guides are intended to discourage consumer deception while international standards, such as the ISO 14021, are also intended to advance specific environmental goals or policies.70

Conclusion
As is often the case when the FTC provides new guidance, companies should expect a period of sustained vigilance and enforcement. Indeed, the Analysis accompanying the Guides notes that the “Commission agrees that enforcement is a key component of greater compliance.”71 At the same time, the 2012 Green Guides show a willingness on the part of the Commission to provide specific guidance and address numerous questions and concerns. Companies that find themselves faced with uncertainty regarding compliance might consider reaching out to the Commission staff—recognizing, however, that there are far more companies making green claims than there are FTC staff.

The initial Green Guides were issued in 1992 and then updated in 1996 and 1998 before the 2012 comprehensive revisions. Green claims continue to be a quickly evolving area and one where, even in the 2012 Green Guides and accompanying Analysis, the Commission has recognized that there are still unresolved questions and further possible work to be done. Thus, companies should not be surprised if the Commission, as it has done in the past, periodically updates the Green Guides, though likely on a less comprehensive basis.●

65 Analysis, supra note 7, at 258, 265.
66 Id. at 9. The Commission cites several cases, including Verrazzano Trading Corp., 91 F.T.C 888 (1978).
67 77 Fed. Reg. 62,124, (to be codified at 16 C.F.R. § 260.1 (c)).
70 Analysis, supra note 7, at 16–17.
71 Id. at 10.
Book Review

Theory Meets Practice:
A Deeper Understanding of Collusion

Robert C. Marshall and Leslie M. Marx
The Economics of Collusion—Cartels and Bidding Rings
MIT Press 2012

Reviewed by William E. Kovacic

No trend in modern antitrust law is more striking than the global acceptance of a norm that condemns cartels as the market’s most dangerous competitive vice. As the 1990s began, only the United States and a few other jurisdictions actively challenged horizontal price fixing, bid rigging, and market allocations. By the decade’s end, lysine, leniency, and vitamins had changed all of that. Today, more and more antitrust systems treat cartels as serious offenses, and many single out cartels as the preeminent focus of enforcement.¹

Expanded prosecution of cartels with increasingly powerful sanctions has inspired an abundance of excellent books about collusion. Superb volumes from recent years include collections of essays on the operation, detection, and punishment of cartels.² With The Economics of Collusion, Robert Marshall and Leslie Marx have surpassed a formidable field.³ Economics of Collusion is the best single volume yet written about the formation and operation of cartels and bidding rings. As described below, five features of the book stand out.

Integration of Theory and Enforcement Experience

In examining how cartels function, Marshall and Marx combine a state-of-the-art distillation of economic theory with a comprehensive reading of publicly available accounts of prosecuted cartels, especially the cartel decisions of the European Commission.⁴ The book begins with an overview

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² Examples include Criminalising Cartels (Caron Beaton-Wells & Ariel Ezrachi eds., 2011); John Connor, Global Price Fixing (2d ed. 2008); Criminalization of Competition Law Enforcement—Economic and Legal Implications for the EU Member States (Katalin J. Cseres, Maarten Pieter Schinkel & Floris O.W. Vogelaar eds., 2006); Handbook of Procurement (Nicola Dimitri, Gustavo Piga & Giancarlo Spagnolo eds., 2006); European Competition Law Annual 2006: Enforcement of Prohibition of Cartels (Claus Dieter Ehlermann & Isabela Atanasiu eds., 2007); How Cartels Endure and How They Fail (Peter Z. Grossman ed., 2004).

³ In offering this opinion, I am not an entirely disinterested observer. I have co-authored papers with Marshall and Marx and have worked with them on various academic research projects involving antitrust law, collusion, and procurement policy.

