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NEW MYTHS AND OLD REALITIES: RECENT DEVELOPMENTS IN ANTITRUST ENFORCEMENT

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ESSAY

NEW MYTHS AND OLD REALITIES: RECENT DEVELOPMENTS IN ANTITRUST ENFORCEMENT

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I. INTRODUCTION

Antitrust enforcement plays an increasingly prominent role in today's business climate. The Antitrust Division of the Department of Justice and the Bureau of Competition (the "Bureau") of the Federal Trade Commission ("FTC") face increasing challenges both from a tremendous increase in the number of mergers and from new forms of competitive issues arising in an increasingly high-tech economy. In the last several years, both antitrust agencies have reviewed a record number of proposed mergers and litigated a number of merger and non-merger cases. There have also been several important court decisions, such as *California*

Dental Association[1] and *Nippon Paper*,[2] in cases brought by the enforcement agencies. Following the recommendation of the FTC and the Justice Department, the Supreme Court overturned the rule of its *Albrecht* decision, and eliminated the *per se* rule for vertical maximum price fixing.[3] Finally, in a series of controversial and well-contested merger cases, the FTC successfully challenged the merger of Staples and Office Depot,[4] as well as two mergers in the drug wholesaling industry.[5]

This Essay reviews these trends in antitrust enforcement. Part II offers a brief overview of the Commission's merger enforcement program. Part III addresses ten "myths" that seem to have developed concerning present-day government antitrust enforcement. After critically evaluating each, the Essay concludes that these myths are either unfounded or contradicted by recent agency actions. Recent merger enforcement actions and recent challenges to anticompetitive conduct are more fairly seen as the product of applying antitrust doctrine to the demands of the economy of the late twentieth century, than as a departure from established doctrine or practice.

II. TRENDS IN MERGER ACTIVITY AND COMMISSION MERGER ENFORCEMENT

No one disputes that this country is in the midst of an unprecedented merger trend. Barely a day goes by without the announcement of a significant merger, strategic alliance or joint venture that touches the lives of millions of American consumers. The task of the FTC and the Antitrust Division of the Justice Department is to identify those merg-

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[1] California Dental Ass'n. v. FTC, 128 F.3d 720 (9th Cir. 1997), *cert. granted*, 119 S. Ct. 29 (1998).

[2] U.S. v. Nippon Paper Indus., Ltd., 109 F.3d 1 (1st Cir. 1997), *cert. denied*, 118 S. Ct. 685 (1998).

[3] *See* State Oil Co. v. Kahn, 522 U.S. 3 (1997) (overruling *Albrecht v. Herald Co.*, 390 U.S. 145 (1968)).

[4] *See* FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

[5] *See* FTC v. Cardinal Health, Inc., 12 F.Supp 2d 34 (D.D.C. 1998) (enjoining the merger between Cardinal Health and Bergen-Brunswig.

ers which pose a threat of the exercise of market power and take enforcement action where appropriate to assure that consumers receive the full benefit of a competitive marketplace.

What is remarkable about this merger trend, in addition to its sheer volume, is the nature of the acquisitions. In the 1980s, many mergers appeared to have been motivated primarily by financial market considerations, such as the junk bond phenomenon.[6] To a far greater extent, today's mergers appear to be motivated by strategic considerations. Some firms want to acquire market share,[7] expand product lines,[8] combine research and development ("R&D") capabilities,[9] gain control of important inputs,[10] or achieve efficien-

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[6] *See* Walter Adams & James W. Brock, *Predation, "Rationality", and Judicial Somnambulance*, 64 U. CIN. L. REV. 811, 816 (1996) (noting that junk bond financing facilitated corporate mergers during 1980's); Dennis J. Block et al., *Current Trends in the Market for Corporate Control*, *in* CONTESTS FOR CORPORATE CONTROL 1996: THE NEW ENVIRONMENT 7, 14-23 (PLI Corp. Law & Practice Handbook Series No. B4-7125 1996) (crediting mergers craze of 1980's to leveraged buy-outs); Louis S. Freeman, *General Overview and Strategies in Representing Sellers*, *in* TAX STRATEGIES FOR CORPORATE ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, FINANCINGS, REORGANIZATIONS AND RESTRUCTURINGS 7, 66 (PLI Tax Law & Estate Planning Handbook Series No. J4-3690 1997) (noting that junk bonds financed many mergers during the eighties).

[7] Consolidation in the banking industry offers a number of example of this acquisition motive. *See, e.g.*, Rick Brooks, *BankAmerica Seeks Growth by More Acquisitions*, WALL ST. J., Oct. 2, 1998, at B4 (discussing market share expansion by NationsBank (recently merged with BankAmerica) through mergers).

[8] Lucent's pending acquisition of Ascend Communications is primarily an effort to expand Lucent's networking equipment product lines. *See* Barnaby J. Feder, *Finally, Lucent and Ascend Tie the Knot for $20B*, N.Y. TIMES, Jan. 14, 1999, at C2.

[9] Several recently announced mergers in the pharmaceuticals industry are motivated by the desire to increase R&D expenditures. *See, e.g.*, Alan Cowell, *Zeneca Buying Astra as Europe Consolidates*, N.Y. TIMES, Dec. 9, 1998, at C1; David J. Morrow, *French Drug Makers to Combine in $10.4B Stock Deal*, N.Y. TIMES, Dec. 3, 1998, at C24 (describing the announced merger between Sanfori and Synthelabo).

[10] A recent example of this type of merger is the deal between TRW and LucasVarity. *See* Jeffrey Ball & Robert Frank, *TRW to Buy*

cies of integration.[11] Some mergers are a response to a sharp increase in global competition,[12] while still others are reactions to new economic conditions such as deregulation,[13] or to industry overcapacity.[14] Some strategic alliances may represent an attempt for a dominant firm to "hedge its bets" by acquiring potential competitors in adjacent markets.[15] Of course, these objectives are not necessarily anti-competitive, but such transactions frequently require close review because the firms are either competitors, in closely related markets, or both.

As the motivations for mergers and acquisitions distinguish today's transactions from prior years, so too do the numbers. Our internal record keeping indicates that Fiscal Year ("FY") 1998 produced the largest volume of merger filings in history, a total of 4728 reported transactions, which is an increase of about twenty-eight percent over the number for FY 1997. That was the seventh consecutive

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LucasVarity for $7 Billion, WALL ST. J., Jan. 29, 1999, at A3 (stating that the motive behind the merger is to gain access to components for use in auto parts assemblies).

[11] For example, the recent merger between Daimler Benz AG and Chrysler Corporation. *See* Steven Lipin & Brandon Mitchener, *Daimler-Chrysler Merger to Produce $3 Billion in Savings, Revenue Gains in 3 to 5 Years*, WALL ST. J., May 8, 1998, at A10.

[12] Recent oil industry mergers have been primarily motivated by increased competition in the face of very low oil prices. *See, e.g.*, Peter Coy, *Tremors from Cheap Oil*, BUS. WK., Dec. 14, 1998, at 34 (describing the Exxon/Mobil merger as a response to increased competition and low oil prices).

[13] For example, most of the mergers among utilities are in response to the move to industry deregulation. *See, e.g.*, Mark Moremont, *Two Utilities in New England Agree to a Deal*, WALL ST. J., Feb. 2, 1999, at A2.

[14] The strategic alliance between Goodyear and Sumitomo is in part a response to global overcapacity in the tire industry. *See Tyres: Tread Carefully*, ECONOMIST, Feb. 6, 1999.

[15] The deal between USA Networks and Lycos can be seen as a preemptive response to a perception that the increasing convergence between cable television and the Internet will create competition between retailers in each medium. *See* Eben Shapiro & Jon G. Auerbach, *USA Networks to Merge Unit with Lycos*, WALL ST. J., Feb. 9, 1999, at A3.

yearly increase since 1991, when there were 1451 filings. Unfortunately, our staffing has not kept pace with the increased workload. We are reviewing more than three times the number of filings with the same staffing we had seven years ago — a testament to the dedication and hard work of the Bureau's staff.

In FY 1998, the Commission initiated twenty-seven merger law enforcement actions, including three preliminary injunctions, one administrative complaint, and twenty-three consent agreements. An additional six transactions were abandoned in the face of probable enforcement action. The FTC also filed one civil penalty enforcement action under Section 7A of the Clayton Act for a Hart-Scott-Rodino ("HSR") Act [16] violation and three civil penalty actions for order violations. We have assessed record civil penalties for violations of the HSR Act and other order violations over the past four years: $3.4 million in FY 1995, $7.9 million in FY 1996, $9.35 million in FY 1997, and $4.5 million in FY 1998. To put these figures in perspective, the Commission has collected substantially more in civil penalties in those four years than the combined total for the 1980s.

One means of coping with the record number of HSR filings without compromising enforcement or imposing undue burdens on transactions that will not prove problematic, involves limiting the use of the second request[17] process to transactions most likely to raise serious concerns.

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[16] 15 U.S.C. § 18a (1994) (establishing a premerger notification and waiting period procedure, applicable to a range of transactions defined as to nature and size by the statute, that provide the Commission and Department of Justice information about planned transactions and a prescribed time period before the transaction may be consummated; thus, allowing the agencies an opportunity to analyze the transaction to determine whether it raises sufficient risk of an anti-competitive outcome to merit enforcement action).

[17] What have come to be called "second requests" are authorized by Section 7a(e). *See* 15 U.S.C. § 18a(e) (providing that, prior to the expiration of the initial waiting period, the agencies may require the submission of additional information, and extend the waiting period for a fixed number of days following that submission).

This effort has significantly reduced the percentage of filings in which a second request has been issued. The absolute number of cases in which we issued second requests actually declined from fifty-eight in FY 1995 to forty-six in FY 1998, despite the increase in HSR filings from 2816 to 4728 over the same period. In other words, we have gone from issuing second requests in slightly over two percent of transactions to issuing them in slightly under one percent.

These are some of the macro trends in merger activity and enforcement. Part III discusses the substance of recent enforcement, first as to mergers and then as to non-merger violations. We approach this topic by raising ten "myths" regarding recent antitrust enforcement and examining these new myths in light of some old realities.

III. MYTHS SURROUNDING ANTITRUST ENFORCEMENT

Periodically, we hear characterizations of current enforcement attitudes. Some are accurate, while others are off base. In recent years, we have heard ten "myths" that have arisen in the antitrust community concerning enforcement. The first seven specifically relate to merger enforcement: (1) that relevant market analysis has strayed from the Horizontal Merger Guidelines; (2) that the federal enforcement agencies intervene too aggressively in high-technology markets; (3) that the Commission only challenges horizontal mergers involving unilateral effects; (4) that penalties for violations of the HSR Act are nothing more than a cost of doing business; (5) that if merger parties offer to divest some package of assets, the FTC will accept it rather than litigate; (6) that once a merger party has entered into a consent decree, its obligations to the FTC are over; and (7) that the new efficiency section of the Horizontal Merger Guidelines has raised the bar for demonstrating efficiency claims. Three other myths deal specifically (or, in the case of the tenth, primarily) with non-merger antitrust violations: (8) that the pace of merger enforcement means the Commission is unable to bring any significant non-merger matters; (9) that the Supreme Court's *Khan* deci-

sion suggests that forms of minimum resale price maintenance may be legal; and (10) that a respondent need not worry about administrative litigation with the FTC because administrative litigation will take years to complete before the Administrative Law Judge and even longer to result in a final Commission decision.

