Emerging Theories of Competitive Harm in Merger Enforcement

J. Thomas Rosch and Darren S. Tucker

At least since the early 1980s, it has been asserted that “the core principles of merger enforcement policy have remained stable.”¹ Horizontal mergers that create, enhance, or facilitate the exercise of market power and vertical transactions that adversely affect horizontal competition are condemned, and consumer welfare is the touchstone by which these assessments are made. That is not to say that merger enforcement policy has been static. New theories of competitive harm and refinements to existing policy have emerged and become codified in judicial precedent or the Merger Guidelines.

In the past few years, the Federal Trade Commission and Department of Justice challenged one merger transaction, and considered challenging another, that departed from the enforcement paradigm of the last thirty years. The first involved a conglomerate transaction, which the courts and agencies have not found objectionable under the Clayton Act in several decades. The second involved a “potential vertical” transaction, which had never before been the subject of antitrust enforcement, to our knowledge.

These cases demonstrate that the antitrust agencies are open to other approaches for analyzing transactions that are believed to present a risk of consumer harm. The cases also suggest that the lack of an existing horizontal or vertical relationship between the merging parties should not necessarily be viewed as an antitrust “green light.”

Conglomerate Merger Enforcement: The Lundbeck Case

In August 2005, Lundbeck, Inc. acquired the rights to Indocin IV and several other drugs from Merck.² At the time, Indocin was the only pharmacological treatment for patent ductus arteriosus (PDA), a serious heart condition affecting low birth weight babies.³ For several years prior to the acquisition, Merck had sold a three-vial course of treatment of Indocin for $77.77. Prior to the acquisition, Lundbeck performed a series of market studies and concluded that Indocin was “significantly under priced to the market.”⁴ After the acquisition, Lundbeck increased the wholesale

² Unless otherwise indicated, background information on the Lundbeck case is taken from the district court’s factual findings, which the FTC did not challenge on appeal. FTC v. Lundbeck, Inc., 2010-2 Trade Cas. (CCH) ¶ 77,160, 2010 U.S. Dist. LEXIS 95365 (D. Minn. Aug. 31, 2010), aff’d, 2011-2 Trade Cas. (CCH) ¶ 77,570, 2011 U.S. App. LEXIS 17231 (8th Cir. Aug. 19, 2011). Lundbeck was previously known as Ovation Pharmaceuticals.
³ Pharmacological treatment is the first-line treatment for PDA for most patients and is much less expensive than surgery. Id. ¶¶ 11–12, 2010 U.S. Dist. LEXIS 95365, at *5–6.
⁴ Id. ¶ 43, 2010 U.S. Dist. LEXIS 95365, at *17. The district court observed that “[c]onsistent with its practice of focusing on its patent-protected drugs, Merck had not changed what was a below-profit-maximizing price of Indocin IV for many years before Lundbeck’s acquisition.” Id. Introduction, 2010 U.S. Dist. LEXIS 95365, at *1–2.
list price of Indocin to $1500 for a three-vial course of treatment. A few months after its acquisition of Indocin, Lundbeck acquired the rights to NeoProfen, the only other drug approved to treat PDA.

In December 2008, the Commission voted unanimously to challenge Lundbeck’s acquisition of NeoProfen as a merger to monopoly. Following a bench trial, the District Court for the District of Minnesota denied the FTC's request for relief, finding that the agency had failed to prove that Indocin and NeoProfen were in the same relevant market, and the Eighth Circuit affirmed.

At the time the FTC challenged the NeoProfen transaction, Commissioners Rosch and Leibowitz issued concurring statements indicating that they would have also voted to challenge the acquisition of Indocin, notwithstanding the lack of a horizontal or vertical relationship between Lundbeck and Merck. The Rosch statement explained that there was reason to believe that the acquisition of Indocin violated Section 7 because it eliminated certain reputational constraints specific to Merck, allowing Lundbeck to raise Indocin's price. In particular, the statement noted that Merck had monopoly power over Indocin but did not exercise it because of concerns that increasing prices on a product to treat a vulnerable population could damage the company’s reputation and sales of other products. Lundbeck, which lacked a large product portfolio, did not face these constraints and was therefore able to exercise monopoly power after the acquisition.

Reaction to the Rosch statement from the private bar was swift and critical, asserting that it flew in the face of modern economics, was inconsistent with the language of Section 7, and lacked useful limiting principles. Former Commissioner Tom Leary, in contrast, argued that the approach described in the concurring statement was consistent with modern antitrust economics, which “focuses to a large extent on changed management incentives . . . to predict the likelihood that prices will increase post-merger.”

Merck’s reluctance to exploit its pricing power was, in his view, “an economic constraint, pure and simple.” He also argued that Merck’s right to price at a monopoly level should not immunize Lundbeck’s acquisition and subsequent monopoly pricing because Section 7 is concerned with changes resulting from a change in ownership.

Since the Lundbeck case, FTC staff has investigated at least one other transaction—also in the pharmaceutical industry—under the principles described in the Rosch statement. In that case, staff concluded that the transaction did not affect the incentives to market the product in a way that would adversely affect consumers and closed that aspect of its investigation.

---

5 A few weeks after the acquisition, Lundbeck increased the wholesale list price of Indocin by 40 percent to $108.88 for a three-vial course of treatment. In January 2000, Lundbeck raised Indocin’s price again, this time to $1,500 for a three-vial course of treatment. Lundbeck delayed implementation of the full price increase for several months due to concerns that Abbott Laboratories would demand a higher price for the rights to NeoProfen if it learned of Lundbeck’s pricing strategy and because of Merck’s sensitivity about price increases while Indocin was still being sold under Merck’s trade dress. Id. ¶¶ 53–58, 2010 U.S. Dist. LEXIS 95365, at *20–22. 6 According to the district court, the NeoProfen acquisition was not the cause of the Indocin price increase. “Lundbeck would have raised the price of Indocin IV to $1500 per three-vial course of treatment even if it had not acquired rights to NeoProfen from Abbott Laboratories.” Id. ¶ 58, 2010 U.S. Dist. LEXIS 95365, at *22; see also id. ¶ 45, 2010 U.S. Dist. LEXIS 95365, at *18 (“After learning of NeoProfen, Lundbeck did not change its plan to increase Indocin IV’s price.”).


9 Thomas B. Leary, Antitrust Scrutiny of a Pure Conglomerate Merger: The Ovation Case, ANTITRUST, Summer 2009, at 74, 76.

10 Id. at 77.
Implications of Conglomerate Merger Enforcement Under the Lundbeck-Merck Standards

Notwithstanding the criticism that challenging the Indocin acquisition under the standards described in the Rosch statement would lead to an unbounded approach to merger enforcement, the Rosch statement (supported by now-Chairman Leibowitz) identified three important limiting principles to challenging conglomerate transactions.11

First, there must be a high degree of confidence in the transaction’s competitive effects. That requirement was satisfied in the Lundbeck-Merck transaction, which had closed prior to the FTC’s investigation. The agency was able to observe two price increases that occurred shortly after the transaction, leading to an aggregate 1300 percent price increase. The agency also was able to observe that the acquisition resulted in “negative efficiencies”: Lundbeck encountered significant manufacturing difficulties with respect to Indocin and within a few years no longer had any of that product to distribute.12

The second limiting principle is that the seller must have monopoly power (or near-monopoly power) in a relevant market but not exercise that power. Merck had monopoly power, given that it was the only company to offer a pharmaceutical treatment for PDA. It did not exercise that power due to a reputational constraint.

The third limiting principle is that the transaction must permit the buyer to exercise the seller’s monopoly power. In other words, the buyer must not be subject to the same reputational or other constraints as the seller. As noted in the separate statement, it was not enough that Lundbeck had increased prices, but rather that Lundbeck had raised prices to a monopoly level.

The proposed approach to conglomerate merger enforcement described in the Rosch statement permits all of the usual defenses to a facially problematic transaction, including entry and repositioning, efficiencies, and failing firm. The preferred remedy for a violation would be divestiture of the assets to a party that would operate them in a manner similar to the seller. The proposed approach, however, departs from the European model of conglomerate merger enforcement, which focuses on tying and bundling concerns.13 Rather, the Rosch statement raises a concern analogous to horizontal mergers: the exercise of market power.

If the principles described in the Rosch statement were adopted by the Commission, the added counseling burden on practitioners should be modest. For one thing, it seems unlikely that many markets would satisfy the second limiting principle, which requires not only the possession of monopoly power (or near monopoly power) but also pricing well below the monopoly profit-maximizing level. In addition, the key evidence on which enforcers would rely in unconsummated transactions would be the acquiring company’s pre-merger planning documents.14 Outside counsel should already be reviewing those documents in HSR-reportable transactions as part of the 4c and 4d document collection. Only if the planning documents disclosed an intent to raise

---

11 Rosch Statement, supra note 8, at 2–3; see also Interview with J. Thomas Rosch, Commissioner, Federal Trade Commission, ANTITRUST, Spring 2009, at 32, 40 (describing limiting principles for challenge to Indocin acquisition).


14 Likewise, consummated transactions that result in a sizeable price increase (or other action that injures consumers) within a short period of time after closing may warrant scrutiny.
prices substantially (or otherwise take action that will injure consumers) would an unconsummated conglomerate transaction likely warrant scrutiny.\(^{15}\)

**Potential Vertical Mergers: The Google/ITA Case**

In April 2011, the DOJ issued a complaint and simultaneously entered into a settlement agreement resolving its concerns with Google Inc.’s acquisition of ITA Software Inc.\(^{16}\) The DOJ said that the acquisition, as originally proposed, would have substantially lessened competition for comparative flight search websites in the United States, resulting in less innovation and reduced choice for consumers.\(^{17}\)

According to the DOJ, prior to the acquisition, ITA was the leading provider of airfare pricing and shopping systems (P&S systems), which provide flight information to Internet travel sites, also known as online travel intermediaries (OTI) or comparative flight search services. Internet travel sites are divided into online travel agencies (OTA), which provide flight search and booking services, and so-called metas, which enable consumers to search for flights but do not offer booking services.\(^{18}\)

The DOJ alleged that P&S systems and comparative flight search services (travel websites) were each relevant product markets. Prior to the transaction, ITA offered a P&S system but not a travel website. Google offered neither a P&S system nor a travel website but planned to develop a travel website in the future, thus making its acquisition a potential vertical transaction.\(^{19}\) Google had initially sought a license from ITA, but those discussions led to an acquisition after Google determined that it needed a “deep integration” with ITA in order for its new travel website to offer a robust feature set.\(^{20}\) Google’s new product would offer flight search capabilities but not booking, thus falling into the meta category of travel websites.\(^{21}\)

The DOJ’s complaint alleged that the merger would give “Google the means and incentive to use its ownership of [ITA] to foreclose or disadvantage its prospective flight search rivals by degrading access to [ITA’s system], or denying them access to [ITA’s system] altogether.”\(^{22}\)

---

\(^{15}\) A more in-depth review would include confirming the acquiring company’s post-merger plans and better understanding the buyer and seller’s (very different) competitive strategies.


\(^{17}\) Unless otherwise indicated, background regarding the Google/ITA case is drawn from the DOJ’s complaint and competitive impact statement. See Google/ITA Competitive Impact Statement, supra note 16, at 2; Google/ITA Complaint, supra note 16, ¶¶ 29, 39.

\(^{18}\) OTAs generate revenue primarily through booking fees and to a lesser extent from advertising. Metas generate revenue through advertising sales and referral fees from the airlines and OTAs. See Google/ITA Complaint, supra note 16, ¶¶ 13–14.

\(^{19}\) The DOJ did not allege that Google was a participant in the comparative flight search services market pre-transaction. While Google’s search engine offered some flight search capabilities prior to the transaction, it lacked the functionality of dedicated travel websites. The DOJ also noted that Google had considered developing its own P&S system but declined to proceed given the cost and time involved. See id. ¶ 42.


\(^{21}\) Google/ITA Competitive Impact Statement, supra note 16, at 9 (“Google intends to launch a new service after completing the transaction that will compete directly with other OTIs by providing flight search results.”); Google, Facts About Google’s Acquisition of ITA Software, [http://www.google.com/press/ita/comp.html](http://www.google.com/press/ita/comp.html) (2011) (“Google has no plans to sell airline tickets directly to customers, but instead will drive potential customers to airline and online travel agency websites.”).

\(^{22}\) Google/ITA Complaint, supra note 16, ¶ 5.
According to the complaint, Google would have an incentive to injure other travel websites because the gain in profits from its new travel service would outweigh any lost profits from reduced licensing revenues from the ITA P&S system. The agency also noted a concern about the loss of ITA’s “corporate independence,” which had given ITA an incentive to treat its customers on nondiscriminatory terms.