⁴ Economics of Collusion will serve as a useful reference tool with citations to over 160 books and articles and useful data on many cartel cases. In studying experience with cartels, Marshall and Marx supplement their own examination of published decisions by drawing upon earlier classic studies of cartels, e.g., George W. Stocking & Myron W. Watkins, Cartels in Action (Twentieth Century Fund 1946), as well as recent contributions that seek to derive lessons about cartel formation and management from modern cases, e.g., Margaret C. Levenstein & Valerie Y. Suslow, What Determines Cartel Success?, 44 J. ECON. LIT. 43 (2006).
that frames the analysis of collusion by setting out the distinction between tacit and explicit collusion, discussing the lingering effects of explicit collusion, and emphasizing the importance of the role of monitoring in enforcing collusive agreements. Marshall and Marx then examine the formation and operation of cartels with a series of first-person narratives. Chapter 2, “The Narrative of a Cartel,” is told from the perspective of a fictional business manager who instructs managers from rival companies about the best ways to design and implement collusive schemes. The narrative in Chapter 3 explores the inner workings of conspiratorial bidding rings. By setting out the gains that conspirators can realize, the narrative underscores why firms strive (and will continue to strive) to invent coordination mechanisms that can counteract enhancements in anti-cartel enforcement. A separate narrative in Chapter 4 portrays coordination problems and their solutions, the dangers of detection, and the forms of economic circumstantial evidence that might support an inference of agreement in the litigation of antitrust claims.

The narratives are powerful pedagogical devices. As a matter of technique, the narratives skillfully integrate conceptual insights with facts assembled from published decisions of cartel cases. For example, the narrative in Chapter 2 is grounded mainly in the facts of the vitamins industry cartel uncovered in the late 1990s. The largest of the industry’s four fictional firms convenes a meeting with its rivals and describes how profits will increase if the firms were to collude. The narrative then turns to the selection of effective mechanisms to carry out the necessary output reductions (market share allocations are the instrument of choice), methods to condition buyers to accept price hikes (emphasizing carefully organized public price announcements), the best way to instruct each firm’s sales team without arousing their suspicions (tell the team to strive for higher margins rather than for higher volumes), and “truing up” techniques to redistribute earnings to ensure that each firm realizes the earnings anticipated by the market share allocation (inter-firm transfers of product at the end of the cartel’s annual accounting period often serve this end). The narrative concludes with a question-and-answer session in which the industry leader addresses issues raised by the prospective cartel participants. The citation protocol used by Marshall and Marx directs the reader to cases that provide the factual foundations for each scenario set out in the narratives.

The joining up of theory with actual experience has a number of applications. It provides insights that can improve the application of antitrust laws by courts and enforcement agencies. Antitrust counsel also will find the scenarios useful in designing antitrust compliance programs and for detecting possible violations. Not surprisingly, because the narratives vividly map out what cartels must do to succeed, the narratives also could serve to instruct prospective cartel participants in how to orchestrate their behavior.

The narratives also offer a larger lesson beyond their informative examination of how cartels are formed and function. Marshall and Marx underscore the adaptability and ingenuity of business managers in responding to ever more severe public enforcement campaigns against collusion. The authors emphasize a crucial point for enforcement agencies: the private gains from collusion create strong, enduring incentives for firms to devise counter-measures to blunt the impact of enforcement advances in detection and punishment. With illustrations from published cartel

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5 Economics of Collusion at 1–26.
6 Id. at 29–54.
7 Id. at 55–70.
8 Id. at 71–80.
cases, Marshall and Marx document the evolution of increasingly sophisticated methods to overcome resistance by buyers, disguise true-ups, and punish deviations.

Cartelization may pose difficult challenges, but the rewards for success provide strong inspiration to surmount them. The pedagogical narratives demonstrate that business managers will press to find means of coordination that are more likely to escape prosecution. Nobody should underestimate their ingenuity and skill in doing so. “Given the creativity and flexibility of successful cartels in crafting solutions to problems,” the authors write, “we expect changes to their operating environment to be greeted with quick and effective adjustments to the collusive structures.”