A. Myth # 1 — Relevant market analysis has strayed from the Merger Guidelines.

A recurrent claim is that the agencies are using the unilateral effects doctrine[18] to bring antitrust challenges without subjecting these challenges to the rigor of market definition[19] as called for by the Horizontal Merger Guidelines.[20] Another formulation of this criticism is that unilateral effects analysis is *Brown Shoe*[21] dressed up in economic

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[18] The unilateral effects doctrine describes how, under certain conditions, a merger may enable the combined firm to raise prices or reduce output unilaterally. This doctrine is one of two major theories of competitive harm set forth in the 1992 Horizontal Merger Guidelines (coordinated interaction is the other major form of competitive harm). *See Joint DOJ/FTC Horizontal Merger Guidelines*, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 § 2.2 (1992) (amended 1997) [hereinafter *Horizontal Merger Guidelines*]. For a discussion of unilateral effects doctrine, see, e.g., Jonathan B. Baker, *Unilateral Competitive Effects Theories in Merger Analysis,* ANTITRUST, Spring 1997, at 21.

[19] The use of unilateral effects doctrine has been discussed extensively as a result of this criticism. *See, e.g.*, Deborah A. Garza, *The New Efficiencies Guidelines: The Same Old Wine in a More Transparent Bottle*, ANTITRUST, Summer 1997, at 6 (discussing problems with unilateral effects model used under Merger Guidelines); Michael L. Weiner, *Explaining New Theories of Unilateral Effects*, ANTITRUST, Spring 1997, at 4 (stating enforcement agencies have encouraged developments through new econometric modeling techniques to predict mergers).

[20] *See Horizontal Merger Guidelines*, *supra* note 18, § 1.

[21] The phrase *Brown Shoe* refers to a doctrine that has developed from the Supreme Court's analysis in *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962). The Court explained in *Brown Shoe* that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Id.* at 325. The Court went on to state that "within this broad market, well-defined submarkets may exist

jargon.[22] The *Staples-Office Depot*[23] case is most commonly cited in support of this criticism of recent enforcement policy.

Staples was the largest merger enforcement action litigated by the government in recent years. Staples and Office Depot are two of the three leading office supply superstores chains in the U.S.[24] The two firms together operated about 1000 superstores and compete head-to-head in numerous metropolitan areas across the country. In fifteen

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which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct consumers, distinct prices, sensitivity to price changes, and specialized vendors." *Id.* Although the *Brown Shoe* distinction between markets and submarkets has been criticized, and is not followed in the *Horizontal Merger Guidelines*, the Supreme Court's analysis correctly recognizes that there are varying degrees of substitution among products. *See* 2A PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 533b at 169-70 (1995). That latter concept – varying degrees of substitutability – is at the core of the unilateral effects doctrine, which holds that a merged firm may be able to raise price (or reduce output) unilaterally if the products of the merging companies are the first and second choices for customers representing a substantial part of the market, and other firms are unlikely to be able to reposition their products to become closer substitutes for those of the merged firm. *See Horizontal Merger Guidelines, supra* note 18, at § 2.21. This is not the *Brown Shoe* submarket analysis, but rather a recognition that within a relevant market, it is possible for a merger to eliminate localized competition between particularly close substitutes. In addition, while the *Horizontal Merger Guidelines* speak only in terms of relevant markets, not submarkets, the "practical indicia" identified by the Court in *Brown Shoe* remain useful in defining markets. As noted by the District of Columbia Circuit, most of the *Brown Shoe* indicia of submarkets are related to substitutability in supply or demand. *See* Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 218 n.4 (D.C. Cir. 1986), *cert. denied,* 479 U.S. 1033 (1987). The District of Columbia Circuit concluded that "submarket indicia" are best viewed as "proxies for cross-elasticities of supply and demand," and thus the identification of a submarket is in principle no different than the identification of a relevant market." *Id.* at 218.

[22] *See* Weiner, *supra* note 19, at 4 (noting this line of criticism).

[23] FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

[24] *Id.* at 1069.

major metropolitan areas, including Washington, D.C., Baltimore, San Diego and Tampa-St. Petersburg, Staples and Office Depot are the only superstores, and the merger would have resulted in a monopoly in those markets.[25] In twenty-seven other metropolitan areas, the two firms have only one other superstore competitor, Office Max.[26] These facts, along with other evidence, suggested the proposed merger was very likely to produce higher prices and also to prevent increased competition in areas where one of the firms was planning to enter the other's territory.[27] The Commission argued, and the district court agreed, that the merger would lead to increased prices for consumers in each of these markets.[28]

There has been criticism that the FTC eschewed the rigorous analytical framework of the Merger Guidelines and instead based its relevant market argument on the *Brown Shoe* approach.[29] A second criticism suggests that the Commission used unilateral effects analysis and attempted to prove the merger was anti-competitive without really defining a relevant market.[30] While both myths provide

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[25] *Id.* at 1073 n.5.

[26] *Id.* at 1069.

[27] *Id.* at 1082.

[28] *Id.* at 1082, 1093. The FTC estimates that consumers may save around $1 billion over a five-year period, or about $200 million per year, or approximately double the FTC's annual budget as a result of the blocking of the merger.

[29] *See* Karen Donovan, *Back to "Brown Shoe"? Superstores are Major FTC Target, New Anti-Trust Theory Says Require a Distinct Submarket*, NAT'L L.J., April 21, 1997, at A1 (asserting that FTC's actions against superstores is reminiscent of *Brown Shoe* submarket theory); Neal R. Stoll & Shephard Goldfein, Staples *and* Boeing: *Rivalry or the Lack of It*, N.Y. L.J., July 15, 1997, at 3 (asserting *Staples* court relied on reasoning of *Brown Shoe*, yet wandered through "a mystical market definition analysis"). *Cf.* Robert M. Vernail, Casenote, *One Step Forward, One Step Back: How the Pass-on Requirement for Efficiencies Benefits in* FTC v. Staples *Undermines the Revision to the Horizontal Merger Guidelines Efficiencies Section*, 7 GEO. MASON L. REV. 133 (1998).

[30] *See, e.g.*, Bruce H. Schneider & Woo Jung A. Cho, *Determining Markets: Anchor Hospitals are not Superstores*, N.Y. L.J., Dec. 30, 1997, at 1 (asserting that relevant market delineation of Staples/Office Depot

interesting dinner conversation, they ignore the more mundane realities of the case.

In *Staples*, the Commission followed the analytical framework of the Merger Guidelines and defined a relevant market in a traditional fashion. The analysis focused on one compelling set of facts — the pricing history of the office superstore firms. This evidence provided a powerful beacon that illuminated the market definition analysis. The simple but compelling story was that the number of superstore firms had the most significant effect on prices in the market. Prices were lowest in three-chain markets, higher in two-chain markets, and highest in markets with a superstore monopoly. The difference in prices between one-chain cities and three-chain cities was approximately thirteen percent — an impressive difference in retailing where profits and profit margins are usually only a small percentage of sales volume.[31]

Why was this percentage important? The critical question in relevant market analysis is whether, if prices increase by five percent, enough consumers will switch to other sellers of the product to make the price increase unprofitable.[32] The answer — based on the pricing practices of Office Depot and Staples — was that consumers in many parts of the country had not switched to alternative sellers despite sustained price differentials exceeding five percent.[33] This strongly suggested that alternative sellers, such as mail order and small office supply stores, were not in the relevant market.

Further, the court found other evidence that supported the Commission's delineation of the relevant product mar-

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merger was flawed because it assumed the relevant market consisted of only three participants).

[31] *See Staples*, 970 F. Supp. at 1076.

[32] *See Horizontal Merger Guidelines, supra* note 18, § 1.11; *Staples*, 970 F. Supp. at 1076 n.8. *See also* Consolidated Gold Fields, PLC v. Anglo Am. Corp., 698 F. Supp. 487, 501 (S.D.N.Y. 1988) (excluding communist-block gold supplies from the relevant market in gold on the basis of the five-percent test).

[33] *See Staples*, 970 F. Supp. at 1076, 1078, 1080.

ket. This evidence fits within the factors listed by *Brown Shoe*: the parties identified a superstore market in their documents; they focused primarily on other superstore competitors in establishing price zones and considering where to enter; and office superstores offer a broader range of products in a unique retail setting.[34] Ultimately, while the case was not litigated as a *Brown Shoe* case, the court's decision relied on the better aspects of the Supreme Court's teaching.

Upon closer inspection, the second claim — namely, that the enforcement agencies are using unilateral effects analysis to avoid applying the rigorous approach to market definition contained in the Merger Guidelines — does not hold up either. While most of the recent cases brought by the Commission have involved unilateral effects analysis,[35] in none of these cases have we sought to avoid the requirement of proving a relevant market.[36]

There is a sense, though, in which the critics are right. The agencies use *Brown Shoe* criteria and measure unilateral effects to determine what cases to bring, because merger analysis requires the agencies to examine the relationship between products made by merging firms and to determine whether the cross elasticities between them are

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[34] *See id.* at 1078-80.

[35] For example, four of the six consent cases in the first five months of fiscal 1999 alleged a unilateral effects theory. *See* Service Corp. Int'l, F.T.C. File No. 981-0353 (accepted for public comment Jan. 15, 1999) *available at* <http://www.ftc.gov/os/1999/9901/9810353agr.htm>; ABB AB & ABB AG, F.T.C. File No. 991-0040 (accepted for public comment, Jan. 11, 1999), *available at* <http://www.ftc.gov/os/1999/9901/9910040 agr.htm>; LaFarge Corp., F.T.C. File No. 981-0161 (accepted for public comment Oct. 20, 1998), *available at* < http://www.ftc.gov/os/1998/ 9810/9810161.htm>; Kloninklijke Ahold NV, F.T.C. File No. 981-0254 (Oct. 20, 1998) (consent agreement), *available at* <http://www.ftc.gov/os/ 1998/9810/9810254agr.htm>. In addition, two out of three recent merger litigations involved unilateral effects theories. *See, e.g.,* FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 937 (E.D. Mo. 1998); FTC v. Staples, Inc., 977 F. Supp. 1066 (D.D.C. 1997).

[36] Of course, some antitrust decisions find violations without defining relevant markets. *See, e.g.*, FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986).

so much more significant than the relationships between products made by other firms that the merger will confer market power on the new firm. In a somewhat cruder sense, that is what *Brown Shoe* submarkets are all about. The *Brown Shoe*-Court clearly was looking for a way to suggest that some products within a broad market may be closer substitutes for one another than other products in the market.[37] The use of unilateral effects analysis is a more focused and disciplined effort to measure those relationships. When there are unique relationships among products made by the merging firms, as evidenced by how the firms behave in the marketplace and by quantitative analysis of past pricing behavior, the merger poses competitive problems.[38] In these situations, the issue of the precise boundaries of the market become, and should become, secondary.[39]

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[37] *See* Brown Shoe Co. v. U.S., 370 U.S. 294, 325 (1962). In discussing the criteria that may define a "submarket," the Court observed that "[t]he boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors ." *Id.* A number of these criteria, including industry or public recognition of the submarket's separateness, the product's peculiar uses, distinct customers, and sensitivity to price changes rather clearly apply to judging the likelihood of unilateral effects.

[38] *See Horizontal Merger Guidelines, supra* note 18, § 2.21.

[39] One important benefit of litigation is to help clarify the law. Other courts have relied on the relevant market definition analysis in *Staples*. *See, e.g.*, FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 45-48 (D.D.C. 1998); Pepsico, Inc. v. Coca-Cola Co., 1998-2 Trade Case. (CCH) ¶ 72,257 (S.D.N.Y. Aug. 27, 1998) (relying on the *Staples* and *Cardinal Health* decisions (that a channel of distribution can define a market, notwithstanding the fact that the products may be available from other sources) to hold that Pepsi's alleged relevant market of "sales of fountain-dispenced soft drinks distributed through independent food service distributors" was sufficient to survive a Rule 12(b)(6) motion to dismiss for failure to state a claim).