**Vertical Merger Enforcement Under the Google/ITA Standards**

Google/ITA appears to be the first challenge to a potential vertical transaction, yet the complaint and competitive impact statement offer little guidance as to which transactions may be subject to an enforcement action under a potential vertical theory in the future. In particular, the DOJ did not describe the scale, likelihood, or timing of entry by a merging party necessary to trigger concerns. The case does, however, signal a possible expansion of the grounds on which the agency will challenge a vertical merger based on input foreclosure concerns.

The likelihood, timing, and scale of a party’s entry are important issues in mergers that raise potential competition concerns. The Agencies have described their views on these issues in the context of horizontal mergers in the 2010 Merger Guidelines, but have not indicated whether the same standards apply to potential vertical transactions. The DOJ, however, did not take the opportunity to address this issue in its Google-ITA court filings, press release, or other public materials discussing its enforcement action. Indeed, those materials describe the transaction as an ordinary vertical merger without highlighting its potential competition aspect.

But even putting aside its potential competition facet, the case also appears to have significant implications for vertical merger enforcement generally. The case indicates a possible expansion of the grounds on which the Antitrust Division will challenge mergers based on an input foreclosure concern. According to the DOJ’s own complaint, many—and perhaps most—of the factors that ordinarily signal a risk of foreclosure were not present.

First, both the upstream and downstream markets were not concentrated. The complaint alleged that there were a total of five “significant competitors” in the P&S systems market. The complaint also identified five current competitors in the comparative flight search services market; although, there were undoubtedly many others. Ordinarily, the existence of unconcentrated

23 Google/ITA Competitive Impact Statement, supra note 16, at 8–9 (“From a competition perspective, ITA’s corporate independence from any particular OTI ensures that all of its customers receive the benefits of ITA’s cutting edge innovation . . . . This will not be the case once Google purchases ITA.”).

24 See 5 PHILLIP W. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1133b (3d ed. Supp. 2011) (“[N]o case has yet presented the problem of potential vertical relationships.”).


26 As the DOJ explained in connection with another recent merger investigation:

>[A] merger may give the vertically integrated entity the ability to establish or protect market power in a downstream market by denying or raising the price of an input to downstream rivals that a stand-alone upstream firm otherwise would sell to those downstream firms. The merged firm may find it profitable to forego the benefits of dealing with its rivals in order to hobble them as competitors to its own downstream operations.


27 Google/ITA Complaint, supra note 16, ¶ 24 (identifying ITA, Travelport, Sabre, Amadeus, and Expedia).
upstream and downstream markets would be compelling evidence that foreclosure was unlikely.28

Second, the nature of Google’s future travel service would give the company a significant incentive not to foreclose other travel websites. Google’s new travel service would rely to some extent on other travel websites. This is because Google’s travel service lacked a booking function and would drive potential customers to other travel websites (specifically, OTAs) and airline websites. Thus, if Google were to injure other travel websites, it would have also diminished the functionality—and presumably profitability—of its own product.

Third, vertical integration resulting from the Google/ITA transaction appears to have offered the prospect of Google developing a superior travel website. Such a development, even if it had harmed competitors, would have benefited consumers. Given that loss of innovation was one of the DOJ’s principal concerns, it would be reasonable to expect that the DOJ’s pleadings would have addressed this topic.29

Fourth, there were a number of uncertainties regarding Google’s yet-to-be-introduced travel website. While it was clear that Google intended to develop a travel website, the timing and nature of Google’s entry were not clear (at least based on the public record). These were important considerations. The more time required for Google to enter into the travel website business, for example, the more competitive the other P&S systems were likely to be and the fewer incentives Google would have to foreclose its rivals.30

Despite these factors, the Antitrust Division concluded that foreclosure was likely and would be profitable. In reaching this conclusion, the DOJ put significant weight on its finding that ITA was an important and growing competitor in the P&S systems market. The complaint alleged that “[n]o other firm offers a P&S system that is comparable” to the one offered by ITA and that other P&S systems were not “adequate substitutes”—allegations that seemed to suggest that ITA’s system was in a relevant market of its own.31 The DOJ also pointed to ITA’s success in winning customer competitions, its technical advantages over its rivals, and its singular focus on its P&S system.

In sum, the DOJ’s challenge to Google’s acquisition of ITA appears to break new ground in two respects. First, the agency may challenge a transaction when one of the parties is a likely entrant into a market in which the other merger party buys or sells. Second, the agency may conclude that

28 See 4A AREEDA & HOVENKAMP, supra note 24, ¶ 1032a (unless “both markets are highly concentrated,” “a vertical merger cannot cause significant foreclosure of existing firms”); Christine A. Varney, Commissioner, Fed. Trade Comm’n, Remarks at the PLI 36th Annual Antitrust Institute, Vertical Merger Enforcement Challenges at the FTC (July 17, 1995), available at http://www.ftc.gov/speeches/varney/varta.shtml (in an input foreclosure case, “the greater the market share of the companies that are vertically integrating, the greater the probability that downstream customers will be injured”). See also Competitive Impact Statement at 4, United States v. Monsanto Co., No. 1:07-cv-00992 (D.D.C. May 31, 2007), available at http://www.usdoj.gov/atr/cases/f223600/223682.pdf (challenging vertical merger where upstream supplier Monsanto had 96% share and downstream supplier DPL had 79% and 87% share of the relevant markets).

If Google cut off access or raised the fees to ITA’s service, competing travel websites would have been able to turn to several other P&S systems, which would result in a significant loss of revenue for Google at the upstream level with unclear benefits at the downstream level (because Google’s downstream business did not yet exist and its success was uncertain).


30 Google/ITA Complaint, supra note 16, ¶ 37 (alleging that ITA’s rivals were improving their systems). In addition, there does not appear to be any claim that the transaction would have foreclosed any upstream competitors or facilitated collusion. Cf. Comcast Competitive Impact Statement, supra note 26, at 20–27 (challenging vertical transaction that would have impeded nascent, innovative competitors from obtaining an important input); Competitive Impact Statement, United States v. Premdor Inc., No. 1:01CV01696 (D.D.C. Aug. 3, 2001), available at http://www.usdoj.gov/atr/cases/f9000/9017.pdf (challenging vertical transaction that would have facilitated collusion through elimination of a disruptive seller).

31 Google/ITA Complaint, supra note 16, ¶¶ 27, 41, Header III.D.2.
a vertical or potential vertical transaction presents a risk of input foreclosure if the merging party's upstream product is superior to that of its rivals.\textsuperscript{32}

**Conclusion**

Antitrust counsel are likely to be more comfortable with challenges to potential vertical mergers than to conglomerate mergers. Nevertheless, application of the limiting principles in the Rosch statement should mean that only a fraction of conglomerate transactions would be potentially at risk of being challenged (assuming either agency were to adopt these standards). In contrast, under the Google/ITA standards, it is unclear how many potential vertical transactions are at risk of an enforcement action or what standards the agency will use to evaluate those transactions. In addition, the Google/ITA case seems to indicate that a concentrated market is no longer a prerequisite to input foreclosure concerns in vertical transactions reviewed by the DOJ. Practitioners would undoubtedly benefit from further clarification of the standards under which the DOJ will review these types of transactions.\textsuperscript{33}

The Commission has not, to our knowledge, indicated whether it would be willing to challenge a potential vertical transaction and, if it did, what standards it would apply. From our perspective, potential vertical transactions should be subject to the Clayton Act, just as transactions raising potential horizontal competition concerns are. The standards for evaluating potential vertical transactions should be similar to those for ordinary vertical transactions, but take into account the likelihood, timing, and scale of future entry by the merging party that is the potential entrant. Whether the vertical integration is dependent on the transaction is also an important consideration. The 2010 Merger Guidelines, although nominally relevant only to horizontal transactions, may offer some useful guidance as to the treatment of potential competition in a vertical context. Under this approach, challenges to potential vertical mergers should be rare but certainly not non-existent.●

\textsuperscript{32} Presumably, the same would be true of a superior distributor in a customer foreclosure case.

\textsuperscript{33} We do not take issue with any of the DOJ’s allegations or its decision to seek a remedy but suggest that additional explanation for the agency’s decision would have been helpful.
Equity, Antitrust, and the Reemergence of the Patent Unenforceability Remedy

Jorge L. Contreras

The conventional legal analysis of technical standard setting derives primarily from antitrust law. But antitrust remedies, taken alone, may not be broad enough to address recent abuses of the standardization process. The principal example of this shortcoming is the well-known case of Rambus, Inc., which, over the course of several years, was alleged to have concealed relevant patent applications from a standards organization in which it participated and then successfully sued the entire DRAM industry for royalties after the standard was “locked-in.” Remarkably, Rambus prevailed in its litigation campaign despite aggressive enforcement efforts by the Federal Trade Commission. 1 Rambus’s success stemmed, in part, from inherent limitations of the antitrust theories asserted against it to reach its opportunistic behavior.

Another tool for redressing deceptive conduct in the context of standard setting is the equitable remedy of patent unenforceability, the use of which was recently affirmed by the Federal Circuit in Qualcomm Inc. v. Broadcom Corp. 2 The Qualcomm decision marks an important advance in the law surrounding standards-based patent hold-up by making available a remedy that is not constrained by the narrow requirements of antitrust law and which is effective toward both defendants in private litigation and the broader community of standards implementers. Though not yet universally acknowledged as such, the remedy of patent unenforceability, when coupled with affirmative theories of liability, may offer the most effective tool available to address patent hold-up in standard setting, both for private litigants and, potentially, for public enforcement agencies.

Standards Hold-Up Litigation

The narrative of patent “hold-up” in technical standard setting is well known: an opportunistic participant in a standards-development organization (SDO), contrary to express rules or common expectations, conceals the fact that it holds a patent or patent application claiming one or more aspects of a standard under development. Then, after the standard has been approved and broadly adopted (“locked-in”), the patent holder emerges to seek royalties from implementers of the standard. 3 Robert Merges and Jeffrey Kuhn colorfully refer to this pattern as “snake-in-the-

---

2 548 F.3d 1004 (Fed. Cir. 2008).
grass.”\(^4\) I will refer to it as “standards hold-up.”\(^5\) By whatever name, many commentators agree that such conduct is detrimental both to the standardization process and to the efficient operation of the networked markets that depend upon it. Thus, before a standard is locked-in, the industry may choose among various technical alternatives: some may be covered by patents and others may not. Patented technology must compete with unpatented technology on the basis of factors including price and technical quality. After lock-in, however, the cost of switching to a new standard increases dramatically, and patent holders who emerge without warning have significant, and arguably improper, leverage to charge rents to implementers of the standard.

Standards hold-up cases have been litigated in two distinct but related modes: private litigation and public enforcement. In the first mode (private litigation), a patent holder sues one or more implementers of a standard for patent infringement and the defendant raises various defenses and counterclaims seeking to render the asserted patents unenforceable against it. Cases in this mode include *Wang v. Mitsubishi*,\(^6\) *Stamblerv. Diebold Inc.*,\(^7\) *Rambus v. Infineon*,\(^8\) and *Qualcomm v. Broadcom*. In the second mode (public enforcement litigation), an enforcement agency, typically the U.S. Federal Trade Commission, initiates an independent action against the patent holder after it has either sued or threatened implementers under the relevant patents. These cases include *Dell Computer Corp.*,\(^9\) *N-Data*,\(^10\) and *Rambus Inc. v. FTC*,\(^11\) and have generally been brought on antitrust grounds, whether under Section 2 of the Sherman Act or Section 5 of the FTC Act. In both litigation modes, the patent holder’s ability to enforce the asserted patents is challenged on the basis of its allegedly deceptive conduct toward the SDO and its other participants.

### Equitable Defenses in Standards Hold-Up Litigation

Remedies in equity trace their origins to 14th century England, where ecclesiastical courts of chancery arose as alternatives to the law courts.\(^12\) Due to their religious origins, the courts of chancery purported to act on the basis of higher moral principles and dealt in flexible remedies, such as injunctive relief and specific performance.\(^13\) As explained by the New York Court of Appeals in the canonical case of *Riggs v. Palmer*, equitable principles ensure that “[n]o one shall be permitted to profit by his own fraud, or to take advantage of his own wrong, or to found any claim upon his own iniquity, or to acquire property by his own crime.”\(^14\) And though the courts of law and equity merged in the United States more than a century ago, equitable principles remain


\(^5\) I consider standards hold-up to occur only when the patent holder is (or was) a member of or participant in the relevant SDO. In this respect I part company with Merges and Kuhn (see discussion infra note 17).


\(^7\) 1988 WL 95479 (E.D.N.Y. 1988).

\(^8\) Rambus Inc. v. Infineon Techs. Ag, 318 F.3d 1081 (Fed. Cir. 2003).


\(^11\) 522 F.3d 456 (D.C. Cir. 2008).