This observation suggests caution in assuming that any specific improvement in enforcement (e.g., leniency, incarceration for culpable individuals) will cause prospective cartel members to abandon hope.

**Keys to Effective Collusion**

A second valuable feature of *Economics of Collusion* is a path-breaking analysis of what cartels and bidding rings must do to succeed. Marshall and Marx model cartels as two-stage mechanisms whose effectiveness often requires the application of collusive and exclusionary tactics.

In the first stage participants reach a consensus about how they will restrict output or, in the case of a bidding ring, depress the price to be offered at an auction. In an important contribution to the literature, Marshall and Marx illuminate what happens next. Not only must the cartel cope with cheating and defections within its own ranks, it must neutralize challenges posed by entrants, suppliers, customers, substitute products, and rivals which chose not to join the conspiracy.

Marshall and Marx adapt Michael Porter’s “five forces” model to identify the external threats to the cartel and to examine how successful cartels cope with them. In many instances, cartels address stage-two threats with exclusionary tactics that individual dominant firms use to chasten rivals. Among other means of exclusion, cartels engage in predatory pricing, file vexatious patent infringement suits, form exclusive dealing contracts with upstream suppliers, and take advantage of public policies (such as anti-dumping statutes and environmental regulations that raise costs for new firms but grandfather existing production facilities) that suppress entry. By analyzing cartels as two-stage mechanisms, Marshall and Marx show how successful collusion often requires recourse to exclusionary behavior, as well.

**Identification and Interpretation of Cartel Structures**

Building on George Stigler’s 1964 article, *A Theory of Oligopoly*, Marshall and Marx identify and explain the structures needed by a cartel or bidding ring to avert cheating by members, and the consequent trail of economic circumstantial evidence that is left in their wake. Pricing, allocation, and enforcement structures are all needed for collusion to be profitable, but each implies a con-
duct or outcome that can lead to the inference of collusion. The authors provide a framework for assessing the relative strength of this economic circumstantial evidence for inferring collusion. Specifically, Marshall and Marx propose a reformulation of the assessment of “plus factors” as tools to distinguish concerted action from unilateral behavior. They identify a category of “super plus factors” entitled to special weight based upon their importance to the operation of a cartel.

These include certain forms of price announcements, internal shifts in incentive mechanisms for sales personnel, and interfirm transfers. Among other applications, antitrust counselors are likely to find this discussion helpful in identifying suspicious activity on the part of their clients and in designing compliance training programs.

Applications to Horizontal Mergers

In a fourth important contribution, this volume draws upon experience with cartels to suggest refinements in the approaches that antitrust law uses to analyze horizontal mergers. Specifically, Marshall and Marx propose that the economic models that are typically built to analyze the unilateral effects of mergers be extended in a simple way to assess potential future coordinated effects. The authors also describe how the close study of past cartels (especially the vitamins cartel) provides lessons for the analysis of possible coordinated effects from a horizontal merger.

Coordination in Auctions and Procurement

The fifth notable feature of the volume is its focus upon auctions and procurement. Marshall and Marx provide practical, insightful guidance about how auctions and procurements can be designed to avert collusion by bidders. The authors note that public procurement policy typically has strived to increase transparency—from mandates that require the registration of bids to the use of ex post disclosure of all bids submitted. The authors underscore that transparency is an ally of bidding rings, for it provides the kind of monitoring opportunities that cartel members need to collude effectively.

Conclusion: Possible Future Enhancements

Economics of Collusion is destined to become an indispensable text for enforcement officials, academics, business procurement officials, corporate compliance officers, and practitioners in law firms and economic consultancies. Two refinements in future editions would make a great book even better. The volume might benefit from a broader review of case studies that have recounted the story of notable individual cartels. These include popular and scholarly accounts of the electrical equipment cartel and the international petroleum cartel. Among other applications, these accounts would provide useful material to elaborate the Marshall and Marx narratives on cartels and bidding rings.