B. Myth # 2 — The agencies intervene too aggressively in high-technology markets.

A fairly recent *Wall Street Journal* had a provocative front-page article entitled "Antitrust Isn't Obsolete in an Era of High-Tech."[40] The article explained that "one of the great myths of our time is that technology is eradicating the imperfections of market economies."[41] This was not news at the antitrust enforcement agencies. An increasing number of enforcement actions involve issues on the cutting edge of some new technologies: innovation markets,[42] standard setting,[43] network effects,[44] market access,[45] and new forms of competition.[46]

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[40] Alan Murray, *Antitrust Isn't Obsolete in an Era of High-Tech*, WALL ST. J., Nov. 10, 1997, at A1.

[41] *Id.*

[42] Innovation market cases are brought to protect competition in research and development for next generation products, even though the product may not currently be on the marketplace. *See* American Home Products Corp., 119 F.T.C. 217 (1995) (consent order involving the market for vaccines not currently produced but still in the clinical pretrial stage).

[43] The nature of certain areas of competition, particularly in high-technology markets, requires collaborative activity between competitors in order to avoid inefficient and needlessly duplicative technical interface standards. For example, all components of a computer, which may be manufactured by different companies, must be technically compatible for the machine to work properly. Abusing the standard setting process to achieve competitive advantage may violate section 5 of the FTC Act. *See* Dell Computer Co., 121 F.T.C. 616 (1996) (consent order).

[44] Competition between networks is prevalent in high-technology industries, and it raises a number of antitrust concerns, including dominance of a network by a single entity, extension of the dominance to complementary markets, and access by competitors to the network. Many of these issues are raised in the on-going Justice Department *Microsoft* case. *See* United States v. Microsoft Corp., Civ. Ac. No. 98-1232 (D.D.C. filed May 18, 1998).

[45] *See id.* One of the issues in the *Microsoft* case concerns whether and how a competitor in the market for Internet browsers (Netscape) should be granted access to Microsoft's market-dominant computer operating system.

[46] In many high-technology industries, competition revolves less around traditional price competition than around nonprice product at-

High-tech markets pose novel issues for antitrust enforcers. Unlike traditional markets, these are often markets with "winner take all" characteristics.[47] Thus, the key competition occurs at the product development and innovation stage. Protecting competition at this stage involves some difficult trade-offs, especially since we do not want to suppress incentives to innovate. The goal of the antitrust enforcement agencies is not to favor one competitor or group of competitors over another; rather, their objective is to ensure that the race is run fairly.[48]

Perhaps the most controversial area of government enforcement in this area involves merger cases in innovation markets. The Commission has brought several innovation market cases in the past three years, primarily involving pharmaceuticals. This fact should not be surprising for two reasons. First, as the *Wall Street Journal* article observed, R&D competition is an increasing focus of the U.S. economy in many areas.[49] Research and development, and innovation, are critically important to the competitiveness of markets, both domestically and internationally. Second, a substantial amount of recent merger activity has occurred in markets where antitrust is particularly important in pre-

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tributes. Competition in computer chips focuses on processor speed and increased graphic capabilities, whereas for new drugs, the focus is on efficacy in treating particular diseases, and for Internet companies, the race is to acquire market share regardless of profitability in order to survive the inevitable market shakeout. Cases brought in these and other high-technology industries focus more on these new kinds of competition than price competition.

[47] Particularly in markets characterized by networks, an industry may reach a "tipping" point where manufacturers of complementary products adopt the dominant technical standard of those products with which interface is necessary, or consumers adopt the product that is most favored by other consumers. Examples include software companies gravitating to the PC standard operating system, or consumers favoring VHS videocassettes over the BETA version once the VHS version reached a certain market level.

[48] *See* David A. Balto & Robert Pitofsky, *Antitrust and High-Tech Industries: The New Challenge*, 43 ANTITRUST BULL. 583 (1998) (discussing the efforts of the antitrust agencies in high-tech fields).

[49] *See* Murray, *supra* note 40, at A1.

serving R&D competition, such as pharmaceuticals and defense.[50] In these critical areas, the goal of antitrust enforcers is to carefully identify those situations where a merger likely will reduce innovation competition. Intervention in innovation market transactions is warranted in carefully limited circumstances — namely, where few firms possess the specialized assets or characteristics needed to compete successfully in the market. Where such intervention is necessary, the aim is to narrowly craft relief to remedy the competitive problem without interfering with the incentives and ability to engage in other R&D.

The Commission's action in *Ciba-Geigy/Sandoz*[51] illustrates this approach to high-tech markets. The transaction involved a $63 billion merger of two pharmaceutical giants that threatened to produce a monopoly in key technologies used to develop gene therapy products, which show substantial promise for the treatment of various cancers and AIDS.[52] There were relatively few potential competitors for this technology because the merging firms controlled critical patents.[53] The merger therefore would have diminished both the incentives for and the ability of other firms to develop competing products. Although this market has yet to be developed, its annual value is expected to reach $45 billion by the year 2010.[54] The FTC secured a consent order intended to preserve competition in this important innovation market, in part by requiring the licensing of certain technology and patent rights to Rhone-Poulenc Rorer.[55]

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[50] *See, e.g.*, Glaxo, plc., 119 F.T.C. 815 (1995) (consent order); Martin Marietta/General Dynamics, 117 F.T.C. 1039 (1994) (consent order).

[51] Ciba-Geigy Ltd., 123 F.T.C. 842 (1997) (consent order).

[52] *See id.* at 844-46.

[53] *See id.* at 849.

[54] *See id.* at 845.

[55] *See* Elyse Tanouye & Robert Langreth, *Genetic Giant: Cost of Drug Research is Driving Talks of Glaxo, SmithKline*, WALL ST. J., Feb. 2, 1998, at A1 (discussing Ciba-Geigy/Sandoz's licensing of gene-therapy technologies and patents); John R. Wilke, *US Forces New Drug Giant to Share Genetic Research*, WALL ST. J., DEC. 18, 1996, at B4 (reporting on FTC's demand that Ciba-Geigy and Sandoz license rivals in order to preserve competition and innovation).

This licensing arrangement ensures that Rhone-Poulenc will be in a position to compete with the merged firm. According to *Business Week*, the FTC's enforcement action "shows a new savvy among trustbusters about high-tech competition."[56]

One issue that generated some controversy was the scope of relief.[57] In innovation market cases, the Commission uses various approaches. In some cases certain assets must be divested, while in others the licensing of technology is required.[58] In *Ciba-Geigy*, the Commission believed that licensing, rather than divestiture of assets, was sufficient. Competitors already had (to varying degrees) the hard assets, e.g., production facilities, researchers and scientists, needed to compete. Rivals and other scientists confirmed that licensing would enable them to develop gene therapy products and replace the competition lost due to the merger.[59] Further, an asset divestiture might have created substantial disruption in the parties' R&D efforts. In this case, therefore, a licensing remedy represented the preferred approach to restoring the competition lost by the merger.[60]

Ciba-Geigy further illustrates the importance of enforcing the antitrust laws carefully but assertively in high-

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[56] Naomi Freundlich et al., *A Booster Shot for Gene Therapy: FTC Trust Busters Put Conditions on a Merger even though the Technology is in its Infancy,* BUS. WK., Jan. 20, 1997, at 92.

[57] For criticism of relief in innovation market cases, see Richard T. Rapp, *The Misapplication of the Innovation Market Approach to Merger Analysis*, 64 ANTITRUST L.J. 19 (1995). For a response, see Thomas N. Dahdouh & James F. Mongoven, *The Shape of Things to Come: Innovation Markets in Merger Cases*, 64 ANTITRUST L.J. 405 (1996).

[58] *See, e.g.*, Montedison, S.p.A., 119 F.T.C. 676 (1995) (consent order involving divestiture); Boston Scientific Corp, 119 F.T.C. 549 (1995) (consent order involving licensing); American Home Products Corp., 119 F.T.C. 217 (1995) (consent order involving licensing).

[59] *See* Ciba-Geigy Ltd., 123 F.T.C. 842, 895 (1997) (Separate Statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger, Roscoe B. Starek, III, and Christine A. Varney).

[60] For a discussion of remedies in high-technology cases, see David A. Balto & James Mongoven, *Antitrust Remedies in High Tech Cases,* ANTITRUST REP., Jan. 1999, at 22.

technology industries. Antitrust enforcement is critical because a firm's competitive strength in these markets is often derived from its intellectual property and these rights can pose a formidable barrier to new entry. On the one hand, the Commission staff always weighs the impact of enforcement on the incentives to innovate. But it is equally important to protect against anti-competitive consolidations or other abuses of intellectual property as it is to prevent the acquisition or abuse of market power with respect to other assets. This is a difficult, but critical, balance to draw.[61]

A somewhat different interaction between intellectual property rights in the high-tech field and restraint of competition was present in the Commission's recent enforcement action against Intel Corp.[62] The Commission alleged that Intel had used its monopoly power in an effort to undermine the patent rights of several of its customers. Further, the Commission alleged that Intel retaliated commercially against customers who had patents that they either sought to enforce against Intel or refused to license royalty-free to Intel. This conduct, according to the complaint, tended to maintain Intel's monopoly power by, among other things, reducing the competitive threat posed by the existence of important technology not under Intel's control or available to it.[63] The case was settled on the eve of trial in March 1999, with Intel agreeing to halt the conduct challenged by the Commission.

The *Intel* case involved the difficult question of the tactics a monopolist may use to maintain its monopoly. Intel makes general purpose microprocessors, the brains of personal computers that process system data and control other

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[61] *See* Willard K. Tom & Joshua A. Newberg, *Antitrust and Intellectual Property: From Separate Spheres to Unified Field*, 66 ANTITRUST L.J. 167 (1997) (discussing the interaction of antitrust and intellectual property laws).

[62] *Intel Corp.*, FTC Dkt. No. 9288 (June 8, 1998) (complaint), *available at* <http://www.ftc.gov/os/1998/9806/intelfin.cmp.htm> [hereinafter *Intel Complaint*].

[63] *See id.*

devices integral to the system. It is a market that has expanded dramatically each year for more than a decade and in which product generations are measured in months, not years. Despite this fast growth and high rate of innovation, Intel has managed to maintain a market share of approximately eighty percent of dollar sales.[64] Barriers to entry are high due to the sunk costs of design and manufacture, substantial economies of scale, customers' investments in existing software, the need to attract support from software developers, and reputational barriers.[65]

The microprocessor market has several unique features. Computer design and manufacture generally requires complex coordination between a number of different disciplines, almost always spread among many different firms. Microprocessors, memory components, core logic chips, graphics controllers, various input and output devices, and software must all work effectively with each other in order for the final product to work. To achieve effective integration, computer manufacturers require product specifications and other technical information about each component. In addition they require such information in advance of designing the computer in order to test and debug to insure the reliability and performance of each component and the system as a whole. This information is provided by all component makers, including Intel, and is subject to formal nondisclosure agreements. This information sharing has substantial commercial value to both sides of the agreement, the component makers and the computer original equipment manufacturers ("OEMs").

The Commission's complaint charged that Intel suspended its traditional information sharing with three customers — Digital Equipment Corporation, Intergraph Corporation, and Compaq Computer Corporation — in order to force those customers to end disputes with Intel concerning

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[64] *See generally* Stephen Labaton, *Intel and the U.S. in Tenative Deal in Antitrust Case*, N.Y. TIMES, Mar. 9, 1999, at A1 (describing Intel's market position).