\(^14\) 22 N.E. 188, 190 (N.Y. 1889) (in an inheritance case in which a young man poisoned his own grandfather to prevent him from amending his will to disinherit the grandson from his share of a large estate, the court declared the bequest to the grandson to be ineffectual in view of his crime).
alive and well. As observed by Henry Smith, equity today serves as a general “private law solution to opportunism.”\(^{15}\)

When a patent holder violates the express or implicit patent disclosure requirements of an SDO and subsequently seeks to enforce patents against implementers of the adopted standard, the infringing defendant may raise one or more equitable defenses. These defenses include fraud, estoppel, laches, waiver, unclean hands, and implied license. For example, in \textit{Stambler v. Diebold Inc.}, the patent holder Diebold was found to have known for ten years that a proposed standard concerning the activation of automated teller machines infringed its patent, yet remained silent “while an entire industry adopted the proposed standard.”\(^{16}\) The court concluded that Diebold’s silence was “intentionally misleading” and granted summary judgment for the defendant based on the equitable doctrines of laches and estoppel.\(^{17}\) In \textit{Qualcomm v. Broadcom}, the Federal Circuit held that Qualcomm’s deceptive conduct before an SDO supported the application of the equitable defense of waiver, relieving the defendant Broadcom of any liability for infringement, and also spoke favorably about the doctrine of equitable estoppel. And in \textit{Wang v. Mitsubishi}, the Federal Circuit ruled in favor of the defendant on grounds of implied license after the patent holder made assurances to an SDO regarding the absence of patents covering a standard.

\textbf{Agency Enforcement and the Failure of Antitrust Remedies to Address Standards Hold-Up}

Public actions to enforce the antitrust laws may be brought by the Department of Justice, the FTC, and state attorneys general. Recently, the FTC has been the most active in seeking to curb deceptive conduct and standards hold-up by means of antitrust enforcement. In \textit{Dell Computer}, the FTC alleged that Dell’s deception of the Video Electronics Standards Association (VESA) constituted unfair competition affecting commerce and thus violated Section 5 of the FTC Act. In the resulting Consent Agreement, Dell was prohibited from enforcing the asserted patents against any implementer of VESA’s VL-bus standard. The breadth of this remedy flows from the FTC’s broad authority to redress market harm under Section 5.\(^{18}\)

The \textit{Dell} decision shaped the debate regarding standards hold-up for more than a decade and may have emboldened the agency to exercise its Section 5 authority to police the standard-setting world more broadly. It did so most notably to redress the now-notorious conduct of Rambus both during and after its participation in the Joint Electron Device Engineering Council (JEDEC). As has been discussed at length in numerous books and articles, Rambus allegedly deceived JEDEC participants regarding the patenting of standards on semiconductor DRAM technology. When Rambus began to seek patent royalties from implementers of these standards, the FTC brought an action charging Rambus with violation of Section 5(b) of the FTC Act and Section 2 of

\(^{15}\) Henry E. Smith, \textit{An Economic Analysis of Law Versus Equity} 8, 17–18 (Working Paper, Oct. 22, 2010), available at http://extranet.isnie.org/uploads/isnie2010/smith.pdf (defining “opportunism” as “behavior that is technically legal but done with a view to securing unintended benefits from the system, and these benefits are usually smaller than the costs they impose on others”).

\(^{16}\) 1988 WL 95479 at 6.

\(^{17}\) Merges & Kuhn, supra note 4, have recently proposed that the equitable estoppel defense be broadened in the context of standards hold-up to become a new defense that they term “standards estoppel.” While their proposal has significant merit, I disagree with the proposed expansion of the estoppel defense to patents held by third parties who were not part of the standards-development process. Such a proposal would perversely enable SDOs to appropriate non-participant patented technology without the patent holder’s acquiescence and thus unduly tilt the playing field in favor of standards adopters.

the Sherman Act. In 2006 the Commission ruled against Rambus under both theories of liability and ordered, among other things, that Rambus license its patents to all implementers of the standards at specified royalty rates. In 2008, however, the D.C. Circuit reversed the Commission’s ruling, holding that it failed to establish that Rambus’s deceptive conduct harmed competition for purposes of the Sherman Act (i.e., that the relevant standards would not have been adopted but for Rambus’s conduct). The court also cast doubt on the Commission’s Section 5 theory, questioning its generous reading of the vague JEDEC intellectual property policy and its conclusions regarding common practices and expectations within the standard-setting community.

Though the validity of the D.C. Circuit’s reasoning in Rambus has been widely debated, a number of commentators argue that antitrust law has proven to be a suboptimal theory for addressing issues of standards hold-up. The weaknesses of antitrust law arise both when it is used as a theory of liability and also when it is used to fashion remedies (two distinct but inextricably related sides of the antitrust coin). Antitrust suffers as a theory of liability because, as the D.C. Circuit reasoned, a showing of antitrust harm is necessarily tied to market-wide effects on competition, rather than effects on individual competitors. Absent proof of market harm, antitrust injury cannot exist. Indeed, the dissent in Dell made this point in 1995, taking the view that the allegations of the Commission’s complaint failed to demonstrate that Dell obtained market power as a result of its alleged misstatements to the SDO.

Antitrust law also falls short in enabling appropriate remedies for standards hold-up. Thus, while the FTC in Dell fashioned a sweeping order under Section 5 that prohibited Dell from enforcing its patents against any implementer of the VL-bus standard, the Commission’s order eleven years later in Rambus exhibits a significant retreat from this early expansive posture. Perhaps influenced by public commentary and the briefs of the parties or a more refined understanding and appreciation of the market harm arising from such conduct, the FTC in Rambus required that Rambus license its patents to any implementer of the JEDEC standard but also permitted Rambus to collect a specified royalty with respect to this license (a royalty that was lower, of course, than


Interestingly, however, while the Rambus case was on appeal to the D.C. Circuit, the Third Circuit held that Qualcomm’s intentional deception of an SDO could give rise to a claim of monopolization under the Sherman Act. Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 314 (3d Cir. 2007). This decision is distinct from the Federal Circuit decision in Broadcom v. Qualcomm discussed infra notes 29–31 and accompanying text.

22 As noted by the FTC in the Rambus Remedy Opinion, supra note 19, at 6, “The Commission enjoys wide latitude for judgment in fashioning a remedial order, subject to the constraint that the requirements of the order bear a reasonable relationship to the unlawful practices that the Commission has found.”
Rambus requested, but significant nonetheless). The rationale for this seeming generosity toward a company that the Commission found to have engaged in a “deliberate course of deceptive conduct” can be explained by the Commission’s need to fashion a remedy calculated to address perceived market harm. Indeed, the Commission noted that imposing a requirement of royalty-free licensing on Rambus would be justified only to the extent “necessary to restore the competitive conditions that would have prevailed absent Rambus’s misconduct.” Instead, the Commission proceeded to construct an elaborate “reasonable royalty” analysis based on a series of assumptions about how the potential DRAM market would have looked “but for” Rambus’s deceptive conduct, and to set royalty rates for Rambus patents accordingly. While the FTC’s remedy opinion was rendered moot by the D.C. Circuit’s reversal of its liability holding, the fact that the FTC’s analysis would have resulted in the award of ongoing royalties to Rambus despite its deceptive conduct suggests that antitrust remedies may not address all of the harms that are likely to arise in the context of standards hold-up and that perhaps other remedial regimes are more likely both to penalize those engaging in standards hold-up and to deter future instances of hold-up behavior.

The Equitable Remedy of Unenforceability

An alternative to the antitrust theories advanced in Rambus is the equitable remedy of patent unenforceability, which offers the flexibility to address both the market-based harms that antitrust remedies seek to address, as well as a broader range of equitable harms. The unenforceability remedy has historically been applied in cases in which a patentee has committed misconduct before the Patent and Trademark Office (PTO) or other substantial irregularities in prosecuting a patent. The remedy renders a patent unenforceable not only toward a particular infringer but toward the entire world, on the theory that the patent holder’s inequitable conduct taints the property right ab initio. Accordingly, this drastic and far-reaching remedy has been called the “atomic bomb” of patent law.

In Broadcom v. Qualcomm, the district court for the first time applied the remedy of unenforceability to patents that Qualcomm failed to disclose to an SDO, analogizing such conduct, in its effect and character, to misconduct before the PTO. The Federal Circuit approved of the dis-

---


24 Rambus Remedy Opinion, supra note 19, at 10.

25 An analogy can be drawn to the criminal law of theft, which punishes the thief in addition to providing restitution to the victim. Under the antitrust theory applied to standards hold-up, the offender might be liable for restitution but not otherwise penalized for the wrong committed.

26 See, e.g., Therasense, Inc. v. Beckton, Dickinson & Co., 2011 WL 2028255, at *16 (Fed. Cir. May 25, 2011); Symbol Tech., Inc. v. Lemelson Med., 277 F.3d 1361, 1368 (Fed. Cir. 2002) (“a patent may be rendered unenforceable if it was obtained after an unreasonable and unexplained delay in prosecution”; AGFA Corp. v. Creo Prods. Inc., 451 F.3d 1366, 1379 (Fed. Cir. 2006) (unenforceability due to inequitable conduct before the PTO).

27 This globally applicable remedy should be distinguished from the more common in personam remedy of patent unenforceability, which is utilized to redress, among other things, patent misuse. See U.S. Philips Corp. v. ITC, 424 F.3d 1179, 1197–98 (Fed. Cir. 2005).

28 See Aptix Corp. v. Quickturn Design Sys. Inc., 269 F.3d 1369, 1376 (Fed. Cir. 2001); Christina Bohannan & Herbert Hovenkamp, IP and Antitrust: Reformation and Harm, 51 B.C. L. Rev. 905, 931 (2010) (“[t]he remedy of unenforceability, which the patent system itself administers against falsified applications, is designed to protect the integrity of the patent issuance process”).


trict court’s reasoning, recognizing its authority to “give a fair, just, and equitable response reflective of the offending conduct.”

And while the Federal Circuit narrowed the scope of the district court’s remedy so as to render Qualcomm’s patents unenforceable only with respect to products complying with the relevant standard, it retained the district court’s broad formulation that extended this remedy to all third parties, rather than limiting its effect to the defendant Broadcom. As a result, the equitable remedy in *Broadcom v. Qualcomm* is just as far-reaching as the FTC’s remedy in *Dell*, but is used following the successful assertion of an equitable affirmative defense (waiver), rather than an affirmative antitrust theory of liability.

**Implications for Agency Litigation**

As demonstrated by *Broadcom v. Qualcomm*, the remedy of patent unenforceability may be applied in private patent litigation following standards hold-up. This remedy may also be available to federal enforcement agencies that wish to sanction hold-up behavior without limiting remedies to redressing a specific antitrust injury. Armed with the equitable remedy of unenforceability, these agencies may be empowered to address instances of actual and threatened standards hold-up through the assertion of affirmative theories of liability, such as fraud and equitable estoppel.

Standardization activity in the United States has typically been reviewed by the DOJ and the FTC. The DOJ has a broad civil jurisdiction that extends to patent matters generally, whether or not associated with antitrust claims. While the DOJ has historically addressed standardization issues through its Antitrust Division, it would not be inappropriate for the Antitrust Division to cooperate with other units of the DOJ to seek remedies extending beyond traditional antitrust remedies, such as patent unenforceability, to redress standards hold-up conduct.

The scope of the FTC’s authority is prescribed by the FTC Act as preventing the use of “unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.” While in practice most applications of the FTC’s enforcement authority have sought to redress violations of the Sherman Act and other antitrust laws, the FTC’s authority is not limited to these claims. The Supreme Court has interpreted the FTC’s authority broadly to encompass any “unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws.” The Court again recognized the FTC’s broad scope of enforcement authority in *FTC v. Indiana Federation of Dentists*, in which it explained that the FTC Act’s standard of “unfairness” encompasses not only violations of the Sherman Act and other

---

31 Qualcomm Corp. v. Broadcom Inc., 548 F.3d 1004, 1026 (Fed. Cir. 2008).
32 Qualcomm argued that it was improper for the district court to impose a remedy of unenforceability in response to the successful assertion of an affirmative defense, and that the only appropriate remedy was a finding of noninfringement. The Federal Circuit disagreed and affirmed the reasoning of the district court. Id. at 1025.
33 In this sense, estoppel may be asserted as an affirmative cause of action seeking to prevent ongoing or threatened hold-up, rather than as an affirmative defense.
34 28 C.F.R. § 0.45(f) (2008) (covering “patent and allied cases and other patent matters [including] civil patent-fraud cases”).
antitrust laws, but also “practices that . . . are against public policy for other reasons.” Thus, while the FTC has traditionally limited its analysis of standard-setting behavior to violations of the Sherman Act, this limitation is not necessarily mandated by the scope of the Commission’s statutory authority.