The authors also might add a concluding chapter to drive home more expressly and completely the interconnections among cartels, dominant firm misconduct, and mergers. Doing so would crystalize a larger point about the future of antitrust analysis. The examination of cartels as two-

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16 Id. at 213–55.
17 Id. at 257–63.
18 Id. at 187–210.
stage mechanisms and the application of cartel experience to the treatment of coordinated effects in merger enforcement cast doubt upon the traditional practice of studying cartels, mergers, and single-firm conduct in separate, airtight compartments. In *Economics of Collusion*, Marshall and Marx advance a modern scholarship that emphasizes vital conceptual links across formerly discrete areas of analysis.\(^{21}\) They show that the understanding of cartels requires attention to the role that exclusion often plays in the success of a collusive scheme. To treat exclusion as a concern secondary to collusion ignores what makes many collusive schemes effective. A final chapter that summarized these interconnections would improve the understanding not only of collusion but also would help foster a new synthesis of thinking about competition law.●

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Paper Trail: Working Papers and Recent Scholarship

Editor’s note: Because Paper Trail co-editors Bill Page and John Woodbury failed to use a market mechanism to choose who would discuss what, both focus on one paper by Herbert Hovenkamp (although Page also reviews a related Hovenkamp paper). Of course, it is not a surprise that both editors would have been drawn to new papers by a leading antitrust authority. While there is some overlap in the discussions, however, there are differences in views and interpretation. Consequently, both discussions are included here. The paper they both review is the Hovenkamp paper that addresses the debate between the advocates of a “total welfare” standard for antitrust enforcement versus a “consumer welfare” standard and then applies the latter to a set of practices that pose special challenges to the standard. Page also reviews a second Hovenkamp paper, which specifically focuses on whether the possible nonexclusionary effects of tying arrangements justify antitrust intervention.

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

—William H. Page and John R. Woodbury

Recent Papers


In this Paper Trail entry, I note two recent papers in which Herbert Hovenkamp, who needs no introduction, considers which market injuries antitrust enforcement should try to remedy. In the broader paper, Implementing Antitrust’s Welfare Goals, he identifies the guiding standard of welfare for most of antitrust law, and then applies it to a set of practices that pose special challenges for the standard. In the other paper, Antitrust and Nonexcluding Ties, he analyzes some of the same practices to consider whether the possible nonexclusionary effects of tying arrangements justify antitrust intervention.

In Welfare Goals, Hovenkamp points out that, while antitrust scholars have contended for years in countless articles over the merits of a total welfare standard (that takes account of the effects of practices on both producers and consumers) versus a consumer welfare standard (that considers only the effects of practices on consumers), courts in most cases focus almost exclusively on consumer welfare. If a practice like a cartel or merger reduces output and increases prices, it will be held unlawful regardless of compensating efficiencies that benefit the producer. Courts cannot actually measure and compare the deadweight welfare loss and productive efficiencies in Williamson’s famous total-welfare tradeoff model,1 but they can usually measure an output restriction and a price increase. In some instances, as in NCAA,2 the court may enjoin a discrete, out-

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put-reducing practice of an efficient joint venture, but if the practice is integral to the joint venture, the court will invariably enjoin the entire joint venture rather than weigh the competing effects.

The presence of obvious efficiencies may affect antitrust analysis, but only because it makes it less likely that the practice will actually reduce output, and thus places a greater burden on the plaintiff to show that it does. In an interesting passage, Hovenkamp notes that the Chicago School standard for optimal sanctions, which measures the fine by the sum of the overcharge and any deadweight welfare loss, actually implements a consumer welfare standard: the offender will commit the violation if it generates enough cost savings to offset the expected penalty, but it will still have to pay the damages to consumers to compensate them for their losses. Again, this standard does not require courts actually to measure productive efficiency gains.