[65] *See Intel Complaint* at ¶¶ 8-9 (describing the costs of entry into the microprocessor market).

the customers' asserted intellectual property rights and to grant Intel licenses to patented technology (not just microprocessor technology) developed and owned by those customers.[66] Digital and Compaq capitulated quickly and entered into cross-license arrangements with Intel. Intergraph was able to resist only because it succeeded in obtaining an injunction against Intel's conduct in a federal court.[67]

Intel's conduct reinforced its dominance of the general purpose microprocessor market in at least three ways. First, Intel's alleged conduct would give it access to technology being developed by others in the industry, disadvantaging other microprocessor manufacturers who are trying to challenge Intel's dominance. Second, forcing other firms to license away rights to their proprietary technology would dull the incentive to innovate, thus harming competition in several ancillary markets. Third, Intel's forced acquisition of technology from computer OEMs reduces the ability of those OEMs to support a non-Intel microprocessor platform by taking away an OEM's proprietary technology that could have been used to market its machines. Thus, Compaq would be much less able to support an AMD or Digital microprocessor system by advertising its own non-microprocessor technology because Intel has forced Compaq to license that other technology and Intel could in turn license it back to other OEMs that support an Intel microprocessor platform.

The proposed order remedies the concerns in the Commission's complaint. It prohibits Intel from withholding or threatening to withhold certain advance technical information or microprocessors from a customer for reasons relating to an intellectual property dispute with that customer.[68]

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[66] *See Intel Complaint* at ¶¶ 11-37.

[67] *See* Intergraph Corp. v. Intel Corp., 3 F. Supp. 2d 1255 (N.D. Ala. 1998). The premilinary injunction in the case has been appealed to the Federal Circuit.

[68] *See* Intel Corp., ¶ II.A, FTC Dkt. No. 9288 (Mar. 17, 1999) (proposed consent order), *available at* <http://www.ftc.gov/os/1999/9903/d09288intelagreement.htm>.

This requirement is limited to the types of information that Intel routinely gives to customers to enable them to use Intel microprocessors, and, unlike *Ciba-Geigy*, it does not impose a "licensing" requirement in the first instance. The order allows companies in disputes to continue to receive relevant information except where the customer elects to seek an injunction against Intel's manufacture, use, sale, offer to sell, or importation of its microprocessors. The order is also careful to protect Intel's legitimate intellectual property rights: Intel will not be required to continue providing information or products with respect to the microprocessors that the customer is seeking to enjoin.[69] In addition, Intel may withhold information for legitimate business reasons, such as a breach of the disclosure agreement.[70]

The *Intel* settlement is important to maintaining competition in several areas. It defines as an abuse of monopoly power[71] the use of that power to extract proprietary, legally-protected intellectual property from potential competitors.[72] Absent this rule of law, a dominant firm in a high-tech industry could use its current market power to extend its dominance to complementary products and to next generation products.

Chairman Pitofsky's statement on the issuance of the proposed consent summed up its importance:

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[69] *See id.* at ¶ II.A-II.B.

[70] *See id.* at ¶ II.B.

[71] Since the litigation was resolved by consent, there was no adjudication of whether Intel possessed monopoly power.

[72] Though the FTC's action against Intel has been criticized by some commentators as undermining the integrity of intellectual property rights, see, e.g., Robert J. Barro, *Why the Antitrust Cops Should Lay off High Tech*, BUS. WK., Aug. 17, 1998, at 20, the action is more properly viewed as an attempt to protect intellectual property rights against overreaching by competitors with market power. In this sense, the *Intel* case demonstrates that the application of the antitrust laws in high-tech markets, where intellectual property rights are of critical importance, requires careful attention to the interaction between the intellectual property rights and competitive restraint — somewhat paradoxically, sometimes it is necessary to use the antitrust laws to protect exclusive rights.

> The heart of the Commission's complaint against Intel was the principle that a monopolist cannot withhold products or information about products in order to retaliate against customers who find themselves in an intellectual property dispute. We recognize that there is an essential balance to be struck between protecting the incentives of smaller rivals to innovate and unduly constricting a dominant firm's conduct of its business. The settlement would fully resolve those competitive concerns without interfering with Intel's legitimate business activities. This is the result that the staff would have sought after a full and successful trial.[73]

Together, the *Ciba-Geigy* and *Intel* cases illustrate the need for antitrust enforcement in high-technology fields to protect incentives to innovate. Although the cases involve threats to competition in different forms, in each instance the Commission's actions are consistent with the aim of preserving competition and innovation by balancing the importance of intellectual property rights and competition.

C. Myth # 3 — The Commission only challenges horizontal mergers involving unilateral effects.

Some commentators have suggested that the Commission is only concerned about horizontal mergers where market concentration is high and there is concern that the merged firm will possess unilateral market power. The Commission's enforcement action regarding the Shell-Texaco joint venture[74] demonstrates that the Commission is also concerned with mergers that increase the likelihood of coordination by the remaining market participants. This

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[73] *See FTC Press Release, FTC Accepts Settlement of Charges Against Intel*, March 17, 1999.

[74] *See* Shell Oil Co., F.T.C. Dkt. C-3803 (April 21, 1998) (consent order), *available in* 1998 FTC LEXIS 54. For a discussion of other vertical integration cases, see Richard G. Parker & David A. Balto, *The Merger Wave; Trends in Merger Enforcement and Litigation*, 54 BUS. LAW. (forthcoming Aug. 1999).

joint venture, which resulted in the largest oil company in the United States, raised several interesting issues in many diverse markets. Ultimately, the Commission entered an order that required the divestiture of an interest in an oil pipeline, a Washington State refinery, and terminals and retail assets in Hawaii.[75]

The primary focus of the FTC's competitive concerns was potential coordinated interaction. In fact, in some of the markets the Herfindahl-Hirschman Index figures ("HHIs")[76] were less than 2000. In one market, the sale of refined gasoline in California, the proposed transaction would raise the HHIs by 154 points to 1635, within the moderately concentrated range. Although the concentration numbers in gasoline refining may not have been as substantial as in other mergers, the evidence suggested there was a significant threat of coordinated interaction. In each of the gasoline refining markets, the products are homogeneous, and wholesale prices are publicly available and widely reported in the industry. Refiners, therefore, can readily identify firms that deviate from a coordinated or collusive price. Existing exchange agreements between refiners would likely facilitate identification and punishment of those deviating from a coordinated or collusive price.

One further critical fact was that industry members have raised prices in the past by selling products outside the market, sometimes at a loss, in order to remove supplies that had exerted a downward pressure on prices. This type of conduct would not make economic sense from the perspective of an individual firm unless it could be confident that it would lead to coordinated supply reductions in the market and a coordinated increase in price. That is, no one firm would rationally choose to reduce its own output in the market if the resulting reduction of market supply would be made up by its competitors, or if its competitors

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[75] *See Shell Oil Co.*, 1998 FTC LEXIS at *16.

[76] The HHI for a given market is computed by summing the squares of the individual market shares of all participants. *See Horizontal Merger Guidelines, supra* note 18, § 1.5 & n.17.

would simply maintain their own output levels but would share in any price increase resulting from the first firm's output sacrifice.

Section 7 of the Clayton Act[77] is well-suited to challenging a merger where there is a history of oligopolistic behavior. As the Supreme Court stated in *Brooke Group*, Section 7 seeks to prohibit "excessive concentration, and the oligopolistic price coordination it portends."[78]

Professor Areeda has observed that such oligopolistic pricing,

> is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[79]

In addition to the problems of coordinated interaction, there was an interesting vertical aspect to the case. Texaco owns the only heated pipeline that carries undiluted heavy crude oil from the San Joaquin Valley of California to refineries in the San Francisco Bay area. Huntway Refining Company is an asphalt refiner in the Bay area, and Shell is the only other refiner of asphalt in northern California. Both Huntway and Shell buy undiluted heavy crude from Texaco, transported by the pipeline, and refine it into asphalt (among other products). The Commission staff was concerned because the transaction would allow the

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[77] 15 U.S.C. § 18 (1994) (forbidding, broadly speaking, any "person" engaged in or affecting commerce from acquiring stock or assets of any other person engaged in or affecting commerce "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly").

[78] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 229-30 (1993).

[79] PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 901'a, 934 (Supp. 1997).

Shell/Texaco joint venture to raise Huntway's costs by increasing prices of undiluted heavy crude to Huntway relative to the price charged to Shell.[80]

The consent order eliminates this risk of price discrimination by requiring the parties to enter into a ten-year supply agreement with Huntway, the terms of which must be approved by the Commission.[81] In fact, the parties have entered into such an agreement, which constitutes a confidential exhibit to the consent order. The consent order prohibits the Shell/Texaco joint venture from increasing the price or reducing the volume of crude oil supplied to Huntway, and also prohibits that joint venture from terminating the supply agreement (except on terms identified in that agreement).[82]

The *Shell Oil* case illustrates that the Commission remains concerned about transactions involving vertical effects and coordinated interaction. While horizontal mergers involving unilateral effects are one category of cases in which the Commission is frequently active, we continue to examine closely cases involving other types of potential harms.

D. Myth # 4 — Penalties for violations of the Hart-Scott-Rodino Act are nothing more than a cost of doing business.

Enforcement of the premerger reporting requirements of the HSR Act continues to be a priority at the Commission. The number of recent enforcement actions and higher penalties reflect the FTC's commitment to monitor compliance

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[80] These concerns are similar to those raised in *Lockheed/Martin Marietta*, 119 F.T.C. 618 (1995). As in the instant case, the concern was that an upstream monopolist could raise the costs of its remaining downstream competitor. Specifically, in *Lockheed*, the concern was that Lockheed could modify a navigation and targeting system in a discriminatory fashion. In the Shell-Texaco joint venture, the concern was more straightforward price discrimination.

[81] *See* Shell Oil Co., F.T.C. Dkt. C-3803 (April 21, 1998) (consent order), *available in* 1998 FTC LEXIS 54.

[82] *See id.*

with the Act closely and to take strong, appropriate action against serious violations.

The enforcement action taken against Mahle GmbH, a German automotive and diesel engine parts manufacturer with businesses in the U.S., and Metal Leve, S.A., a competing Brazilian manufacturer illustrates this point. The complaint charged that Mahle acquired 50.1 percent of the voting securities of Metal Leve for approximately $40 million around June 26, 1996, without Mahle and Metal Leve filing the requisite premerger notifications.[83] The complaint further alleged that both firms knew that their deal posed serious antitrust problems and completed the transaction knowing that they were violating the HSR Act. According to the complaint, each of the two firms "consulted with U.S. counsel or U.S. investment bankers and were apprised of the requirement under the HSR Act that they each file Notification and Report Forms with U.S. antitrust authorities."[84] In fact, the complaint alleges that each firm had "considered ignoring the HSR reporting requirements" and treating the HSR reporting obligation "as a trade off between the costs of compliance with the Act and the potential risks of noncompliance with the Act."[85]

The penalties imposed as a result of the firms' actions were substantial; they consisted of three main components. First, within days of discovering the acquisition the Commission required the parties to implement a hold-separate order.[86] Second, there was a prompt investigation of the acquisition resulting in swift and substantial divestitures of assets to restore competition lost as a result of the merger.

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[83] *See* U.S. v. Mahle GMBH, ¶ 17, No. 1:97CV01404 (D.D.C. filed June 19, 1997) (complaint), *available at* < http://www.ftc.gov/os/1997/9706/mahlecmp.htm>.

[84] *Id.* at ¶ 18.

[85] *Id.* at ¶ 20.

[86] "Hold-separate order" is the term used broadly in Commission practice to refer to an order, or even an agreement, to maintain assets that are the subject of a merger or acquisition transaction in a separate status in the various respects necessary to avoid frustrating or unduly complicating any divestiture that might be required.

Third, the companies agreed to pay civil penalties in excess of $5.6 million dollars — the highest civil penalty amount ever obtained under the HSR Act for a single transaction — for their failure to file a premerger notification.[87] The FTC insisted upon the maximum penalty from both the buyer and the seller because of the serious and knowing nature of the violation.