The FTC has recently evidenced a willingness to address intellectual property issues beyond the strict boundaries of the Sherman Act in its 2003 report, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy, and its 2011 report, The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition. In this comprehensive report, the Commission critiques several perceived weaknesses of current patent law that may broadly impact markets and competition and recommends thirty-five specific changes to the law governing both patent litigation and prosecution. A number of these recommendations and the accompanying analysis are not based directly on antitrust law, but on general principles of patent law and its effect on markets.

Thus, while the federal enforcement agencies have traditionally relied on antitrust remedies to address perceived instances of standards abuse and hold-up, there is no reason to restrict the enforcement agencies to the limited tools of antitrust law when alternative approaches, such as the equitable remedy of patent unenforceability, may be better suited to addressing deception and harm in the standard-setting context.

Conclusion
It has been widely suggested that opportunistic and deceptive behavior by participants in the standard-setting process disrupts that process and introduces inefficiencies that are difficult to cure using traditional antitrust remedies. Equity presents a powerful and flexible mechanism that is designed to deter private party opportunism. As such, equity is an intuitively appealing theory with which to redress standards hold-up, the quintessence of opportunism. As a theory of liability, equity does not depend on the acquisition of market power or market effects to assign liability, as does antitrust law. And while antitrust remedies, as demonstrated by the FTC’s short-lived remedial order in Rambus, seek to correct dislocations to the market that may have been caused by deceptive conduct and the improper exercise of market power, equity seeks to prevent the wrongdoer from profiting from his own wrongdoing. In this respect, the deterrent value of equitable remedies is likely to be greater than that of market-based antitrust remedies.


41 2011 FTC Report, supra note 3.


43 See supra note 15 and accompanying text.

44 The appeal of equity as a theory of liability is discussed by Merges & Kuhn, supra note 4 and accompanying text.

45 See Head v. Porter, 70 F. 498, 501 (D.Mass. 1895) (“[I]t would be inequitable that he should make a profit out of his own wrong.”).
One can only speculate whether the Rambus saga might have ended differently (and less favorably for Rambus) had a more liberal application of equitable remedies been applied. As to the future, one hopes that the availability of the patent unenforceability remedy will strengthen deterrence of opportunistic and inefficient standards hold-up behavior.
The Potential Impact of Adding a Whistleblower Rewards Provision to ACPERA

Kevin R. Sullivan, Kate Ball and Sarah Klebolt

The U.S. Department of Justice Antitrust Division has called its Corporate Leniency Program (Leniency Program) its “most effective investigative tool,” providing government prosecutors “unparalleled information from cartel insiders about the origins and inter-workings of secretive cartels.” Under the Leniency Program, a successful leniency applicant can avoid criminal prosecution, criminal fines, and prison sentences for its executives.

Despite these benefits, reporting companies still faced the threat of civil claims potentially exposing them to enormous damage awards because of exposure to treble damages and joint and several liability for the conduct of their co-conspirators. To address this strong disincentive to self-report anticompetitive conduct, Congress enacted the Antitrust Criminal Penalty Enhancement Act (ACPERA) in 2004 to further enhance the Leniency Program by eliminating both treble damages and joint and several liability for the leniency applicant if it provides “satisfactory cooperation” to civil claimants. On June 9, 2010, President Obama signed legislation extending ACPERA for another ten years. While this Extension Act modified some provisions of the original Act, Congress delayed acting on two proposed additions to ACPERA—a whistleblower rewards provision and a whistleblower protection provision. Instead, Congress commissioned the Government Accountability Office (GAO) to study and report back on the appropriateness of adding these two provisions.

On July 25, 2011, the GAO issued its report finding that there was no consensus among selected DOJ Antitrust officials and “key stakeholders” regarding the addition of a whistleblower


2 Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, §213(b), 118 Stat. 665, 666 (codified as amended at 15 U.S.C. § 1 note). Although the specifics of what constitutes “satisfactory cooperation” are unclear, the statute does state that cooperation includes: (1) “providing a full account to the claimant of all facts known to the applicant . . . that are potentially relevant to the civil action; (2) furnishing all documents or other items potentially relevant to the civil action that are in the possession, custody or control of the applicant;” and (3) “using its best efforts to secure and facilitate . . . cooperation.”


4 Id.

5 The GAO “interviewed DOJ Antitrust Division officials and reviewed speeches by division officials . . . ; academic studies; and articles prepared by economists and attorneys on the Antitrust Division’s criminal cartel enforcement efforts.” U.S. GOVT ACCOUNTABILITY OFFICE, GAO-11-619, CRIMINAL CARTEL ENFORCEMENT: STAKEHOLDER VIEWS ON IMPACT OF 2004 ANTITRUST REFORM ARE MIXED, BUT SUPPORT WHISTLEBLOWER PROTECTION 52 (July 2011) [hereinafter GAO Report]; available at http://www.gao.gov/new.items/d11619.pdf. A summary of the Report indicates that as an organization, “DOJ generally agreed with GAO’s findings but did not comment on [GAO’s recommendations].” GAO Highlights, id. (second page).

6 These key stakeholders included seven antitrust attorneys in private practice, seven antitrust attorneys in nongovernmental antitrust organizations, and seven academics who focus on antitrust law and enforcement issues.
rewards provision, but that key stakeholders who were interviewed as part of the GAO's report widely supported adding a whistleblower protection provision.\(^7\) While a few stakeholders believe that a rewards program could motivate whistleblowers to report criminal activity, more than half of the key stakeholders interviewed believed that adding a rewards program could hinder DOJ's enforcement program.\(^8\) Ultimately, the GAO recommended that Congress consider adding a whistleblower protection provision to provide civil remedies for those who face retaliation for reporting criminal antitrust violations.\(^9\) The GAO, however, declined to recommend adding a whistleblower rewards provision. Despite the GAO's recommendations, though, Congress could decide to add a whistleblower-rewards provision to ACPERA at a later date.

**Whistleblower Rewards Programs in Foreign Jurisdictions**

The United States is not the first country to consider adding a whistleblower rewards program to its antitrust enforcement regime. The United Kingdom, South Korea, and Hungary currently have antitrust whistleblower rewards programs in place. In 2008, the UK's Office of Fair Trading (OFT) began offering financial rewards to antitrust informants. The Rewards Program builds on the OFT's leniency program by offering financial rewards to people who have valuable inside information about the existence of a cartel. Under the UK's informant reward scheme, an individual may receive up to £100,000 for providing information on a cartel to the OFT. The amount of the reward depends on a number of factors, including: (1) the value of the information; (2) the amount of harm to the economy and consumers; (3) the effort taken in order to give the information; and (4) the risk taken in order to give the information.\(^10\) The reward is discretionary, so if OFT decides not to use the information, the informant will not get paid.\(^11\) The reward is not available to individuals who have been directly involved in the cartel they are reporting, as those individuals are covered by the UK's leniency program. Furthermore, complainants who simply report their general concerns about possible cartel activity are not able to collect a reward, as the program is meant to apply exclusively to individuals with significant insider information.\(^12\)

In 2002, the Korea Fair Trade Commission (KFTC) introduced its Cartel Informant Reward Program, which provides cash rewards to individual whistleblowers for reporting information on cartels. The original ceiling on the reward was only 20 million won (approximately $18,780 USD), which was increased to 100 million won (approximately $93,900 USD) in 2003. The first several years of the program were not considered successful, generating fewer than ten reports in a four-year period.\(^13\) The lack of success has been attributed to the negative perception in Korea about reporting, fear of retaliation, and low cash rewards.\(^14\) In 2005, the KFTC modified the program by increasing the reward to up to 1 billion won (approximately $1 million USD) and guaranteeing con-

---

\(^8\) *Id.* at 38.  
\(^9\) *Id.* at 50.  
\(^11\) *Id.*  
\(^12\) *Id.*  
\(^14\) *Id.*
fidentiality by using an enforcement decree under the Monopoly Regulation & Fair Trading Act (MRFTA).\(^\text{15}\)

In April 2010, Hungary introduced its Informant Rewards Program to encourage private persons to report anticompetitive activity. Under Hungary’s Informant Reward Program, any natural person who has knowledge of a cartel and provides to the Hungarian Competition Authority essential written evidence will receive an award amounting to at least 1 percent, but no more than 50 million forints (approximately $238,000 USD), of the fine levied against the participants in the cartel.\(^\text{16}\)

Importantly, parallel application to Hungary’s leniency program and the information reward program is prohibited.\(^\text{17}\) Thus, if a representative of a cartel requests leniency, he or she is not also entitled to an informant’s reward.

### Adding a Whistleblower Rewards Provision

**Proponents’ Views.** The general concept of adding a whistleblower rewards provision to U.S. antitrust statutes enjoys support from prominent individuals in the antitrust community, including former FTC Commissioner William Kovacic.\(^\text{18}\) The most often cited argument in favor of adding a whistleblower rewards program is that the current leniency program does not offer reporting incentives to people who are not participants in reported activity.\(^\text{19}\) Proponents of a whistleblower rewards provision believe that employees who are aware of cartel activity but are not actually involved in the activity are in an ideal position to assist the government in reporting and gathering evidence of anticompetitive conduct.\(^\text{20}\) Despite their awareness of the conduct, proponents believe that many employees may fail to report such conduct because of the potential for retaliation from employers, social stigma, and the lack of rewards for the time spent assisting authorities. Proponents believe that a reward is necessary to compensate potential informants for the substantial risk they undertake.\(^\text{21}\)

Proponents also argue that offering a reward to informants may increase the cost of colluding because it increases the number of potential informants an employer must “bribe” to keep quiet.\(^\text{22}\) Proponents argue that reward programs complement leniency programs because they motivate the colluding firm to detect, report, and stop “bribing” its own informed employees, destabilizing collusion.\(^\text{23}\)

---

\(^\text{15}\) Id. The amount of the reward is determined by the seriousness of the violation and by the quality of evidence reported.


\(^\text{17}\) Id. For more information on Hungary’s Informant Reward Program, see, for example, REGULAR QUESTIONS ABOUT THE CARTEL INFORMANT REWARD, http://www.gvh.hu/gvh/alpha?do=2&st=2&p=154&m=129_doc=6429.


\(^\text{20}\) Id.

\(^\text{21}\) Id.


\(^\text{23}\) Id.
Finally, proponents of adding a whistleblower rewards provision to ACPERA argue that programs, such as the U.S. Civil False Claims Act (CFCA) and antitrust whistleblower rewards programs in the United Kingdom, South Korea, and Hungary, provide both evidence that a rewards program will result increased cartel reporting and a framework for the proposed provision. 24

Key commentators argue that the qui tam provisions in the CFCA provide a helpful framework for potential rewards and anti-retaliatory provisions in ACPERA. 25 The CFCA allows individual whistleblowers, called “relators,” to file qui tam 26 lawsuits against companies or individuals that have committed fraud against the federal government in return for a fraction of the fines and recovered funds. 27 To do so, the relator files a complaint in federal court, and the DOJ decides whether to intervene. If the DOJ declines to join in the qui tam action, the relator has the right to prosecute the case on his or her own. 28 If the DOJ intervenes, the government takes the lead role and the relator takes on a secondary role. 29 The relator will receive a certain percentage of the government’s recovery if the relator prevails in the action, either through litigation or in a settlement. If the government has intervened in the action, the relator shall receive “at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action.” 30 If the government has not intervened, the relator shall receive an amount “not less than 25 percent and not more than 30 percent of the proceeds.” 31 The CFCA also has a provision that prohibits retaliation against an employee who files claims under the act. 32

Opponents’ Views. While DOJ Antitrust Division officials acknowledge that adding a rewards program could result in greater cartel detection, these officials believe that the potential benefits would be outweighed by a number of disadvantages that could hinder DOJ’s enforcement program. 33 Indeed, their main concern is the threat to the DOJ’s criminal cases because jurors may question the credibility of a witness who stands to benefit financially from a successful enforcement action. 34

---

24 See Low & Kotchen, supra note 19. No empirical evidence exists supporting the argument that these three jurisdictions have seen an increase in cartel enforcement.

25 See Kovacic, Paying Informants, supra note 18.

26 A qui tam provision would not work in the criminal context because that would allow a whistleblower to bring a criminal lawsuit against a cartel member on behalf of the government and be rewarded for a portion of the penalties. The DOJ has the sole authority to prosecute criminal antitrust cases so any incentive program added to ACPERA would have to be a rewards provision and not a qui tam provision. See GAO, supra note 6, at 38.