I would also note that the D.C. Circuit in *Microsoft* held that practices that obviously benefitted consumers by lowering prices and improving the product were invariably lawful because they did not harm the “competitive process.” The defendant could also avoid liability for practices with more ambiguous effects by offering a “procompetitive justification.” Although the court held out the possibility that the plaintiff could nevertheless win by “demonstrat[ing] that the anticompetitive harm of the conduct outweights the procompetitive benefit,” it never reached that stage in the analysis of any of Microsoft’s practices.

After establishing consumer welfare as the usual standard, Hovenkamp turns his attention to cases that pose special challenges for the standard: ones in which the effects on consumers are unclear, mixed, or unmeasurable. In these circumstances, he suggests that a resolution of the case may require examination of efficiencies that mainly benefit producers. Three of the problematic practices are types of tying arrangements. Hovenkamp points out that, although tying arrangements are usually analyzed as exclusionary restraints under both Sections 1 and 2 of the Sherman Act, the applicable legal standards do not require a showing of foreclosure for the ties to be unlawful. Consequently, in both *Welfare Goals* and *Nonexcluding Ties*, he focuses on possible nonexclusionary uses of ties. Because he considers the same practices in both papers, I will discuss their treatments of these practices together.

In the traditional leverage theory of tying, the seller uses its monopoly power over the tying product to require buyers also to purchase the tied product and thereby foreclose rivals and harm consumers in the tied product market. But the theory also implied that consumers might pay a second monopoly price for the tied product. That lasted until Ward Bowman showed that a monopolist of either of two products used in fixed proportions can extract the full monopoly profit without a tie. The same result would hold even if the products were imperfect complements, i.e., not always used together by consumers. In most cases, a tie will reduce the combined price of the products. First, if the two products were priced noncompetitively by separate firms, welfare would be lower than if a single firm sold them in a bundle. Eliminating this sort of double marginalization provides a strong incentive for separate producers of the tying and tied products to merge or form a joint venture. Second, if there are strong complementarities in production—as with various lev-

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5 Id. at 59.

6 But cf. Michael D. Whinston, *Tying, Foreclosure & Exclusion*, 80 AM. ECON. REV. 837 (1990) (showing that where there are scale economies in the production of the tied good, the tie might permit foreclosure).
els of health care that use similar staff and equipment—it may be cheaper to produce or to dis-
tribute the products together.

In both papers, Hovenkamp considers ties in which the tied product is used in variable pro-
portions with the tying product. He uses the familiar example of printers and ink cartridges, in
which the seller charges less for the printer and more for the cartridges under the tie than if the
products were priced separately. A Chicago analysis of this practice would note that it is based
on the perception that the buyers’ usage of cartridges is directly correlated to their intensity of
demand for the printer itself; by tying, the seller is able to charge more to the higher-intensity
demands and is also able to sell at profit to lower intensity demanders, who would not have pur-
chased at all but for the tie. Thus, the tie expands output and eliminates the deadweight monop-
oly welfare loss. Since the seller could lawfully accomplish the same goal by metering the use of
the tied product directly, the tie should be lawful under a total welfare standard.

Because Hovenkamp is concerned with the efficacy of the consumer welfare standard, he
focuses his analysis of variable proportions ties on whether buyers gain or lose from the practice.
He sorts buyers into three categories according to how they are affected by the tie. He suggests
that buyers with a low intensity of demand who enter the market because of the price reduction on
the tied product receive an “unqualified welfare gain” in “whatever surplus they achieve from enter-
ing.” Other buyers with a high intensity of demand for the product but who nevertheless use only
a small number of tied products are also better off: they would have purchased the products at a
higher combined price in the absence of the tie. High-intensity buyers who purchase a high vol-
ume of the tied product, however, will be worse off, because they pay more for the tied product than
they save by the price reduction on the tying product. If the gains to the first two categories of buy-
ers exceed the losses of the third, then the tie increases consumer welfare. Hovenkamp notes in
Nonexcluding Ties that “because the seller does not tie unless it is profitable, any outcome that
increases consumer welfare will also increase general welfare.” Hovenkamp recognizes it would be
impossible for a court to measure the gains and losses in consumer surplus to implement this con-
sumer welfare analysis. He suggests that other consumer benefits, like economies of scale to lower
prices or elimination of double marginalization, might play a role.