There are several other enforcement actions that illustrate the enforcement agencies' concerns in this area. In 1998, the Commission filed a complaint in district court alleging HSR violations by Loewen Group, Inc., in its acquisition of Prime Succession, Inc.[88] The $500,000 civil penalty obtained from Loewen for a negligent HSR violation is significant. While the Commission generally has not sought penalties for first-time, inadvertent violations, negligence is not a defense. The FTC always examines the circumstances of each unlawful failure to file to determine whether we should exercise prosecutorial discretion and seek no penalty. Loewen's failure to file involved the simplest, most basic HSR reportability criterion, the $15 million size of transaction test. Loewen maintains that, despite considerable sophistication in HSR matters, no one realized the transaction would become reportable when, late in a complex negotiation, it increased the amount of voting securities it was going to acquire from $10 million to $16 million.[89]

Two factors especially influenced the decision to seek penalties in this situation. Loewen knew that the acquisition it planned was likely to be of interest to the antitrust authorities. Loewen is one of the three largest owners of funeral homes in North America. It was buying the Prime chain of funeral homes, the fourth largest chain, which operated in many of the same markets as Loewen. Loewen

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[87] *See* John R. Wilke & Bryan Gruley, *FTC Levies Record Penalty on Germany's Mahle over Deal for Brazil Firm*, WALL ST. J., Feb. 28, 1997, at A2.

[88] *See* FTC v. Loewen Group, Inc., No. 98-0815 (D.D.C. filed March 31, 1998), *available at* <http://www.ftc.gov/os/1998/9803/loewecmp.fed.htm>.

[89] *See id.* at ¶¶ 16-20.

and the other parties to the transaction assumed that an antitrust investigation would result from a Loewen filing and that such an investigation might result in one or more divestitures. Had there been a premerger antitrust investigation, Loewen might have lost its large nonrefundable down payment because it could not have closed in the time required by the contract. Under these circumstances, where there were antitrust issues and the party secured an economic benefit from its failure to file, the Commission determined that Loewen should not be excused for this failure even if the violation was unintentional. The $500,000 amount of the penalty the respondent has agreed to pay is comparable to the penalties the FTC has obtained for other admitted unintentional violations of the Act where aggravating circumstances were present.

The Commission recently settled another HSR Act case arising out of the same transaction. In the FTC's settlement with Blackstone Partners and Howard Lipson, our consent judgment obtained the maximum penalty available against the company, $2.785 million, and, for the first time, required an official of the company to pay a fine as well.[90] Blackstone filed an HSR notification prior to the acquisition of Prime Succession, Inc. but failed to include a document — Blackstone's central decision-making document — required by Item 4(c).[91] That document would have alerted us to possible competitive problems. Without it, the filing described no competitive overlap, and Blackstone's request for

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[90] *See* United States v. Blackstone Capital Partners II Merchant Banking Fund LP, Civ. Act. No. 99CV00795 (D.D.C. Mar. 30, 1999) (stipulated final judgment and order), *available at* <http://www.ftc.gov/os/1999/9903/blkstip.htm>.

[91] Item 4(c) of the Premerger Notification Form requires the involved entities to produce materials prepared by the entities or their employees analyzing the competitive or market share effects of the acquisition under consideration. Item 4(c) further requires the disclosure of the individual(s) who prepared the produced document. *See* Antitrust Improvements Act Notification and Report Form, *reprinted in* 6 Trade Reg. Rep. ¶ 42,400 at 42,503-04 (instructions for completing Item 4(c)) [hereinafter Notification Form].

early termination of the waiting period was granted.[92] Only after the merger was consummated did the Commission learn of the competitive problem.

We sought the maximum penalty from Blackstone for this violation because the accuracy and completeness of Notification Forms, especially the responses to Item 4(c), are the keys to effective premerger antitrust review. These documents, which are prepared by or for the parties' decision makers, are by definition created to analyze the transaction. Thus, they can quickly reinforce or contradict competitive concerns that we might have, or alert us to issues that we might otherwise miss.[93] Accordingly, we take very seriously any failure to submit important 4(c) documents. We have previously obtained $2.97 million from Automatic Data Processing, Inc. for its failure to submit 4(c) documents,[94] and we have stressed on numerous occasions the need to comply fully with the requirements of Item 4(c).[95]

In this case, the FTC also required the payment of a civil penalty by the Blackstone official who both certified the filing as "true, complete and correct"[96] and was one of the

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[92] *See* United States v. Blackstone Capital Partners II Merchant Banking Fund LP ¶¶31-34, Civ. Act. No. 99CV00795 (D.D.C. Mar. 30, 1999) (complaint), *available at* <http://www.ftc.gov/os/1999/9903/blkcmp.htm> [hereinafter *Blackstone Complaint*].

[93] Congressman Rodino recognized the critical importance of these kinds of documents when he sought passage of the premerger notification act that bears his name:

> [T]he government will be requesting the very data that is already available to merging parties, and has already been assembled and analyzed by them. If the parties are prepared to rely on it, all of it should be available to the Government.

122 CONG. REC. H10,293 (daily ed. Sept. 16, 1976).

[94] United States v. Automatic Data Processing, Inc., 1996-1 Trade Cas. (CCH) ¶ 71,361 (D.D.C. Apr. 10, 1996) (consent order).

[95] *See, e.g.*, Report from the Bureau of Competition, Prepared Remarks of William J. Baer before the American Bar Association, Antitrust Section, Spring Meeting 1998 (Apr. 2, 1998), *available at* <www.ftc.gov/speeches/other/baeraba98.htm>.

[96] Rule 803.6(a) of the Premerger Notification Rules requires that an official of a entity submitting a notification certify the contents of the filing. *See* 16 C.F.R. § 803.6(a) (1998). The required certification states,

authors of the 4(c) document that Blackstone failed to submit.[97] There were a number of reasons we believed that individual should be held liable: he had primary responsibility for negotiating the underlying deal, knew it might raise antitrust questions, and knew that delaying the deal could jeopardize its closing. Moreover, he was one of the authors of the critical 4(c) document, knew of its importance to Blackstone's decision-making, and had a copy of it in his files.[98] Finally, when questioned on Blackstone's failure to provide the document, he gave inconsistent answers.[99] All told, we were convinced that he knew or should have known that the filing was not "true, complete and correct." We expect those who certify compliance with the HSR Act to take their responsibilities seriously, and we will enforce the Act against individuals who fail to exercise due care.

Other concerns arise where there is preconsummation integration of the merging parties. The HSR Act is intended to maintain the competitive status quo during the waiting period while the antitrust agencies perform their investigation and decide whether to seek to enjoin the proposed transaction. The HSR Act was passed because it is difficult or even impossible to obtain effective antitrust relief after parties have merged their operations.[100] In order to preserve the possibility of effective remedies for anticompetitive transactions, the Act establishes strictly limited waiting periods during which the antitrust agencies may conduct their premerger review of all proposed transactions. Parties must wait until the period expires or is ter-

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inter alia, the filing is "true, complete, and correct." Notification Form, *supra* note 91, at 42,521. Howard Lipson certified the notification containing this language. *See Blackstone Complaint*, *supra* note 92, at ¶ 45.

[97] *See id.* at ¶ 43.

[98] *See id.* at ¶¶ 41-43.

[99] *See id.* at ¶ 46.

[100] *See* H. REP. NO. 94-1373, at 5 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2637.

minated by the agencies before they may proceed with their transactions.[101]

In *Input/Output*,[102] announced on April 12, 1999, the Commission filed a consent judgment against Input/Output for effectively "jumping the gun" by beginning to exercise control before the HSR waiting period had expired. Input/Output acquired DigiCOURSE, a subsidiary of The Laitram Corporation, in return for eleven percent of the voting securities of Input/Output.[103] Even before filing their HSR notifications, the parties began to implement their purchase agreement by integrating their personnel and operations.[104] This kind of premature integration defeats the purpose of the HSR Act. The FTC secured a civil penalty total of $450,000, which was close to the maximum we could have obtained in court.

This case is important because it clarifies that once a purchase contract is signed, the parties may not proceed further with joint activity — such as assuming control through management contracts, integrating operations, joint decision making, or transferring confidential business information for purposes other than due diligence inquiries. Such "indicia of beneficial ownership"[105] are inconsistent with the purposes of the HSR Act and will constitute a violation of the waiting period requirement.[106]

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[101] *See* 15 U.S.C. § 18a(b), (d) (1994) (setting forth the waiting period requirements).

[102] United States v. Input/Output, Inc., Civ. Act. No. 1:99CV00912 (D.D.C. Apr. 12, 1999) (consent order), *available at* <http://www.ftc.gov/os/1999/9904/inputoutput.pdf>.

[103] *See id.* at ¶ 13.

[104] *See id.* at ¶ 15.

[105] "Indicia of beneficial ownership" are used under the HSR Act to determine when a party obtains ownership of stock. *See* Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,458 (Jul. 31, 1978) (discussing indicia of beneficial ownership). Consequently, when a party has acquired sufficient indicia of beneficial ownership, it is deemed to be the owner of the stock.

[106] Similar issues were raised in *Titan/Pirelli*. In that case, the seller allowed the buyer to take over some operations of the to-be-acquired assets during the waiting period. Where a definitive contract to acquire is joined with the exercise of operational control through a

Preconsummation information sharing also can violate Section 5 of the FTC Act.[107] That issue arose in connection with Insilco Corporation's acquisition of Helima-Helvetion's aluminum tube manufacturing facilities.[108] There the parties closed a nonreportable HSR transaction, ignoring our warning that we had substantive Section 7 problems with the deal. Subsequent investigation found not only those problems, but also revealed that prior to closing the parties had exchanged key information on customers, prices and cost. We settled the case last August with an agreement that required divestiture of two mills and associated assets and also prohibited Insilco from again obtaining or providing, without specific safeguards, certain competitively sensitive, customer-specific price and cost information of the type it had obtained from Helima in premerger discussions.[109] Our concern was that competition was lessened prior to the acquisition.

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management contract before the expiration of the waiting period, beneficial ownership is transferred, and the HSR Act is violated. *See* United States v. Titan Wheel International, Inc., No. 96-1040 (D.D.C. 1996) (defendant agreed to $130,000 civil penalty, maximum allowable under law).

[107] 15 U.S.C. § 45 (1994). This section, in pertinent part, makes unlawful "[u]nfair methods of competition in or affecting commerce." It has been held to comprehend conduct prohibited by the Clayton Act, Robinson-Patman Act, and the Sherman Act. *See, e.g.*, American News Co. v. FTC, 300 F.2d 104 (2d Cir.), *cert. denied*, 371 U.S. 824 (1962); FTC v. Motion Picture Adver. Serv. Co., 344 U.S. 392 (1953); FTC v. Cement Institute, 333 U.S. 683 (1948). It also extends to certain conduct "even though the practice does not infringe either the letter or the spirit of the antitrust laws." FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 239 (1972).

[108] *See* Insilco Corporation, F.T.C. Dkt. No. C-3783 (Jan. 30, 1998) (consent order), *available at* <http://www.ftc.gov/os/1998/9801/insilcodto.pdf>.

[109] *See id.*

E. Myth # 5 — Offer to divest some package of assets and the FTC will accept it rather than litigate.

Most merger cases brought by the FTC or the Justice Department are resolved through consent orders, rather than litigation. One of our important initiatives over the past three years has been to carefully review whether an adequate package of assets is being divested.[110] Our objective, as always, is to ensure that the divestiture package will fully restore the level of competition that existed before the merger.

For a number of years, there seemed to be a strong impression in the private bar that the Commission was more interested in accumulating consent decrees, adding notches to its belt, than in securing complete relief. In most cases where competitive problems are identified, adequate relief can be secured without litigation. In some cases, however, the merger itself may pose such significant risks to competition that settlement cannot be had, and litigation is the only proper course. For the sake of consumers in those markets, the enforcement agencies are obligated to seek full relief. Settling cheap has another cost: it encourages firms to test our mettle in future cases and use the threat of litigation to achieve another less than complete resolution of the problem. So the agencies have drawn the line in places where respondents thought they were entitled to a settlement, but we thought the relief was not adequate.