31 Id.

32 31 U.S.C. § 3730(h)(1)–(2) (“Any employee, contractor, or agent shall be entitled to all relief necessary to make that employee, contractor, or agent whole, if that employee, contractor, or agent is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment because of lawful acts done by the employee, contractor, or agent on behalf of the employee, contractor, or agent or associated others in furtherance of other efforts to stop 1 or more violations of this subchapter. Relief under paragraph (1) shall include reinstatement with the same seniority status that employee, contractor, or agent would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys’ fees. An action under this subsection may be brought in the appropriate district court of the United States for the relief provided in this subsection.”).

33 See GAO, supra note 6, at 38–45.

34 Id. at 38–39.
The GAO report identified several other concerns by DOJ Antitrust Division officials and key stakeholders on how a whistleblower rewards program could hinder the DOJ's enforcement program. These stakeholders, including antitrust officials, expressed concern that a rewards program could (1) result in claims that do not lead to criminal prosecution because they lack sufficient information or are fraudulent claims; (2) undermine internal compliance programs by offering incentives for employees to report to the government instead of internally reporting; and (3) require additional government resources to administer the program.

In addition to the concerns identified in the GAO report, are several other considerations weigh against a whistleblower rewards provision. For example, the DOJ’s Leniency Program currently provides strong incentives to those have the most valuable information about cartel activity to come forward. The Leniency Program has been successful because those who potentially face punishment are the individuals most likely to know about cartel activity. Conversely, those who are not likely to be punished for cartel activity are less likely to be aware of the cartel activity because cartel behavior is by nature very secretive and non-participants are unlikely to have critical information to assist in an investigation.

Additionally, a whistleblower rewards program may also deter productive cooperation among firms, such as procompetitive information sharing. This type of cooperation could be mistaken for collusion by employees, and due to the cash reward incentive, an employee might report the activity. If employees have the incentive to report perceived cartel activity instead of reporting the matter internally, companies engaged in legal procompetitive cooperation may be discouraged from doing so in the future for fear of becoming entangled in an antitrust investigation.

The current leniency program gives the DOJ the flexibility to adjust fines and penalties to best serve the public interest. However, a whistleblower rewards program could complicate this process. For example, consider this scenario: An employee, motivated by a whistleblower rewards program, reports cartel activity at his company. The DOJ then launches an investigation, and the employee’s company agrees to cooperate. However, the company is on the brink of bankruptcy and a large fine could put it out of business, resulting in thousands of lost jobs. The DOJ may conduct an “ability to pay” analysis, possibly resulting in a greatly reduced fine or no fine at all. However, in this scenario the whistleblower has been promised a generous portion of any penalty the company pays. In this situation, the whistleblower may be compensated very little, if at all, for his or her efforts, negating incentives for future whistleblowers and ultimately decreasing the effectiveness of such a program.

Because the Leniency Program and ACPERA already provide strong incentives for companies to self-report cartel activity quickly upon discovery, it is unlikely that the whistleblower rewards provision is necessary for cartels to be exposed. In fact, a whistleblower rewards provision might actually undermine the Leniency Program by making self-reporting nearly impossible. If a company discovers or uncovers possible cartel activity, conducting an internal investigation may be nearly impossible when employees have financial incentives to report the conduct to the government before the company does.

Finally, there is insufficient information to assess the effectiveness of the whistleblower reward programs in the UK, South Korea, and Hungary. For example, since the UK introduced its rewards program in 2008, there has been little publicity about the program and it is unclear whether the
OFT has made any payment to an individual pursuant to the program. Furthermore, to the extent these countries do report an increase in the rate of the detection of cartels, it is possible that the increased rate of detection is linked more to the corporate leniency programs in these countries than the informant reward programs. Because these programs are relatively new, it remains to be seen if they provide a long-term benefit to their respective countries’ antitrust regimes. More data on the rewards actually being granted, the quality of evidence procured, and views among companies and individuals that the programs in fact act as a deterrent are necessary to properly evaluate their effectiveness.

Conclusion
Adding a whistleblower rewards provision is likely to be a counter-productive addition to U.S antitrust policy. It is unlikely that employees who are not engaged in cartel activity will be able to provide the Antitrust Division with the vital information needed to prosecute a cartel. The implementation of such a policy may both eliminate procompetitive collaboration among firms and result in higher internal costs to firms. Furthermore, with a whistleblower rewards program, the financial interests of the whistleblowers could supersede both the actual individuals damaged by the cartel and general public policy considerations.

37 In February 2011, following the launch of EC investigations into suspected price-fixing and market allocation by truck manufacturers, OFT appealed for further information in its civil and criminal investigations by offering the possibility of rewards of up to £100,000 for individuals that came forward with information. A public and specific appeal by OFT in a particular case appears to be unprecedented in the UK. See Office of Fair Trading, OFT Request for Information on Suspected Cartel Activity Involving Manufacturers of Commercial Vehicles, http://www.oft.gov.uk/about-the-oft/legal-powers/enforcement_regulation/Cartels/commercial-vehicle-criminal/request/.
Editor’s Note: Editor Bill Page notes two recent examples of experimental studies of antitrust issues, one focused on exclusive dealing and one on price fixing; and Editor John Woodbury describes a new metric to “score” the post-merger likelihood of parallel accommodating conduct, a new coordinated-effects concept in the 2010 Horizontal Merger Guidelines. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Recent Papers

Claudia M. Landeo & Kathryn E. Spier, Exclusive Dealing and Market Foreclosure: Further Experimental Results (Sept. 2011), J. Institutional & Theoretical Econ. (forthcoming)

Miguel A. Fonseca & Hans-Theo Normann, Explicit vs. Tacit Collusion—The Impact of Communication in Oligopoly Experiments (July 2011)

These papers report the results of experiments aimed at testing under controlled circumstances the feasibility of different methods for reducing competition. Both start by describing, in a general way, the legal treatment of the practices at issue and the received economic theory of the practice’s competitive effects. They then describe their hypotheses about what variations in the practices appear to be correlated with the achievement of cooperation. Finally, they describe the experiments the authors designed to test their hypotheses, using student subjects in the roles of market actors. In both, a primary focus is on the efficacy of non-binding communication as a means of achieving coordination. Both also shed light on the value and limitations of experimental economics in enhancing our understanding of antitrust issues.

Landeo and Spier’s paper is motivated by the controversy over the feasibility of using exclusive dealing contracts as a means of foreclosing rivals from the market.¹ They pose the issue as a conflict between the Chicago School, especially Robert Bork, and post-Chicago scholars. Although it is fair to say that Chicago scholars have been (and still are) skeptical of the feasibility of harming rivals by exclusive dealing contracts in real-world markets, they have long recognized contractual exclusion as a theoretical possibility.² Post-Chicago scholars have developed the theory in far greater detail. Yet, as these authors note, empirical evidence is in short supply because “in practice, contracts are drafted and negotiated in private business settings and are not easily observed by researchers.” Experimental economics adds depth to this literature by pro-

viding one kind of testing of the theory’s predictions: researchers create versions of the game with appropriate rules, have students play the games anonymously over a computer network, and then analyze the outcomes to see if the conditions for exclusion are met.

Anonymous game play by college students is obviously different in countless ways from competition in real-world markets. The authors recognize that these sorts of experiments have uncertain “external validity” because they “cannot predict the effects of exclusive contracts in richer environments.” Nevertheless, an “experiment might provide useful feedback to theorists” because if “findings in this simple environment do not conform to the theory, there is little hope that this theory can explain subjects’ behavior in more complex settings.” They add that “[t]here is a trade-off between control [in experimental design] and external validity. Experimental methods are complementary techniques to field data analysis."

The Landeo and Spier paper I’m noting here builds on an earlier article by the same authors,3 which tested hypotheses in widely cited theoretical studies by Rasmussen, Ramseyer, and Wiley4 and by Segal and Whinston.5 Those studies predict that, where there are scale economies in production, a monopolist can prevent entry by signing up enough buyers to exclusive deals to deny potential entrants the ability to achieve a minimum efficient scale. If buyers can coordinate uniform rejection of the offers of exclusivity, entry occurs and the buyers (and society) are better off; if they fail to coordinate, some or all buyers sign the deal and the entrant is excluded. Moreover, if the monopolist can offer better deals to some buyers than others, it can adopt a strategy of “divide and conquer,” making it rational for all buyers to sign.

Landeo and Spier’s first article reported the results of an experiment consisting of several variations of a game with three players—a monopolist and two buyers. The seller is making a monopoly profit; the buyers can gain consumer surplus slightly larger than the monopoly profit if entry occurs. The seller tries to avoid entry by offering to pay the buyers one of four amounts to sign exclusive contracts. Thus, the seller offers the buyers a sure payment of less than the consumer surplus to induce at least one of them to give up the chance of getting the full consumer surplus from entry. Students played random roles in the games. In one set of variations, the seller made equal offers to both buyers. The buyers had to coordinate their responses in order to achieve the preferred (and socially optimal) outcome—rejecting the exclusionary contract and allowing entry.6

In a subset of these games, the buyers were allowed to communicate by simply stating their intentions before accepting or rejecting the offers. Other variations of the game tested whether allowing the seller to discriminate by offering different amounts enhanced the likelihood of collusion. The study found that allowing communication increased the likelihood of entry (rejection of the exclusionary offers), but much less so if the seller could discriminate in the amount of its offers and thus pursue a divide-and-conquer strategy. The study also found that buyers were more willing to accept exclusionary offers if they knew the seller was another student and not a computer. This result suggests the influence of a (misplaced) sense of fairness in the human dimension of

---


6 The theoretical analysis modeled the process of exclusion when the seller must make equal offers to the buyers as a stag-hunt game, in which two players must coordinate their actions to achieve a preferable outcome. In the classic hypothetical posed by Rousseau, two hunters must coordinate their actions in order to kill a stag for food. If one tries for the stag while the other acts on his own to bag a rabbit, the one who tries for the stag will get nothing. If neither tries for the preferred outcome, they can both get a rabbit.
The negotiations: students in the role of buyers seem to care that the seller proposing an exclusive deal will get a payoff of zero if both buyers reject the deal. In the game, of course, students knew that the seller was another student; it is not clear what role notions of fairness might play in real-world buyers’ dealings with a monopolist.

Landeo and Spier’s current paper introduces a fourth player in the role of the potential entrant who receives a payment only if the buyers coordinate a rejection of the exclusionary offer. The results of the experiment suggest that, despite the presence of the potential entrant, buyers were more likely to accept the exclusive deal if it is offered by another human being than if it is offered by a computer. Significantly, however, exclusion was less likely if the entrant could communicate with the buyers. Most potential entrants appealed to the buyers’ self-interest, with messages like: “Please reject this proposal. Neither of you should settle for less than 1000 tokens. This offer is way too low.” A few appealed directly to the buyers’ sense of pity for the entrant. The study found (as the authors predicted) that these communications increased the likelihood of buyers to coordinate to reject the exclusionary offer, even when the buyers could not communicate with each other. The authors suggest that the entrants provided a “focal point” that might have elicited the buyers’ regard for the entrants or simply made a coordinated rejection a “more prominent” outcome. Generally, the presence of a human agent talking with the other players was found to be important.

Fonseca and Normann’s paper presents the results of experiments testing the role of communication among rivals in coordinating prices. Like Landeo and Spier’s paper, this one is motivated by an issue of antitrust law and a corresponding dispute in the economic literature. The authors take it as given that the law allows rivals to coordinate prices tacitly, but forbids them from doing so by communicating. The literature recognizes that cheap talk may facilitate coordination, but there is controversy over how useful it is in prisoners’ dilemma type games, as oligopoly is often modeled.

To explore this issue, the authors designed and ran an experiment, with student subjects, examining the effect of allowing communication on prices in markets with 2, 4, 6, and 8 firms. Like Landeo and Spier, Fonseca and Normann point out that this approach allows control of the conditions of the experiment, and allows researchers to examine issues that, as a practical matter, may never appear in field data. Case studies can only study cartels that have come to light, and so may ignore the most successful ones.

Fonseca and Normann constructed a Bertrand (price-setting) oligopoly with 300 customers, each willing to pay up to $100 for a single product. Any firm could produce all 300 units at zero marginal cost. The firm that charged the lowest price in the game received its price times 300; if more than one firm charged the lowest price, they shared equally that price times 300. Firms that charged higher prices got nothing. For markets with 2, 4, 6, and 8 firms, the authors compared prices when firms could not communicate at all with prices when firms could communicate (using instant-messaging software) with all of their rivals before entering their prices. In the main experiment, the No-Talk period came first. For both the No-Talk and Talk conditions, the firms repeated the game (and saw the resulting prices) at least 20 times. The authors ran a number of other variations of their experiments in order to isolate the effects of communication from other influences, such as learning.