I would suggest, however, that in these circumstances, courts should explicitly shift to a total
welfare standard. If the tie is successful in achieving perfect price discrimination, then it harms
essentially all buyers who would have purchased at a single monopoly price; it has a neutral effect
on buyers who enter the market because of the tie, because they pay a price equal to the full value
they place on the products. The seller thus captures as profit the entire value of the products
above their cost of production. Nevertheless, the tie unequivocally increases output and total
social welfare and should thus be lawful.

Hovenkamp also considers (in both papers) the case of bundling in fixed proportions, a prac-
tice that can be used to discriminate in price between customers who assign different values to
each of the bundled products. He shows that, under certain assumptions, bundling can result in
a lower consumer surplus than would occur with one set of unbundled prices, but a higher con-
sumer surplus than would occur with the higher unbundled prices that the seller would certainly
charge if the tie were prohibited. Thus, Hovenkamp suggests that prohibiting bundling, in these
circumstances would increase consumer surplus only if it were combined with effective and
costless price regulation—an unlikely prospect in the real world. He also notes that this sort of
bundling is likely to eliminate double marginalization or reduce joint costs of provision. Thus, pro-
hibiting bundling in these circumstances would probably hurt consumers and reduce total
welfare.
The third practice Hovenkamp considers in both papers is the bundling of imperfect comple-
ments. While buyers of perfect complements always need both (or all) products, at least some 
buyers of imperfect complements will only want one of them. If the products are offered only in a 
package, some buyers may be injured by having to purchase a product they do not want, but 
Hovenkamp insists that the injury is not a matter of antitrust concern.\(^7\) If the bundle is offered at a 
discount and the individual products are offered separately, the tie will benefit purchasers of the 
bundle, but may harm buyers of the products individually if the price of is higher than would pre-
vail in the absence of bundling. Again, where the effects on consumers are mixed, a total welfare 
analysis should control.

In *Welfare Goals*, Hovenkamp goes on to discuss other vertical restraints that raise theoretical 
concerns under a consumer welfare standard, but pose practical challenges to implementing that 
standard. First, he considers vertical customer restraints that are used to impose third-degree 
price discrimination on different categories of buyers. Such a practice might conceivably reduce 
overall output, but proving any output effect would be hard because it is not clear what the seller 
would do in the absence of the tie. Second, he considers resale price maintenance. It is som-
times assumed that consumers benefit from RPM whenever it increases output. Even if prices are 
higher, output must have increased because consumers received valuable point-of-sale services 
and thus their demand increased. Hovenkamp notes, however, that it may only be marginal con-
sumers who value the additional services and drive the increase in output. In those circum-
stances, intramarginal, well-informed consumers will be harmed by the higher prices and total 
welfare may decline. He implies that trying to sort out these differences would not be worth the 
effort, particularly because sellers might have an incentive to integrate forward to avoid the appli-
cation of Section 1.

In a final section, Hovenkamp rejects arguments that antitrust tools should be used to advance 
non-economic goals. He mentions a merger of small firms in a competitive market that would elimi-
nate jobs; a merger to monopoly that might preserve jobs; and a dominant firm that refuses to 
license a technology that its rivals need to remain in business. In each of these instances, he 
argues, courts should limit their analysis to competitive considerations and not try to preserve 
employment or small competitors for their own sake. Other legal policies would be preferable ways 
to advance these sorts of goals.