For example, in *Staples* the parties offered to divest sixty-three stores, primarily in metropolitan areas where the proposed merger resulted in a monopoly. The Commission rejected the proposed settlement.[111] This decision is justifiable on several grounds. First, the proposed relief would not have solved the diminution of competition in

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[110] For a further description of these initiatives, see George S. Cary & Marian R. Bruno, *Merger Remedies*, 49 ADMIN. L. REV. 875 (1997). *See also* Balto & Mongoven, *supra* note 60.

[111] *See* Bruce Ingersoll & Joseph Pereira, *FTC Rejects Staples' Settlement Offer*, WALL ST. J., Apr. 7, 1997, at A3 (reporting FTC's comments regarding rejection of Staples' divestiture offer).

those markets where the number of superstore competitors was reduced from three to two. Second, significant potential competition would have been lost if the settlement had been approved. All three superstore firms were entering each other's territories at an increasing rate, which would have led to significant price reductions in new markets.

The FTC's challenge of Mediq Inc.'s proposed acquisition of Universal Hospital Services ("UHS") provides another example of a proffered settlement that was inadequate to restore competition. Mediq and UHS are the two largest firms in the country that rent durable, movable medical equipment — such as respiratory devices, infusion devices and monitoring devices — to hospitals on an "as-needed," short-term basis.[112] Much of the contracting for durable medical equipment is done on a national basis, and hospital chains and group purchasing arrangements require a national network for this equipment. This acquisition would have given Mediq a near monopoly in the national market, and a near monopoly in numerous local geographic markets as well. Competitive concerns were heightened because earlier acquisitions by Mediq had led to higher prices.

In an attempt to forestall litigation, the parties presented a purported "fix-it-first" involving Medical Specialties, a firm that currently rents infusion pumps to home healthcare customers. The parties proposed to sell Medical Specialties rental equipment and provide it with an option to lease several facilities. However, the proposed relief was inadequate for a number of reasons. First, the new firm would have had a substantially smaller inventory than UHS, which itself was considerably smaller than Mediq. Second, customers — particularly national ones, like hospital buying groups — testified that Medical Specialties would not have the amount and breadth of equipment nec-

[112] *See* FTC v. Mediq, Inc. ¶ 12, Civ. No. 97-1916 (D.D.C. 1997) (complaint), *available at* <http://www.ftc.gov/os/1997/9707/mediqcmp.htm>.

essary to replace UHS.[113] Finally, much of the business that Medical Specialties claimed it needed in order to successfully compete in the hospital rental market was under long-term exclusive contracts with UHS and Mediq.

The Commission found the proposed relief inadequate and authorized the staff to seek a preliminary injunction on August 22, 1997.[114] The defendants attempted to short-circuit the litigation by having Judge Sporkin approve the proposed settlement, but the Judge was unwilling to second-guess the FTC. On the eve of the preliminary injunction hearing, the parties dropped the proposed acquisition.[115]

Finally, the Drug Wholesaling cases[116] raised an issue of whether some form of regulatory relief would have ameliorated the anticompetitive effects of the proposed mergers and permitted the transactions to proceed.[117] Facing an antitrust challenge from the FTC, the parties pledged not to increase prices and to pass on fifty percent of the cost-savings from the mergers. In response the FTC argued that involving the court as a regulator of prices would have been a "second-best" solution to the problem of reduced competition between the four firms, would have been unsound antitrust policy, and would have been contrary to law.

The Commission's argument was based on the premise that price regulation would have been ineffective and ultimately harmful to consumers. Historically, one of the most significant consumer benefits from competition in the drug wholesaling industry was steadily declining prices. A

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[113] *See FTC Will Move to Block Merger of Hospital Equipment Rental Firms*, NAAG ANTITRUST REP., July-Aug. 1997, at 12, 13 (reporting that Mediq and UHS possessed the largest share of the relevant market).

[114] *See Mediq* at ¶¶ 9-11.

[115] *See FTC Press Release, Mediq Informs FTC That it will Abandon Merger with UHS in Face of Challenge*, Sept. 22, 1997.

[116] FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34 (D.D.C. 1998) (challenging the proposed mergers between McKesson and AmeriSource and between Cardinal Health and Bergen-Brunswig).

[117] While these cases, strictly speaking, do not involve divestitutre as a potential remedy, they raise similar issues about the ability of actions to actually remedy the anticompetitive effects of a transaction.

maximum price imposed by the court would have effectively frozen prices and halted the trend of declining prices resulting from competition. The court ultimately rejected the defendants' promise as an antidote for anticompetitive effects, relying in main on the Commission's rationale and evidence from McKesson's attempt to acquire a predecessor of AmeriSource in 1988.[118] Had the 1988 transaction been permitted to go forward based on a "price cap" promise, consumers would have been deprived of substantial decreases in price over the intervening decade.

Taken together, these cases show that the Commission is focused on the obtaining remedies that effectively reduce the anticompetitive effects of transactions. In some cases, the nature of the industry involved or the anticompetitive effects produced by the transaction are such that a remedy, such as divestiture or a price cap, simply will not reduce the anticompetitive effects.

F. Myth # 6 — Once you have entered into a consent decree, your obligations to the FTC are over.

The FTC has also tried to deal with the perception that securing agreement on a remedy is all that the Commission cares about, that implementation was secondary. Over the past several years, we have implemented a number of reforms to improve the divestiture process. These changes include imposing shorter divestiture periods, identifying up-front buyers, broader asset divestiture packages, appointing interim trustees, and imposing crown jewel provisions. The Bureau now insists that divestitures be accomplished in a shorter time so that competition is restored more quickly and it is less likely that assets will deteriorate in the interim. These reforms have begun to show progress in the divestiture process: the average time to implement divestitures has fallen from about fifteen months in 1995 to three months in 1998.[119]

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[118] *See Cardinal Health*, 12 F. Supp. at 52 n.11 & 62-67.

[119] *See* Cary & Bruno, *supra* note 110, at 878 (providing the 1995 figure). The 1998 figure is based on internal statistics.

Currently, many consent agreements have up front-buyers.[120] In other cases, the Commission imposes a relatively short divestiture period, typically no more than four to six months. In these cases, we often require the parties to enter into an asset maintenance agreement, to ensure that the divested assets retain their competitive viability. The asset maintenance agreement is an essential part of the divestiture package and if parties fail to fully comply with their obligations they can expect enforcement action.

The Commission's 1997 case against Schnuck Markets provides several instructive lessons about our insistence that firms fully honor their divestiture obligations.[121] Schnuck had acquired several grocery stores in the St. Louis metropolitan area and was required in July 1995 to divest twenty-four stores to a Commission approved buyer. The stores were divested in March 1996, but they did not resemble the stores originally acquired by Schnuck in several important respects. The Commission alleged that during the divestiture period Schnuck failed to maintain the stores properly: it operated the supermarkets to be divested differently from the other supermarkets it operated; it reduced staffing, provided inadequate signage and inadequate customer service, failed to maintain routine cleaning, repair, and maintenance; maintained non-published telephone numbers; and failed to make available certain promotional features and other ancillary services for customers.[122] Not surprisingly because of these actions, sales at the divested stores fell significantly.[123] Moreover, one week before the stores were to be divested, Schnuck issued customers at the divested stores check-out coupons informing

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[120] *See id.* at 880 (stating that up-front buyers were involved in 85% of consent orders in FY 1997).

[121] FTC v. Schnuck Markets, Inc., No. 01330 (E.D. Mo. filed Sept. 5, 1997) (complaint), *available at* <http://www.ftc.gov/os/1997/9709/schnuckcmp.htm>.

[122] *See id.* at ¶¶ 16-19.

[123] The press reports that sales dropped approximately thirty-seven percent. *See* Calmeta Y. Coleman, *A Grocer Drove Off Customers on Purpose, Competitor Contends*, WALL ST. J., July 10, 1997, at A1.

them that the issuing supermarket would soon close and directing them to shop at a designated, alternative Schnuck location.[124]

The relief secured by the Commission was notable in a number of respects. First, Schnuck paid a $3 million civil penalty, the second highest penalty ever for a violation of a competition order. Second, in order to remedy the competitive harm created by Schnuck actions the Commission required the divestiture of two additional stores. These stores heretofore had been closed by Schnuck. Third, the investigation and settlement represented a collective effort of the FTC and the Missouri and Illinois Attorneys General.

A similar case involved the $3.7 billion CVS/Revco merger, which created the nation's largest drug store chain by number of stores. The Commission's order required divestiture of 120 former Revco stores or pharmacy counters, 114 in Virginia and six in the Binghamton, NY area, in order to maintain the level of competition in these markets that existed pre-merger, especially as to retail sale of pharmacy services to third-party payors.[125]

CVS failed to execute properly on its obligation to provide the buyer all the assets needed to step into its shoes. Just before transferring the pharmacies at issue to Eckerd, the divestiture purchaser, CVS had removed its automated computer prescription system, resulting in substantial difficulty in accessing customers' prior prescription records. The Commission filed an action in federal court that included an agreement from CVS to pay a $600,000 civil penalty because it, like Schnuck, had failed to maintain adequately some of the assets it had agreed to divest.[126]

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[124] *See Schnuck Markets* at ¶ 20.

[125] *See* CVS Corp., FTC File No. 971-0060 (May 30, 1997) (consent order), *available at* <http://www.ftc.gov/os/1997/9705/cvsrevco.htm>.

[126] *See* FTC vs. CVS Corp., No. 98-0775 (D.D.C. filed March 26, 1998). CVS also paid a fine of $1.58 million to the Virginia Board of Pharmacy for violating its regulations about the proper transfer of prescription records.

Another recent failure to honor divestiture obligations involved Rite Aid, operator of the country's third largest chain of drug stores. In 1998, Rite Aid agreed to pay a civil penalty of $900,000 to settle charges that it failed to divest three drug stores in Maine and New Hampshire under a 1994 order issued in connection with its acquisition of LaVerdiere Enterprises, Inc.[127] Divestiture was eventually accomplished under a Commission-appointed trustee. This penalty may seem large for a violation involving only three stores, but the evidence indicated that Rite Aid had made essentially no effort to carry out its obligation to divest. Respondents must take very seriously the obligations they undertake in consent orders.

In August 1998, a consent order requiring Columbia/HCA Healthcare Corporation to pay a $2.5 million civil penalty was entered by the U.S. District Court for the District of Columbia.[128] The order settled a number of Commission charges: that Columbia/HCA had violated a 1995 FTC order to divest hospitals in Utah and Florida in a timely manner, that it failed to honor a hold-separate agreement relating to the Utah hospitals, and that it violated an earlier FTC order by failing to satisfy the conditions on which the Commission had approved its acquisition of a competing hospital chain.[129] The $2.5 million civil penalty in this case was the FTC's largest settlement, and the second largest penalty, for failure to divest on time.

The Commission's consent orders require divestiture to fully restore the competition lost from a merger. Where parties either fail to divest in a timely manner or to main-

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[127] *See* FTC v. Rite Aid Corp., No. 98-0484 (D.D.C. 1998) ($900,000 civil penalty order entered), *available at* <http://www.ftc.gov/os/1998/9802/final3.jdg.htm>.

[128] *See* FTC v. Columbia/HCA Healthcare Corp., 98 Civ. 1889 (D.D.C.) (entered Aug. 5, 1998) (consent order), *available at* <http://www.ftc.gov/os/1998/9807/9610013.jdg.htm>.

[129] *See* Statement of Chairman Pitofsky & Commissioners Anthony & Thompson, Jul. 30, 1998, *available at* <http://www.ftc.gov/os/1998/9807/9610013.jdg.htm>

tain divested assets in a fashion that permits the full restoration of competition, they can expect enforcement action.[130]

G. Myth # 7 — The new efficiency section of the Horizontal Merger Guidelines has raised the bar for demonstrating efficiency claims.