The results of the experiments were consistent with the authors’ hypotheses that prices decline as the number of rivals increases (regardless of whether they can talk), and that allowing talking increases prices. For example, the average price in a four-firm market was 6.0 if firms could not talk, but 81.3 if the firms could talk. Without talking, duopolists could tacitly collude to some
degree, but in markets with more than two firms, the participants frequently chose a price of 1—the lowest possible price other than zero; with talking, particular in the two and four-firm markets, the low price was frequently 100 or 99. This result is the most striking in the paper—cheap talk pays extremely well. Moreover, the gains from cheap talk persisted after talking stopped: the authors found that, in games in which the Talk period came first, prices were higher in the No-Talk period than in games in which the No-Talk period came first.

The authors note that the gains from talking were greatest (in absolute terms) for markets with 4 and 6 firms, and lower for markets with 2 and 8 firms. The price increase attributable to talking was 43.2 for two firms, 75.3 for four firms, 62.5 for six firms, and 54.1 for eight firms. They describe these results as “an inversely U-shaped relationship between the gain from communication and the number of firms, and suggest that, given the same expected fine, an oligopoly with an intermediate number of rivals (here, four) would be most likely to form a cartel, rather than settle for the gains from tacit collusion in the case of the duopolies or competition in the other oligopolies.7

The authors also present an interesting analysis of pricing strategies. When participants were not allowed to talk, groups with more than two firms were virtually never able to collude on a particular price; prices were widely dispersed and changed frequently, in a cyclical pattern. When allowed to talk, firms were often able to collude and winning and losing prices were within a narrow range. Firms that could talk typically tried to coordinate on a price of 100 with all sharing the profits equally, although firms in a few markets successfully adopted the strategy (similar to bidrigging cartels) of taking turns winning everything at a price of 99. When a firm defected from an agreed price of 100, firms communicated to mediate the dispute, trying, for example, to coordinate compensatory results and reestablish the collusive price. In rare instances, they used threats of punitive prices of 0 or 1 to induce the return of cooperation. Once a price war began, however, firms had little success in reestablishing collusion, although prices still remained high relative to markets where firms could not talk at all.

—WHP

7 I would note, however, that any expected fine (and therefore the likelihood of collusion) would presumably not be an absolute amount, but would vary directly with the amount of the overcharge.

Serge X. Moresi, David Reitman, Steven C. Salop & Yianis Sarafidis, Gauging Parallel Accommodating Conduct Concerns with the CPPI  

Unlike the analysis of unilateral effects, quantifying the impact of a merger on the likelihood of coordinated effects has been elusive, with near exclusive reliance on “plus” factors. While there have been some advances in quantifying this impact, these typically require a substantial modeling superstructure, such as a full-blown simulation.¹ A recent paper by my colleagues Serge X. Moresi, David Reitman, Steven C. Salop, and Yianis Sarafidis (Moresi et al.) offers another means

of quantification, only without the need for a full-blown simulation or voluminous data requirements. Instead, their analytical model relies on readily available data and so may prove useful as a coordination screen.

The analysis of a merger’s effect on the ability of the industry to tacitly collude played a central role in the 1997 (and earlier) Horizontal Merger Guidelines. In those Guidelines, the approach was very Stiglerian: “Successful coordinated interaction entails reaching terms of coordination that are profitable to the firms involved and an ability to detect and punish deviations that would undermine the coordinated interaction.” (Section 2.1) Thus, in considering the effect of the merger on coordinated interaction, antitrust practitioners would assess whether the merger facilitates tacit collusion by making an agreement more likely and by making detection and punishment of “cheaters” more effective.

The 2010 revision to the Horizontal Merger Guidelines (HMGs) retains this analytic framework as one component, but also goes a step beyond. Specifically, the HMGs now acknowledge the possibility that a merger might facilitate coordination through “parallel accommodating conduct” even in the absence of a mechanism to detect and punish deviant firms. Specifically, the HMGs note:

Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival’s response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. (Section 7)

As noted in the paper, concerns over this kind of conduct are not new. Indeed, these concerns were discussed no later than seventy years ago by economists. The difficulty in implementing this approach is to show that such behavior is individually rational from the standpoint of each firm. The Moresi et al. model addresses that difficulty and evaluates the effects of the merger on the likelihood of parallel accommodating conduct (PAC). The paper develops an index to assess the extent to which the firms are prone to PAC pre-merger. This pre-merger index is then compared to a post-merger index. The larger the difference between the two indices, the more prone is the post-merger market towards a price increasing PAC.

The underlying conceptual framework is straightforward. Suppose two firms, A and B, are considering whether to increase prices relative to the status quo. In period 1, A decides whether or not to increase its price by some percentage. In period 2, B decides whether to match that percentage price increase or keep its price unchanged. If B matches, then the price increase “sticks.” If B does not match, then in period 3, A’s price reverts back to its period 1 price.

Using this framework (and a number of assumptions), the paper develops what it calls a “Coordinated Pricing Pressure Index” (CPPI). To do so, the authors first identify the highest per-

---

2 The concepts described in this paper were developed while the authors were consulting to Sprint on the competitive effects of AT&T’s acquisition of T-Mobile.

3 While this may sound like a Stackleberg leader-follower model, the paper observes that there are some key differences. Most importantly, in the Stackleberg model, the follower sets its price “very quickly” within the same period, while the PAC model considered by the authors assumes that the “following” firm responds with a period lag (n.12). However, if both firms are “infinitely patient” in that each does not discount the future profits, then its similarity to Stackleberg increases. But to keep the analysis and the formula simple (i.e., without requiring a full-blown model), the percentage price increase is assumed to be the same for A and B, which is not a required assumption in the Stackleberg formulation.
percentage price increase that A profitably could implement (assuming that B would match) and, similarly, the highest percentage price increase that B profitably could implement (assuming that A would match). The authors then define the CPPI as the smaller of those two percentage price increases. If A were to choose to merge with a third firm, one would calculate a post-merger CPPI for the post-merger A and B. The change in the CPPI could then serve as an indicator of the increased likelihood of post-merger PAC.

Notwithstanding its derivation, the Moresi et al. paper reflects a reluctance to label the CPPI as a predicted price increase. This is because there are numerous other factors that can affect the likelihood of a PAC. In particular, as noted below, the CPPI does not account for potential responses of non-coordinating firms to the PAC. Thus, the paper emphasizes that the CPPI is a price pressure index, not a predicted price increase.¹

The paper establishes a property of the CPPI which facilitates the analysis. Specifically, the paper justifies the assumption that the other firm would exactly match the price increase (as opposed to a lower amount). This is because a firm always finds it easier to match a price increase of, say, 10 percent than to initiate a price increase of 10 percent. Roughly speaking, in the case where A initiates a price increase, B already has an incentive to raise the price somewhat in period 2 by virtue of its response to A’s period 1 price increase. The same can be said for A if the roles were reversed such that B initiates a price increase in period 1 and A chooses to match. Given the future stream of returns from the initiating firm’s higher price, the remaining firm is willing to set an even higher price than it would have been willing to initiate. That is, by matching as opposed to initiating, the downside risk of being the first to raise its price has been removed and matching is that much more likely to occur. As a result, the Moresi et al. paper shows that the only price increases that matter for the CPPI are those of the initiating firms.

One can explain the analysis conducted in the paper as follows. To determine the price increase preferred by A if it initiates the price increase and B follows, A compares the gains and losses from various potential price increases and chooses the maximum price such that the price increase is just profitable, i.e., such that the gains exceed the losses by some very small amount.

The loss to A is the profit loss experienced in period 1 when B has not yet matched A’s price increase—the dollar margin earned by A times the output reduction following the price increase, net of increased profits earned on the remaining units sold on which the higher price is charged. In period 1, the loss to A is in part B’s gain: some of A’s lost output will be diverted to B as a result of A’s higher price.

Some of the losses A experiences in period 1 are recovered in period 2 if B matches A’s percentage price increase. That is, when B raises its price in period 2 to match A’s percentage price increase, it will lose some sales, and A will capture a fraction of those lost sales. The gain to A in period 2 is the profitability of the increase in sales at the A-initiated higher price. With differentiated products, how much of that period 1 loss is recovered by A when B matches depends, inter alia, on the diversion ratio from B to A. The higher the diversion ratio, the greater is the profit recovery and thus the larger is the PAC price increase that A can initiate in period 1 (since the corresponding greater loss in period 1 will be compensated by the greater profit recovery in period 2 and beyond).

¹ In particular, the CPPI is a break-even (or just profitable) price increase, not a profit-maximizing price increase. Under the authors’ assumptions, however, the Moresi et al. paper shows that these two price increases are closely related.
While going through a lot of algebra, the paper derives a succinct formula for the maximum percentage price increase that A profitably could implement when it initiates the price increase:

\[ S_A = m_A \frac{F_{BA} m_B}{(1 - F_{BA})} \]

where \( F_{BA} = \frac{D R_{BA} q_B m_A}{(q_A m_B)} \).

\( S_A \) is the maximum percentage price increase that is just profitable to A; \( m_A \) and \( m_B \) are the profit margins earned by A and B respectively; and \( q_A \) and \( q_B \) are the initial quantities sold by A and B respectively. 5

The expression \( F_{BA} \) can be thought of as the ratio of A’s quantity gains in period 2 to its quantity losses in period 1. To see this, recall that under Bertrand competition among single product firms, \( m = 1/e \), where \( e \) is the firm’s own price elasticity. Thus, \( F_{BA} \) can be rewritten as follows:

\[ F_{BA} = \frac{D R_{BA} q_B e_B}{(q_A e_A)} \]

When A raises its price in period 1 (say, by \( s \) percent), the reduction in A’s quantity demanded is given by the initial quantity \( q_A \) times A’s own-price elasticity \( e_A \) (times \( s \)). This corresponds to the term \( q_A e_A \) in the above equation. In period 2, when B matches A’s percentage price increase, B’s quantity demanded drops by \( q_B e_B \) (times \( s \))—B’s initial quantity times B’s own price elasticity. The amount gained by A as a result of B’s price increase is the diversion ratio from B to A times B’s quantity reduction. This corresponds to the term \( DR_{BA} q_B e_B \) in the above equation.

There is a similar formula for \( S_B \), the maximum percentage price increase that B profitably could implement when it initiates the price increase. 6 It is identical to the above formula except that B plays the role of A and vice versa. As mentioned above, the CPPI is defined as the smaller of those two percentage price increases, \( S_A \) and \( S_B \). For later reference, assume that the smaller of the two percentage price increases is equal to \( s^* \) (i.e., \( CPPI = s^* \)).

The first thing to note is that the CPPI formula depends on data that are readily available: the margins, the diversion ratios (either through a separate analysis or assuming proportional diversion) and the firms’ volume shares. Thus, like the Gross Upward Pricing Pressure Index (GUPPI) for unilateral effects, the CPPI can be calculated without the need to run a full-blown simulation.

The discussion above focused on the pre-merger CPPI. Of course, for purposes of assessing the competitive effects of a merger, we need to know how the merger affects the likelihood of PAC. In order to do so, a post-merger CPPI is required. Suppose that there is a third firm, C, in this market and suppose as well that A is considering merging with C. Then, under some assumptions, one can recalculate the CPPI using the same formula as above and assuming that A merges with C.

The difference between the pre-merger CPPI and the post-merger CPPI represents the change in the price pressure resulting from the merger. The Moresi et al. paper refers to this as the Delta CPPI. The Delta CPPI can be used to “score” the impact of the merger of firms A and C on the likelihood of parallel accommodating conduct by firms A and B. The larger is the difference, the greater should be the PAC concern created by the merger.

---

5 For purposes of exposition, I have simplified the formula from that used in the paper. In its derivation, the Moresi et al. paper accounts for two factors not included in expression (1). First, the paper includes a discount factor to account for the fact that a dollar earned by A in period 2 is not valued as much as a dollar earned in period 1. Second, it is possible that the pre-merger market is already engaging in PAC. The paper’s version of expression 1 includes terms to account for the possibility of discounting and pre-existing PAC.

6 Unless A and B are symmetrically positioned, there is no reason for the just-profitable price increase for A when A initiates the price increase to be the same as that for B when B initiates the price increase.
As the paper acknowledges, some of the assumptions of the CPPI and Delta CPPI are limiting, most notably the assumptions that both firms must raise their prices by the same percentage and that other firms in the industry don’t respond to the price increases of A and B; and relatedly, that only two firms (A and B) are relevant for the PAC.7 These limitations lead the authors to stress that, like the GUPPI, the CPPI and delta CPPI are indices useful for “scoring” the likelihood of PAC post-merger but not as a prediction as to how much price will increase post merger.

But even a high Delta CPPI is not sufficient to conclude that a merger will lead to an increased likelihood of PAC, although it may be sufficient to warrant further agency scrutiny: “It is often the case that PAC does not occur. There may be various impediments to successful PAC, such as the lack of information; fear of entry or repositioning; or incentives to secretly or openly cut prices after engaging in PAC.” (p. 6)

Similarly, the post-merger CPPI (and hence the Delta CPPI) does not account for efficiencies, which could result in the post-merger A preferring lower prices. Thus, the CPPI is not the end of the analysis, but one component of that analysis.