—WHP

Herbert Hovenkamp, *Implementing Antitrust’s Welfare Goals*, University of Iowa Legal Studies Research 

In this paper, a dean of antitrust—Herbert Hovenkamp, Ben V. and Dorothy Wille Professor of Law, 
University of Iowa—addresses the debate between the advocates of a “total welfare” standard for 
antitrust enforcement versus a “consumer welfare” standard. The former asks whether a particu-
lar practice or merger may increase the sum of consumer and producer surplus (profits) and if so, 
the practice or merger should be approved. The consumer welfare standard asks a seemingly 
simpler question of whether consumers will be better off as a result of a practice or merger, 
regardless of its effects on profits (which may increase because the practice or merger permits 
the firm to eliminate duplicative costs or to exercise market power).

\(^7\) See Brantley v. NBC Universal, Inc., 675 F.3d 1192, 1196 (9th Cir. 2012).
Hovenkamp notes that an important touchstone for the consumer welfare standard is the economics of perfect competition. Under certain assumptions about costs and consumer preferences, competition maximizes consumer welfare—all profits are dissipated via lower prices and increased output because of competition. In these highly stylized and most fundamental of economic models, there is no producer surplus.

But in the real world, antitrust must address practices or mergers that may harm consumers through higher prices, resulting in distorted consumer choices but nonetheless resulting in resource savings through more efficient production. A total welfare standard would “approve” of a joint venture (to use the Hovenkamp example) that increased prices to consumers somewhat but resulted in significant variable cost savings. That same joint venture would be condemned under the consumer welfare standard notwithstanding the cost savings.

Having described the basics of the total vs. consumer welfare standard, Hovenkamp regards the debate over which to rely on as “trivial” because “few if any decisions have turned on the difference.” (p. 4) First, he argues that the real difference in antitrust is not about which standard to use but rather presumptions about the self-correcting nature of markets. Associating the total welfare standard with the “Chicago School,” Hovenkamp observes that that School presum es that the self-correcting mechanisms of markets are more robust than the “Harvard School” which he associates with the consumer welfare standard.

Hovenkamp concludes that the Harvard School won, but the description he provides is more consistent with a “Post-Chicago” characterization, given how the Chicago School emphasis on efficiencies resulted in modifying the early “Harvard School” views that many seemingly restrictive practices were nakedly anticompetitive. Instead, the Post-Chicago School recognizes that these practices can be (and in many if not most cases are likely to be) efficient in that they promote consumer welfare without harming competition and that “predatory pricing is rare, but perhaps not impossible” (p. 6). Needless to say, I doubt that the debate is over.

Hovenkamp’s second reason for believing the standard debate to be trivial is the fact that (in his view) the courts “almost invariably apply a consumer welfare test.” (p. 6)

He concludes with two “propositions.” First, if a practice (or merger) produces unambiguous short-run consumer losses via reduced output or higher prices, the courts and the antitrust agencies will not credit any immediate cost savings or any long run cost savings. (Indeed, I would argue that the difference in time horizons—long-run vs. short-run—is a key difference between the Chicago and Post-Chicago views.)

But second, if the practice (or merger) increases the welfare of some consumers while lowering that of others in ways not easily quantified, then the consumer welfare standard becomes more problematic. In those cases, Hovenkamp suggests that the producer gains may become more relevant if there are “measurable output effects” (p. 11). But he also concludes that “output effects may be helpful. In most cases, neither [output effects nor producer gains] will be dispositive.” (p. 11)

The paper then describes the kinds of matters that create problems for the application of the consumer welfare standard because they seem to require a weighing of benefits to some consumers against the losses experienced by other consumers. As one example, he focuses on “variable proportion” ties. One such tie might be a firm that ties the purchase of its printers to the use of its cartridges. Instead of charging a high price for the printer and a low price for the cartridge

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8 While not discussed, the issues of interpersonal utility comparisons are equally problematic for the total welfare standard.
(reflecting the relative costs of each), the printer manufacturer may find it profitable to charge a low price for the printer and a higher price for the cartridge. Those that use the printer more intensively will pay a higher total price for use of the printer than those that use it less intensively.