In 1997, the FTC and Department of Justice revised the efficiency section of the Merger Guidelines. This effort stemmed from the Commission's 1995 hearings on competition in a global, high-tech marketplace.[131] One of the subjects on which there was a general consensus, was the need to clarify analysis of merger efficiencies. The report of the Commission's policy planning staff described the law on the treatment of merger efficiencies and how the enforcement agencies analyzed efficiency claims.[132] The revised Guidelines drew upon both hearing testimony and the analysis in the staff report.

The revised Guidelines sought to achieve four objectives:

(1) Explain how efficiencies may affect the analysis of whether a proposed merger may likely lessen competition substantially in a relevant market;

(2) Define more precisely which efficiencies are attributable to a proposed merger and which could be achieved in other ways without posing as great a cost to competition;

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[130] In January 1997, Red Apple Companies, Inc. and affiliated persons agreed to a $600,000 civil penalty judgment for failure to divest five Manhattan supermarkets in a timely manner. *See The Supermarket Industry and the Federal Trade Commission*, THE FOOD INDUS. REP., Jan. 20, 1997, *available in* 1997 WL 10396494 (discussing the Red Apple divestiture enforcement action).

[131] *See Global Competition/High-Tech Innovation* (visited Apr. 11, 1999), <http://www.ftc.gov/opp/global.htm> (reproducing agendas and testimony from the 1995 hearings).

[132] *See* FEDERAL TRADE COMM'N, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH, GLOBAL MARKETPLACE, VOL. I, CH. 2, (1996).

(3) Clarify what parties have to do to demonstrate claimed efficiencies are valid; and
(4) Set forth how efficiencies are factored into the analysis of the competitive effects of a merger.[133]

The Guidelines instruct, as the courts have for several years, that only efficiencies that are merger-specific and cognizable will be considered in the analysis.[134] Cognizable efficiencies are those that can be verified and do not arise from anti-competitive reductions in output or service. A merger will not be challenged if the efficiencies "are of a character and magnitude such that the merger is not likely to be anti-competitive in any relevant market."[135] This is not simply a matter of comparing the magnitudes of the anti-competitive effects and the estimated efficiencies. Rather, it is essential to determine how the claimed efficiencies will affect market behavior. Where the potential anti-competitive consequences of a merger are substantial, the merger likely will be anti-competitive unless the efficiencies are extraordinarily great.

Some critics suggest that the enforcement agencies have actually made demonstrating efficiency claims more difficult. We think that criticism misses the mark. The goal of the revision was to provide clarification and guidance so firms could better understand how efficiencies are analyzed. We did not come into the process with any preconceived notions. The enforcement agencies neither sought to raise nor lower the burden for efficiency claims. Ultimately, we found that the enforcement decisions on efficiencies were

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[133] *See* Robert Pitofsky, Efficiencies in Defense of Mergers: 18 Months After, Address Before the George Mason Law Review, Antitrust Symposium: The Changing Face of Efficiency (Oct. 16, 1998), *available at* <http://www.ftc.gov/speeches/pitofsky/pitofeff.htm> [hereinafter, Pitofsky, *Efficiencies*]; *FTC News Release, FTC/DOJ Announce Revised Guidelines on Efficiencies in Mergers*, April 8, 1997.

[134] *See, e.g.*, FTC v. University Health, Inc., 938 F. 2d 1206, 1222 (11th Cir. 1991); United States v. Rockford Mem'l, Corp., 717 F. Supp. 1251, 1288 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir. 1990).

[135] *Horizontal Merger Guidelines, supra* note 18, § 4.

appropriate, but the mode of analysis was not well presented in the brief discussion in the 1992 Guidelines.[136]

What resulted from the process of revision was the sense that efficiencies needed to be analyzed with some rigor and should be based on an adequate factual foundation. Hopefully, the new efficiency Guidelines set forth a framework for that analysis and provide greater clarity about the role of the efficiency defense.

An interesting example of the operation of the revised Guidelines' treatment of efficiencies in action can be found in Judge Sporkin's decision in last summer's Commission injunction action against the McKesson/AmeriSource and Cardinal Health/Bergen Brunswig mergers—mergers involving the nation's four largest drug wholesalers: McKesson merging with AmeriSource and Cardinal Health with Bergen-Brunswig. If the mergers had been permitted, the two survivors would have controlled over eighty percent of the prescription drug wholesaling market, significantly reducing competition on price and services. The Commission filed the two actions in district court in March, and the case was litigated for approximately seven weeks during June and July. Judge Sporkin enjoined both acquisitions in a seventy-three page opinion issued at the end of July.[137] Judge Sporkin's decision may well be a model that future efficiency decisions are likely to resemble. Although the court recognized that there are decisions that have rejected consideration of efficiencies, it followed the analysis set out in the 1997 revisions to the Merger Guidelines.[138]

Among the efficiencies claimed by the parties were: (1) distributional efficiencies through the closing of overlapping centers; (2) superior purchasing practices; (3) increased buying power; and (4) reduction in overhead and inventory costs.[139] However, Judge Sporkin found that the evidence

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[136] *See* Joint DOJ/FTC Horizontal Merger Guidelines, § 4, *available in* 1992 FTC LEXIS 176, at *64-*65 (containing pre-revision version of section 4). *See also* Pitofsky, *Efficiencies*, *supra* note 133.

[137] FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34 (D.D.C. 1998).

[138] *See id.* at 61-62.

[139] *See id.* at 62.

strongly suggested that many of the efficiencies could be produced in the absence of the merger, and that the parties would pass only fifty percent of the savings on to consumers (instead of their historical average of eighty percent). Ultimately, the court concluded that although there would be some efficiencies, they were insufficient to overcome the anti-competitive aspects of the transaction.[140]

Perhaps the most important aspect of the efficiency analysis is the court's consideration of the role of excess capacity. Although elimination of excess capacity could have resulted in some cost-savings, the critical question, as posed by the revised efficiency section of the Guidelines, is how the proposed efficiencies affect competition in the market.[141] In its examination of competitive effects, the court recognized that competition, and therefore consumers, would not benefit from the reduction in excess capacity. Since excess capacity was the catalyst for aggressive competition, the court concluded that the "mergers would likely curb downward pricing pressures and adversely affect competition in the market."[142] This recognition of the effect of the efficiencies on post-merger competition is an important insight and is consistent with the approach of the revised Merger Guidelines to focus on the impact of efficiencies on overall competition.

H. Myth # 8 — The pace of merger enforcement means the Commission is unable to bring any significant non-merger matters.

While the antitrust enforcement agencies have been facing unprecedented challenges on the merger front, this does not mean, nor should it mean, that we have become less vigilant about our non-merger responsibilities. In fact,

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[140] *See id.* at 63.

[141] *See Horizontal Merger Guidelines, supra* note 18, § 4 ("The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anti-competitive in any relevant market.").

[142] *Cardinal Health, Inc.*, 12 F. Supp. 2d at 64.

in FY 1998, the Commission brought 13 enforcement actions involving anticompetitive conduct, the highest total in over a decade.[143] Both agencies continue to conduct a number of non-merger investigations, involving a broad spectrum of activities including distribution practices, efforts to defeat new forms of health care delivery and cost containment, and restrictions by horizontal competitors.

1. Distribution Practices

Toys R Us. In October 1998, the Commission issued its decision finding that Toys R Us had violated Section 5[144] by orchestrating a boycott of the warehouse clubs, like Costco and Sams Club.[145] In the early 1990s, the warehouse clubs began selling toys at prices that were lower than Toys R Us prices, which tarnished the Toys R Us low-price image and threatened its market position. To protect itself, Toys R Us went to the major toy manufacturers to obtain their agreement, with Toys R Us and with each other, not to sell the same toys to the clubs as were being sold to Toys R Us, or to package two or more toys into more expensive, less desirable "club specials." These club specials raised the clubs' costs and inhibited consumers from readily comparing the Toys R Us prices to those of the warehouse clubs.[146] As a consequence, the conspiracy reduced the pricing pressure that the clubs were exerting on Toys R Us.

The Commission found that the manufacturers did not perceive these restrictions to be in their individual self-interest. Consequently, Toys R Us had to pressure its suppliers with threats that it would not carry toy items that

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[143] *See FTC Wraps up Record Year in Antitrust Enforcement* (visited Apr. 26, 1999) <www.ftc.gov/opa/1998/9810/compar.htm>.

[144] See note 107, *supra*, for a more complete discussion of Section 5 of the FTC Act.

[145] Toys "R" Us., Inc., Dkt. No. 9278 (Oct. 13, 1998) (opinion and final order), *available at* <http://www.ftc.gov/os/1998/9810/toyspubl.pdf> [hereinafter *Toys "R" Us*]. The decision and order have been appealed to the United States Court of Appeals for the Seventh Circuit. Toys "R" Us., Inc. v. FTC, No. 98-4107 (7th Cir. filed Dec. 7, 1998).

[146] *See Toys "R" Us*, Dkt. No. 9278 at 15-18.

the suppliers sold to the clubs and provide them with assurances that other manufacturers were going along with the boycott. The Commission found that Toys R Us sought, received, and communicated assurances from the manufacturers that they would restrict sales to the clubs.[147]

The Commission found that the Toys R Us-orchestrated boycott effectively halted and reversed the rapid growth of the clubs' toy sales, which would otherwise have driven Toys R Us to lower its prices.[148] It also found that the boycott frustrated consumers' ability to compare Toys R Us' prices with those charged by the clubs. The Commission reasoned that whether considered under the rationale of *Klor's, Inc. v. Broadway-Hale Stores, Inc.*[149] or the Supreme Court's more recent pronouncements in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*,[150] Toys R Us' boycott was illegal *per se*.

In *Klor's*, an independent appliance distributor alleged that a rival department store chain orchestrated an agreement with and among ten appliance manufacturers to sell to the independent distributor only on highly-unfavorable terms or not to sell to it at all. The Supreme Court held that the allegations were sufficient to plead a *per se* violation of Section 1 of the Sherman Act.[151] In *Northwest Stationers*, the Supreme Court defined the criteria for treating a boycott as *per se* illegal,[152] and the Commission found that each criterion was met here. It found that:

> The purpose of the group boycott agreement was anti-competitive, in that it was designed to disadvantage competitors of one of the participants; the firms involved were dominant in their markets; the boycott cut off access to products and relationships needed for the boycotted firms to compete ef-

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147 *See id.* at 27-36.

148 *See id.* at 37-44.

149 359 U.S. 207 (1959).

150 472 U.S. 284 (1985).

151 *See Klor's*, 359 U.S. at 212-13.

152 *See Northwest Stationers*, 472 U.S. at 294.

> fectively; and lastly, the practice was not justified by plausible arguments that it enhanced overall efficiency.[153]

The Commission also held that Toys R Us' conduct in orchestrating the boycott was unlawful even under a rule of reason review.[154] That holding was based on the Commission's findings that Toys R Us' conduct in organizing a group boycott of the warehouse clubs produced demonstrable anti-competitive effects such as preventing a decrease in the prices that consumers pay for toys and that the sole business justification proffered — the prevention of free riding — was mere pretext. The Commission also held that "each agreement in the series of vertical agreements, standing alone, even without the evidence of horizontal agreement among many of the toy manufacturers violates section 1 of the Sherman Act upon a full rule of reason review."[155]

One issue that has been raised by some commentators is whether the *Toys R Us* case suggests that all nonprice restraints by a firm with a similar market share face antitrust challenge? It is important not to mistake the Toys R Us policy for a typically benign non-price vertical restraint. For instance, in an exclusive dealing situation, one company agrees to deal with another company exclusively for the purpose of promoting interbrand competition. These agreements generally raise profit margins to induce sellers to provide pre-sales or other valuable services to consumers that otherwise would go uncompensated. The *Toys R Us* case has two important distinguishing features from an exclusive dealing agreement. First, this case involved a horizontal agreement among toy manufacturers. Second, there were no pro-competitive efficiencies associated with the Toys R Us scheme. Toys R Us claimed that it bore substantial risk of buying in bulk early in the season, acted as a

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[153] *Toys "R" Us*, Dkt. No. 9278 at 65-66.