Still, like the HHI and the GUPPI, the CPPI may serve as one useful way for scoring the risk of post-merger PAC. But the authors here are quick not to overclaim with respect to the usefulness of the CPPI:

We want to clarify that we have formulated this CPPI to gauge upward pricing pressure for only one form of coordinated effects (PAC), within the confines of a particular oligopoly model (price competition with differentiated products) and under particular assumptions (e.g., PAC by only two firms). However, PAC obviously is neither the only type of oligopoly conduct that might occur in a market nor the only oligopoly model used by economists. . . . Therefore, we are not claiming that the CPPI is the only possible index that could be formulated to score coordinated effects concerns. Instead, the CPPI described here is one useful index for gauging the effects of a merger on concerns about coordinated interaction through PAC in industries with differentiated products. (pp. 5–6)

While it’s not yet clear that the CPPI will become as central as the GUPPI in merger analysis, the Moresi et al. paper has presented an interesting and potentially powerful screening device for PAC-type coordinated behavior concerns. It relies exactly on the same inputs as the GUPPI—margins, shares, and diversion ratios—and so is easily implemented. In closing, I note that the discussion in the paper (including alternative formulations of the CPPI) is far more extensive than the exposition here.

—JRW

---

7 The model also assumes linear demand, which is a frequent (and convenient) assumption for GUPPIs and for full-blown simulations. See, e.g., Carl Shapiro, The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years, 77 Antitrust L.J. 701, 750 (2010); Kovacic et al., supra note 1.
Not Just for “Consumers”: Lanham Act Liability for Promotional Statements to Distributors and Other Business Customers

Randall K. Miller

Competitor false advertising remedies under the Lanham Act apply equally to “business-to-business” communications and traditional “consumer” advertising. A common misconception is that Lanham Act false advertising cases are limited to “classic” advertising campaigns that have widespread distribution to the general public. Reinforcing the misconception, many of the better known Lanham Act false advertising cases feature consumer products, such as mouthwash, chicken, sweeteners, infant formula, and diaper pails. Yet there is a different, but equally important species of Lanham Act cases about promotional statements that the consuming public never sees: promotions to businesses.

Business-to-business (B2B) promotional statements arise in a variety of contexts, such as when a company sells raw material to a downstream manufacturer or when a company negotiates product placement on the shelves of national retailers like Wal-Mart or Target. Such statements are often made verbally or in PowerPoint slides and emails rather than through the use of billboards and television commercials. Although statements in business settings are not made to the general public, they are covered by the Lanham Act’s prohibition against misleading promotional statements of fact.

Cases in the B2B setting have been sporadic and isolated, and commentators and jurists have not previously recognized or discussed these cases as a unique genre of Lanham Act cases. As illustrated by a pair of New York cases from 2011, one involving rodenticides (Reckitt Benckiser, Inc. v. Motomco Ltd.) and the other involving ingredients for nutritional supplements (Merck Eprova AG v. Gnosis S.P.A.), the number of B2B Lanham Act cases appears to be rising, and courts are increasingly willing to treat allegedly misleading statements in B2B letters, emails, and slides as actionable under the Lanham Act’s false advertising provision.

4 PBM Prods., LLC v. Mead Johnson & Co., 639 F.3d 111 (4th Cir. 2011).
The Lanham Act Protects Competitors, Not Consumers

The Lanham Act authorizes companies to sue competitors whenever they have suffered competitive injuries caused by false or misleading promotional statements. A threshold requirement for a Lanham Act case is that the challenged statement qualify as “commercial advertising or promotion.” The statement at issue must comport with the generally accepted “Gordon & Breach” four-factor test for “commercial advertising or promotion,” under which the statement must qualify as:

1. commercial speech;
2. by a defendant who is in commercial competition with plaintiff;
3. for the purpose of influencing consumers to buy defendant’s goods or services; and
4. disseminated sufficiently to the relevant purchasing public to constitute “advertising” or “promotion” within that industry.

Remedies for Lanham Act violations include injunctions, which can issue quickly (within days or weeks following suit), money damages for the competitive harm caused, and recovery of attorneys fees.

Section 43(a) of the Lanham Act extends broadly to *any* “false or misleading description of fact, or false and misleading representation of fact” that “misrepresents the nature, characteristics, qualities, or geographic origin of [the advertiser’s] or another person’s goods, services, or commercial activities.” By these terms, the Lanham Act reaches false representations of fact as long as they are promotional in nature, that is, intended to induce a sale. This applies equally in the B2B setting.

The Lanham Act is not limited to “consumer” advertising. The courts have observed that the Lanham Act is not a “consumer protection act”; instead, the Act focuses solely on competition-related injuries. As one court noted:

> Congress’ purpose in enacting Section 43(a) was to create a special and limited unfair competition remedy, virtually without regard for the interests of consumers generally and almost certainly without any consideration of consumer rights of action in particular. The Act’s purpose . . . is exclusively to protect the interests of a purely commercial class against unscrupulous commercial conduct.

Indeed, consumers are barred from filing Lanham Act cases. “[T]he focus of the statute is on anti-competitive conduct in a commercial context,” and “consumers” have “no competitive or commercial interests” to vindicate in a Lanham Act case.

Lanham Act litigants can battle over allegedly deceptive promotional statements regardless of the audience to which the promotional statements are directed. There need not be a consumer protection element to the case, and the general public need not be involved at all in a Lanham Act false advertising case that is addressed to business promotions.

---

14 Conte Bros. Auto., Inc. v. Quaker State-Slick 50, Inc., 165 F.3d 221, 229 (3d Cir.1998).
B2B Lanham Act False Advertising Cases

The courts have found liability under the Lanham Act for statements made to various types of business purchasers, including downstream manufacturers and distributors, retailers, physicians and healthcare providers, and government purchasers.

Promotional statements made by makers of raw material to downstream manufacturers, including claims about the characteristics and performance of the raw ingredients, have been found to be actionable under the Lanham Act. For example, in *Merck Eprova AG v. Gnosis S.P.A.*, the parties sold ingredients to manufacturers of nutritional supplements and the plaintiff alleged that the defendant misrepresented the “isomer” content of its raw ingredients. The court denied the cross motions for summary judgment on the Lanham Act claim. Likewise, in *Seven-Up Co. v. Coca-Cola Co.*, the parties sold soda syrup concentrate to bottling companies. The defendant gave a sales presentation to eleven bottlers urging them to switch their exclusive distributorships from Seven-Up to Sprite. The sales presentation contained allegedly misleading comparative sales statistics, and the case went to the jury on the Lanham Act false advertising issue, although the defendant was able to prevail on the merits.

Manufacturers often move products to the ultimate consumer through national retail chains. Interactions with these retailers typically involve not only the decision to carry an item but also complex negotiation over such issues as shelf space, store displays, pricing, discounts, profit margins, and payment to the retailer of “slotting fees” and other incentives. Competition is fierce and failure to persuade the retailer could result in exclusion from important retail outlets. The courts have held that promotional statements made by companies in these negotiations are actionable under the Lanham Act. For example, in *Reckitt Benckiser, Inc. v. Motomco Ltd.*, the parties made claims to large national retailers about competing rodenticide products sold under the d-CON and Tomcat brands. Among the claims at issue, the defendant made statements to retailers indicating that environmental restrictions adversely affecting the plaintiff’s product had actually gone into effect when, in fact, the regulations were merely contemplated. The court found these statements actionable under the Lanham Act and issued injunctive relief.

Statements to retailers also were found to be actionable in *Cashmere & Camel Hair Manufacturers Institute v. Saks Fifth Avenue*, where garment manufacturers made presentations

---

16 Id. at *4.
17 86 F.3d 1379 (5th Cir. 1996).
18 Id. at 1386.
19 See note 67, infra.
20 The winner of the retail account sometimes will obtain significant additional benefits, such as obtaining category management contracts. For cases discussing the dynamics of negotiations with large national retailers, see, e.g., *Conwood Co., L.P. v. U.S. Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002); *Church & Dwight Co., Inc. v. Mayer Labs., Inc.*, No. C-10-4429 EMC, 2011 WL 1225912, at *3 (N.D. Cal. Apr. 1, 2011); *El Aguila Food Prods. Inc. v. Gruma Corp.*, 301 F. Supp. 2d 612, 615 (S.D. Tex. 2003), aff’d, 131 Fed. App’x 450 (5th Cir. 2005).
22 Id. at 455. The court found that it was “literally false” for the defendant to state that the EPA “risk mitigation decision” at issue “is a law, regulation, or anything else having current legal force.” Additionally, with regard to contemplated New York regulatory action, the court found that it was literally false for the defendant to make definitive statements suggesting that plaintiff’s products were subject to “imminent” adverse regulatory action.
23 284 F.3d 302 (1st Cir. 2002).
to national department store chains like Saks Fifth Avenue, claiming that their garments contained “cashmere.” In fact, the garments were actually made from “recycled” cashmere rather than “virgin” cashmere, the latter of which is superior in terms of softness and durability. The court reversed summary judgment in favor of the defendant and held that plaintiff presented a triable issue that the unqualified “cashmere” label was false advertising.

Promotional statements to retailers can have a significant market impact. One court noted that where competitors sell their products through nationwide retail chains, “making statements and sales presentations to representatives of only a few such chains could have a large impact in the industry.”

Several Lanham Act false advertising cases have focused on verbal statements made by pharmaceutical and medical device sales representatives when meeting with hospitals, physicians, or other healthcare providers. For example, in Zeneca Inc. v. Eli Lilly and Co., Lilly was accused of engaging in off-label promotion of its osteoporosis product, Evista, for reduction of the risk of breast cancer. Sales representatives did not make the statements at issue to patients (the ultimate user of the product) but instead to prescribing physicians in “detail” sessions. The court found that “[s]ales representatives are an important source of information for physicians about prescription drugs, and physicians—who are the ‘gatekeepers’ for patients—often rely to some extent on the information they are given by sales representatives in determining what drugs to prescribe.” In many of these healthcare cases, the courts considered surveys of doctors who had been “detailed” by sales representatives and sales representative “call notes” to help determine the content of the verbal claims.

Statements made to government contracting bodies, even in a single bid proposal to a single government agency, can be actionable under the Lanham Act. For example, Tao v. Analytical Services and Materials, Inc. involved statements made in a bid proposal to NASA. The statements in question attributed Tao’s work to the defendant and “misrepresented Tao as a venture or subsidiary of [the defendant].” The defendant moved to dismiss, challenging whether these statements could constitute commercial advertising. The court denied the motion, holding that “[w]hile . . . the submission of a proposal in response to a NASA request is not advertising in the traditional sense of the term . . . it is reasonable to infer that in the aeronautical engineering industry, services are promoted through proposals to the relevant government agency.” In contrast,

24 Id. at 312.
25 Id. at 315–20.
26 Lampi Corp. v. Am. Power Prods., Inc., No. 93 C 1225, 1994 WL 501996, at *2 (N.D. Ill. 1994); See also Sanderson Farms, Inc. v. Tyson Foods, Inc., 547 F. Supp. 2d 491, 498 (D. Md. 2008) (discussing loss of three retail accounts based on a claim that chicken products were “raised without antibiotics”).
29 Id. at *8 (citation omitted).
30 Id. at *33.
32 Id. at 569. In its bid proposal to NASA, the defendant allegedly “took credit for expertise and capabilities belonging to Tao.” Id.
33 Id. at 574.
in *Suntree Technologies, Inc. v. Ecosense International, Inc.*, the court held that statements provided to government agencies in product brochures (and not in a bid) were made for “training” purposes, rather than to induce a commercial transaction, and therefore did not qualify as “commercial advertising or promotion.”

**Unique Issues**

**Is It “Commercial Advertising or Promotion”?** Because B2B promotion typically is communicated in an informal way and to a relatively small audience of business customers, one threshold defense is to assert that the communication is not “advertising” at all. To satisfy the “commercial advertising or promotion” test, plaintiffs must demonstrate that the statement at issue is not an isolated, informal, or personal communication, but rather is a promotional statement—made to induce a sale—and sufficiently disseminated to the target market. Plaintiffs also can bolster their case by demonstrating that the statement is part of a concerted, intentional, and organized campaign to induce a commercial transaction and to target the customers for which the plaintiff and defendant compete.