How does this practice affect consumer welfare where the benchmark is a higher standalone price for the printer and lower standalone price for the cartridges? Some consumers who would not buy a printer at the standalone price will now do so provided that they use the printer less intensively than others. These consumers unambiguously gain from the practice. Other consumers who use the printer more intensively will be harmed by the practice—the total cost of the printer services (printer plus cartridges) will be higher than would have been true with standalone prices.

Hovenkamp notes that “whether consumers in the aggregate are better or worse off from such an arrangement would be nearly impossible to assess.” (p. 14) Further, even if the effect of the tie was to increase the sale of printers, that would not mean that consumers are in the aggregate better off.9

As another example, he considers the effect of bundling of complements on consumer welfare. If the two products are perfect complements (i.e., fixed proportions, left shoes/right shoes being the classic example), then the bundling may result in production or distribution cost savings that are passed on to consumers or the bundling may result in the elimination of double marginalization. Both outcomes are unambiguously welfare increasing.

But suppose instead that these are imperfect complements—there are some consumers who value the bundle but there are other consumers who value only one component of the bundle. If the demands of those that value the bundle are more elastic than those that want only one component, the firm can set a relatively low price for the bundle but higher standalone prices for the components. That is, the firm can use the bundling to price discriminate between the two consumer types.

As with the variable proportions tie, evaluating the consumer effects of the tie is difficult. It would require balancing the gains to consumers with a more elastic demand who buy the bundle and the losses to those consumers with a less elastic demand for only one of the bundle components, all compared to the prices of the components if the practice were prohibited.

Hovenkamp also discusses the evaluation of vertical restraints in this same context where some consumers gain and others lose from the adoption of a particular practice. For example, RPM may promote point-of-sale services that would benefit consumers who are new and unfamiliar with the product but harm those who already had substantial product experience before the adoption of RPM. To induce the point-of-sale service, the price will be higher with RPM than without and the product “veterans” will be harmed.

The paper also notes that if the manufacturer is integrated downstream into product distribution, it can set a price that covers the cost of providing point-of-sale services. And Hovenkamp adds that this would hardly be an antitrust violation.10

9 Importantly, Hovenkamp does note that there are considerations that can tilt the balance to benefitting consumers. First, larger sales of cartridges and printers may be subject to scale or scope economies, in which all consumers will benefit from lower prices. Second, the tie can eliminate some of the double marginalization that would result if cartridges and printers were supplied by independent providers.

10 But suppose that we know that the RPM harms consumers on balance and that the vertical integration occurs solely for the purpose of implementing RPM. Putting aside the a numerous reasons why one might decide not to interfere in this decision (in particular, the costs imposed by a government policy that “reviews” the organizational structure of the firm), it seems to me that a finding that RPM harms consumers should lead to the same conclusion about the welfare effects of vertical integration to bypass the RPM ban.
The question remains that in these “hard” cases where there are differential consumer effects, what should the role of antitrust be? Hovenkamp concludes that “it depends.” Hovenkamp suggests that in these cases, antitrust enforcers and the courts might “have to rely on secondary indicators or intuitions about net harm.” (p. 28) However, he provides little guidance as to what those indicators are. Surely, intuition is not a solid basis for a finding of antitrust harm. And where there are no secondary indicators or intuitions, Hovenkamp counsels that “the law should be reluctant to intervene,” (p. 28) which generally sounds like a sensible prescription.

Hovenkamp’s discussion of the total vs. consumer welfare standard, while interesting, is not as comprehensive as those found elsewhere. Overall, the key contribution of this paper is to remind us of what we don’t know in applying either a consumer welfare standard or a total welfare standard. When consumers are differentially affected by a merger or a business practice, applying the standard becomes much more difficult if not impossible. It is surprising that when identifying practices that are hard because they differentially affect consumers, the paper does not consider cases in which those practices are motivated by (non-price) anticompetitive exclusion, where the consumer welfare call may be much easier in that this interpersonal welfare comparison is not required.●

—JRW