There is no magic minimum level of dissemination. The courts have found that a “single letter” to a potential customer can constitute commercial advertising or promotion under the Lanham Act as long as the purpose of the statement at issue is to influence a commercial transaction. In *Mobius Management Systems, Inc. v. Fourth Dimension Software, Inc.*, the court considered a letter written by a computer software manufacturer to a potential business customer that was intended to halt the impending purchase of a competitor’s product. The business customer intended to customize and implement the software product onto its platform for processing of data for banks and other financial institutions. The defendant’s letter made comparisons between the products and urged the potential purchaser not to consummate the transaction. The court concluded that “to label this behavior as anything but ‘commercial advertising or promotion’ would defeat the broader remedial purposes of the Lanham Act.”

“The level of circulation required to constitute advertising and promotion will undeniably vary from industry to industry and from case to case” depending on the size of the market and other contextual factors. For example, when the target market consists of only a handful of potential customers, extensive dissemination is not necessary. In *Derby Industries, Inc. v. Chestnut Ridge Foam, Inc.*, the parties were “competitors in the highly specialized business of prison mattress production and sales.” At issue was a videotape that defendants distributed to seven different entities, which the court found to be “commercial advertising or promotion” under the Lanham Act.

The court noted that the “prison mattress industry is a highly specialized market consisting of a considerably smaller number of end-users than a product that is used by the general consum-

---

35 Id. at *11.
38 Id. at 1020–21.
Public such as antifreeze, motor oil or even certain pharmaceutical drugs.” The court also was persuaded by the fact that the videotape “constituted prefabricated promotional material intended for the purpose of generating sales.” Similarly, in International Technologies Consultants, Inc. v. Stewart, the court held that a single letter about construction of a “float glass plant” was actionable where “the relevant market for services to design float glass facilities” was anywhere from 4–6 customers per year (as the plaintiff claimed) to 20–25 customers per year (as the defendant claimed).

Courts have made clear that the “form” of the advertising does not matter—the Lanham Act is not limited to “traditional” or “classic” advertising that is disseminated widely through “traditional media channels”:

In cases involving “sophisticated” business purchasers, courts have held that the bar for proving deception may be higher than in consumer cases. The rationale is that business purchasers are less gullible, more careful, and have the resources and experience to scrutinize promotional statements and evaluate the product itself prior to purchase. In Suntree Technologies, Inc. v. Ecosense International, Inc., for example, the “sophistication” of government purchasers was a factor that the court considered in awarding summary judgment to the defendant in a case involving an allegedly misleading product brochure.

“Sophistication” of the Target Audience. In cases involving “sophisticated” business purchasers, courts have held that the bar for proving deception may be higher than in consumer cases. The rationale is that business purchasers are less gullible, more careful, and have the resources and experience to scrutinize promotional statements and evaluate the product itself prior to purchase. In Suntree Technologies, Inc. v. Ecosense International, Inc., for example, the “sophistication” of government purchasers was a factor that the court considered in awarding summary judgment to the defendant in a case involving an allegedly misleading product brochure.

41 Id. at 822.
42 Id. at 822. Other examples include Champion Labs., Inc. v. Parker-Hannifin Corp., 616 F. Supp. 2d 684, 695 (E.D. Mich. 2009) (holding that whether a single presentation to GM by a fuel filter maker could be “commercial advertising” was a jury question and explaining that “[u]nless the jury finds that the market is made up solely of GM, by showing the presentation to GM, Racor arguably sufficiently disseminated the presentation in the market.”); Porous Media Corp. v. Pall Corp., 173 F.3d 1109, 1121 (8th Cir. 1999) (a document touting a medical device (ventilator filters) sent only to five companies was “commercial advertising or promotion” under the Lanham Act, where the “relevant purchasing public” was a small number of companies that dominate the “niche” market for the competing filter devices). See also Seven-Up, 86 F.3d at 1386–87 (applying the Act to a sales presentation given to eleven bottlers); Nat’l Artists Mgmt. Co. v. Weaving, 769 F. Supp. 1224 (S.D.N.Y. 1991) (phone calls made to customers of a booking agency by a former employee who was starting a competing business constitutes commercial advertising or promotion).
44 Id. at 758. See also VIP Pros., LLC, No. CV10-0998, 2011 WL 98992, at *3 (denying motion to dismiss where the alleged false statement was made at “trade shows [which] were attended by independent retailers and mass-market buyers” because the “issues that remain, including the breadth of dissemination and Defendant’s purpose, are fact-intensive inquiries not suitable for resolution in a motion to dismiss.”); Carpenter Tech. v. Allegheny Techs., 646 F. Supp. 2d 726, 737 (E.D. Pa. 2009) (in case involving competitors who sell nickel base alloy ingots to industrial purchasers, letters alleging patent violations stated a claim for false advertising under the Lanham Act; fact issues remained about “how many customers received letters,” “what percent of the market those recipients comprise,” and whether the defendants’ motivation included solicited sales).
48 “Context is particularly important where the targeted consumers are a well-informed and sophisticated audience because such an audience is less likely to be misled.” Energy Four, Inc. v. Dornier Med. Sys., Inc., 765 F. Supp. 724, 731 n.2 (N.D. Ga. 1991) (citing Sandoz Pharm. Corp. v. Richardson-Vicks, Inc., 902 F.2d 222, 229 (3d Cir. 1990)).
The importance of the audience's sophistication varies based on a number of considerations. First, the courts have rejected the notion that business purchasers, no matter how sophisticated or knowledgeable, are “as a matter of law, incapable of being misled” by promotional statements under the Lanham Act.49 Second, audience sophistication properly relates more to “implied falsity” than to “literal falsity.”50 Some courts have held that “when determining whether a claim is literally false, audience sophistication is irrelevant.”51 Third, arguments related to audience sophistication may be most persuasive when used to demonstrate how the business audience’s understanding of particular terminology is different than that of the general public.

For example, in *Princeton Graphics Operating, L.P. v. NEC Home Electronics (U.S.A.), Inc.*,52 the court determined that the use of the term “compatible” regarding computer monitors meant something different to the “retail channel” (distributors, wholesalers, retailers, retail chains, and corporate purchasing personnel) than it did to the general public. The court found that a consumer would understand “compatible” simply to mean that the monitor “works with” a computer, whereas the retail channel would expect “compatible” to denote performance “at or beyond the standard’s requirements,” a very precise concept.53 Similarly, in *Bridal Expo, Inc. v. van Florestein*,54 a case involving a “vendor brochure” in the wedding industry, the court held that the plaintiff was required to demonstrate deception from the perspective of “sophisticated audiences such as vendors, who have familiarity with the Houston wedding market.”55

**Proving Implied Claims Without Surveys.** In Lanham Act cases involving consumer advertising, a claimant typically must present a well-designed survey in order to prove an implied claim.56 However, in B2B cases, a survey may not be practical where there is only one customer (like a government agency) or a limited number of customers (like department store chains) because the sample size is too small. *Merck Eprova AG v. Gnosis S.P.A.*,57 addressed this issue and concluded that the unavailability of a survey is not fatal in such circumstances because a survey is not the only type of “extrinsic evidence” that can support an implied claim. *Merck Eprova* involved sales of raw ingredients to about a dozen large manufacturers of nutritional supplements and allegations that the defendant’s promotional statements misrepresented the “isomer” content of defendant’s product. The court held that five depositions were sufficient to create a jury issue on whether an

49 *Seven-Up Co.*, 86 F.3d at 1386 n.11.

50 See, e.g., *LG Elecs. U.S.A., Inc. v. Whirlpool Corp.*, 661 F. Supp. 2d 940, 948 (N.D. Ill. 2009) (“Federal false advertising claims generally fall into two categories: literal falsity and implied falsity. Where a statement or claim made in advertising is literally false, ‘the plaintiff need not show that the statement either actually deceived customers or was likely to do so.’ Where a statement or claim is literally true or ambiguous, however, a plaintiff must prove that the statement ‘implicitly convey[s] a false impression, [is] misleading in context, or likely to deceive consumers.’”) (citations omitted).


53 Id. at 1261.


55 Id. See also *Utah Med. Prods., Inc. v. Clinical Innovations Assocs.*, 79 F. Supp. 2d 1290, 1309–10 (D. Utah 1999) (striking expert testimony of a biomedical engineer because “he had not done any research at all with respect to how a clinician in labor and delivery would understand the term sensor tip in conjunction with intrauterine catheters,” and holding that the plaintiff bore the burden of determining falsity in light of the target audience, which involved a showing that the claims were “false as commonly understood by the consuming population of obstetric and gynecologic clinicians based on their knowledge and experience.”).


implied claim was made. Although “surveys are certainly the regular method” of demonstrating implied claims, the court saw “no reason why this cannot be done in the form of depositions in a case like this where the number of potential direct consumers is arguably fairly small.”

**Proving the Content of the Promotional Message.** Unlike consumer advertising, where the actual advertisement at issue can be attached to a complaint, the content of B2B promotional statements themselves may not be so easy to identify, particularly at the beginning of a case. Sometimes the messages are communicated verbally through a series of face-to-face meetings. Plaintiffs often may have to piece together indirect evidence of the advertising content from PowerPoint slides and emails, sales force “talking points” or “scripts,” and “call notes.” Claimants should be prepared to marshal these different sources of proof in order to present a comprehensive and cohesive description of the advertising message communicated.

**Defense Strategies**

Notwithstanding the increasing number of cases recognizing B2B communications as actionable under the Lanham Act, defendants may still challenge whether the statements at issue in these cases truly are “advertising.” At the pleading stage, defendants can consider arguing that the complaint lacks sufficient particularity necessary to establish the “commercial advertising and promotion” element of a Lanham Act claim. Defendants had success with this strategy in the 2011 case, *Boykin Anchor Co., Inc. v. AT&T Corp.*63 where the court considered an AT&T e-mail raising performance concerns about plaintiff’s “seismic anchors”—a product that holds telecommunication switching equipment in place during a seismic events like earthquakes. The court granted defendant’s motion to dismiss on the basis that the email was not “commercial advertising” because it was not written for the purpose of proposing or influencing an actual product sale.64

At summary judgment, defendants also may demand evidence to support the claim that the statement falls within the ambit of the Lanham Act. For example, in *Suntree Technologies, Inc. v.*


Ecosense International, Inc., the parties sold competing “baffle boxes,” which are “stormwater treatment structures that remove organic debris, trash, oil and other pollutants from stormwater before the stormwater reaches lakes, rivers and streams.” The baffle boxes were sold to cities and counties through a government contracting process. The plaintiff challenged the defendant’s product brochure provided to government purchasers as “false advertising” because the materials contained pictures of the plaintiff’s product and falsely suggested that the defendant’s product had the same features and performance as the plaintiff’s product. The Suntree court found at least two reasons why the product brochure at issue was not “advertising”: (1) “the purpose of the maintenance presentation was not to influence consumers to purchase EcoSense’s product but rather to provide training to those who had already done so”; and (2) the plaintiff “failed to present any evidence relating to the brochure’s dissemination, and, due to the sophistication of the consumers, it is unlikely that a simple product brochure could influence them to purchase EcoSense’s baffle boxes.”

As indicated by the Suntree case, to survive summary judgment, a plaintiff will have to affirmatively prove that the nature, purpose, and use of the statement qualifies it as advertising under the Lanham Act. Finally, even if a case makes it past summary judgment, at trial, issues of causation and damages can be tested directly by taking testimony of the business purchasers. This is in contrast to consumer advertising cases, where causation and damages often are debated with experts drawing statistical inferences from aggregate consumer data. In the B2B setting, the number of purchasers are often manageable enough to take direct testimony.

Conclusion

A company does not have to market its products directly to the general public to face exposure for false advertising under the Lanham Act. A competitor’s promotional statements to business customers must comply with the same basic requirement of truthfulness expected when statements are made to the general public. When a competitor crosses the line, a Lanham Act suit to stop the promotional statements is an option, particularly in light of recent cases on this topic.

Competitor false advertising cases involving promotions to business customers constitute an established and distinct type of Lanham Act case. When litigating this type of case, practitioners should be prepared to address the unique issues that arise in this context, such as determining the content of promotional claims with secondary evidence; proving implied claims through direct evidence rather than with surveys; and assessing how the purchasers’ level of sophistication affects their understanding of the promotional claims. Defendants can hold plaintiffs to their burden of proving that the challenged statements truly should be considered “advertising,” not only at the motion to dismiss stage but also at summary judgment, where the plaintiff will be required to adduce evidence that the statements were made for the purpose of influencing a product sale.

66 Id. at *2.
67 Id. at *11.
68 For example, in Seven-Up, the court set aside a jury verdict based on the distributors’ testimony that although they were given the false sales presentation and considered it, it was not a “substantial” factor in the decision to switch from Seven-Up to Sprite. Seven-Up Co. v. Coca-Cola Co., 86 F.3d 1379, 1382, 1387–88 (5th Cir. 1996) (noting that the plaintiff need not show that the false statements were the “only” or “predominant” cause of the purchase decision—only that they were a “substantial” cause).