[154] *See id.* at 82.

[155] *Id.* at 87.

showroom for the toys, conveyed substantial information to manufacturers about sales levels for each toy, and provided other valuable services. The evidence showed, however, that Toys R Us was already compensated for the services it actually provided. Thus, there was no risk of free-riding. Moreover, the program was wholly unrelated to promoting interbrand competition and was in fact designed to and did reduce competition among toy manufacturers.

Mylan Laboratories. On December 22, 1998, the Commission sued Mylan Laboratories and three other companies in the U.S. District Court for the District of Columbia, alleging that their exclusive supply agreements for the key active ingredients of two widely prescribed anti-anxiety drugs, lorazepam and clorazepate, resulted in unlawful restraints of trade, monopolization, attempted monopolization, and conspiracy to monopolize in the markets for generic versions of those drugs.[156] Our action alleges that these illegal activities enabled Mylan to raise the price of these drugs by 2000 to 3000 percent.

In pursuing the action under section 13(b) of the FTC Act,[157] the Commission seeks both *permanent* injunctive re-

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[156] FTC v. Mylan Laboratories, No. 98-CV03114 (D.D.C. filed Feb. 8, 1999) (amended complaint), *available at* <http://www.ftc.gov/os/1999/9902/mylanamencmp.htm>.

[157] 15 U.S.C. § 53(b) (1994). That section provides, in pertinent part:

> (b) Whenever the Commission has reason to believe -
> (1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and
> (2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public -
> the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be

lief and ancillary relief, including disgorgement of ill-gotten gains and/or restitution to those injured, naming a figure of $120 million. The Commission's complaint charges that Mylan, Cambrex Corporation, Profarmaco S.R.L., and Gyma Laboratories of America, Inc., violated the FTC Act when they conspired to obtain monopoly power for Mylan in the generic lorazepam and clorazepate tablet markets in the United States.[158] The complaint also charges monopolization and attempted monopolization of, and restraint of trade in, the markets through exclusive licensing arrangements for the supply of the raw materials necessary to produce lorazepam and clorazepate tablets.[159]

The complaint further alleges that the exclusive licensing agreements and other conduct lack any legitimate business purpose, or, to the extent that they had such a purpose, it was outweighed by the anti-competitive purpose and effects.[160] All of the violations alleged by the Commission's complaint hinge on vertical, supplier/purchaser relationships, as did the conduct found unlawful in *Toys R Us*. It should be emphasized, however, that these cases do not signal some broad opposition to non-price vertical restraints. As *GTE/Sylvania*[161] and its progeny indicate, non-price vertical restraints can often have effects that are, on

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> in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond: Provided, however, That if a complaint is not filed within such period (not exceeding 20 days) as may be specified by the court after issuance of the temporary restraining order or preliminary injunction, the order or injunction shall be dissolved by the court and be of no further force and effect: Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction.

Id.

[158] *See Mylan Laboratories,* No. 98CV03114 at ¶¶ 18-31.

[159] *See id.*

[160] *See id.* at ¶¶ 33-34.

[161] Continental TV v. GTE Sylvania, 433 U.S. 36 (1977). *See also* Beltone Electronics Corp., 100 F.T.C. 68 (1982).

balance, pro-competitive. Rather, our concern in both cases is with the use of such restraints with manifestly anti-competitive purpose and effect by powerful buyers.

Summit/VISX. In another non-merger matter of importance, *Summit/Visx*, the complaint alleged that Summit and VISX were the only two firms legally able to market lasers to perform a new, and increasingly popular, vision correcting eye surgery, photorefractive keratectomy ("PRK"), and that the companies, instead of competing with each other, placed their competing patents in a patent pool and shared the proceeds each time a Summit or VISX laser was used. [162] In addition to price-fixing, the complaint charged that VISX fraudulently acquired a key patent from the federal patent office.[163] Finally, the complaint also charged that the result of these alleged illegal activities was higher prices and limited choice for consumers.[164]

In February 1999, the Commission accepted consent orders that would settle all of the allegations of the complaint against Summit and part of the allegations against VISX.[165] The patent-pooling and price fixing charges against both parties were included in the settlement. Under the proposed settlement, Summit and VISX would be prohibited from fixing prices in the future or agreeing in any way to restrict each other's sales or licensing of their PRK lasers and patents. The charge that VISX fraudulently acquired a key patent remains under litigation.

The consent orders apply the principles of the FTC and the U.S. Department of Justice's Antitrust Guidelines for the Licensing of Intellectual Property.[166] The Guidelines

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[162] *See* Summit Technology, Inc., FTC Dkt. No. 9286 (Mar. 24, 1998) (complaint), *available at* <http://www.ftc.gov/os/1998/9803/summit.cmp.htm>.

[163] *See id.* at ¶¶ 14-20.

[164] *See id.* at ¶ 25.

[165] *See* Summit Technology, Inc., FTC Dkt. No. 9286, (Feb. 23, 1999) (final consent order), *available at* <http://www.ftc.gov/os/1999/9903/d09286summitd&o.htm>.

[166] U.S. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property, reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132 (Apr. 6, 1995).

address the analysis of intellectual property licensing in general, and patent pool arrangements, such as that between Summit and VISX, in particular. The Guidelines recognize that intellectual property licensing arrangements and patent pools may be pro-competitive, but that antitrust concerns arise when an agreement or pool affects competition among companies that would have been competitors in the absence of the agreement.[167]

This enforcement action is not an all-out assault on patent settlements, which are an important device for resolving disputes. But the case should remind counsel and their clients to look carefully at the terms of any patent settlement to make sure that it doesn't impair head-to-head competition between the parties that otherwise would have existed. This case also illustrates that, while the potential harm to competition from unwarranted pooling arrangements is great, their detection is normally difficult. Indeed, that is why in recent years former Assistant Attorney General William Baxter[168] and current Assistant Attorney General Joel Klein[169] have both argued that a mechanism needs to be established to notify antitrust authorities whenever competitors settle significant patent disputes. The effort required by the FTC staff to uncover this scheme and the interim harm consumers suffered confirms the wisdom of that approach.[170]

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[167] *See id.* at 20,743-44.

[168] *See* Prof. William F. Baxter, Comments at the Author's Symposium on Competition Policy, International Property Rights and International Economic Integration, Aylmer, Quebec (May 13, 1996) (on file with author).

[169] *See* Joel I. Klein, An Address on Cross-Licensing and Antitrust Law, *before* American Intellectual Property Law Association (May 2, 1997), *available at* <http://www.usdoj.gov/atr/public/speeches/1123.htm>.

[170] The staff estimates that the consumer harm last year from the suppression of competition for this new surgical technique was some $30 million and, unless the pool is broken up, will grow dramatically as the popularity of the PRK procedure increases.

2. Health Care Distribution and Cost Containment

In the field of health care, the antitrust enforcement agencies continue to be active in identifying problems and taking enforcement action where necessary. In seeking to fulfill this goal the FTC does not favor one form of health care delivery or one group of market participants over another. The objective is to remove obstacles to competition so as to permit the market to decide.

Most of our past enforcement actions have involved efforts to forestall the development of privately funded managed care. Yet for many citizens, private insurance is unavailable and the government must step in. Many states are currently developing forms of publicly sponsored insurance to provide medical coverage for the otherwise uninsured. Some of the FTC's recent health care enforcement actions involved these types of programs.

College of Physicians & Surgeons. The Commonwealth of Puerto Rico developed a program for providing health care coverage for the uninsured, known as the Reform, which currently covers about thirty percent of the population. Around November 1996, the College of Physicians and Surgeons (the "College") decided to take collective action to attempt to raise their reimbursement level under the Reform, which would have raised the costs to the taxpayers of Puerto Rico. The College ultimately called an eight-day strike, closing their offices and, in some cases, canceling elective surgery without notice.[171]

This case offers another fine example of state and federal cooperation. The staff of the Bureau and the Attorney General's Office of the Commonwealth jointly investigated the matter and ultimately filed a complaint and a consent decree, under which the College and three large medical groups that contracted with the government agreed not to

[171] *See generally* FTC v. College of Physicians & Surgeons, Civ. No. 972466 (D.P.R. Oct. 2, 1997) (complaint), *available at* <http://www.ftc.gov/os/1997/9710/ prphycmp.htm>.

engage in future boycotts or unintegrated collective price fixing.

One noteworthy aspect of the relief is that the College is required to provide $300,000 in restitution to the catastrophic fund of the Puerto Rico Department of Health.[172] Such relief is particularly appropriate here, where the Commonwealth paid higher prices for health services during the strike.[173] This case is also notable as the only case in which an enforcement agency has charged several independent practice associations ("IPAs") or medical groups with conspiring together to boycott insurers. Our earlier cases have generally involved single medical groups that engaged in price fixing, group boycotts, or other illegal activity.[174]

Parkside. One significant trend in the evolution of health care delivery is the creation of outpatient facilities to perform procedures that formerly required hospitalization. One such type of facility involves lithotripsy, a non-surgical alternative for treating kidney stones. In Chicago, a joint venture of a large number of urologists (about forty-five percent of the market) created two outpatient facilities known as Parkside. About two-thirds of lithotripsy procedures performed in Chicago occurred at these two Parkside facilities.[175]

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[172] *See* FTC v. College of Physicians & Surgeons, Civ. No. 972466 (D.P.R. Oct. 2, 1997) (consent order), *available at* <http://www.ftc.gov/os/1997/9710/prphyord.htm>.

[173] *See id.* The Commission has obtained restitution in two other competition consent agreements. *See* FTC v. American Home Products Corp., No. 92-1365 (D.D.C. June 11, 1992) (consent agreement); FTC v. Mead Johnson & Co., No. 92-1366 (D.D.C. June 11, 1992) (consent agreement) (cited approvingly by Judge Sporkin in his opinion in *FTC v. Abbott Laboratories*, 853 F. Supp. 526, 537 (D.D.C. 1994)).

[174] *See generally Conduct Involving Health Care Providers* (visited Mar. 9, 1999) <http://www.ftc.gov/bc/hcindex/conduct.htm> (collecting FTC actions in the health care field involving price fixing and boycotts).

[175] *See* Urological Stone Surgeons, FTC File No. 93-0028 ¶¶ 4-6 (Jan. 6, 1998) (complaint), *available at* <http://www.ftc.gov/os/1998/9801/parkside.pkg.htm>.

What was problematic about Parkside was not the creation of the venture or its size, but rather the price fixing engaged in by the joint venture. According to the complaint, beginning in 1985 the respondents agreed to fix the price of lithotripsy professional services delivered at Parkside, and in furtherance of that agreement: (1) agreed to use a common billing agent and to establish a uniform charge for lithotripsy professional services; (2) prepared and distributed fee schedules for lithotripsy professional services at Parkside; and (3) billed a uniform amount, either the amount listed in the fee schedules or an amount negotiated on behalf of all urologists at Parkside.[176] Although the joint venture may have been an innovative response to the market, the setting of the urologist professional fee by the joint venture was just plain, old-fashioned horizontal price fixing.[177] The joint venture set the urologist fee not only for the owners of the joint venture, but also for non-owner urologists.[178] None of this price setting was reasonably necessary for the joint venture to market its product.

This case is notable in at least two respects. First, the 1996 Revised Joint DOJ/FTC Statements of Antitrust Enforcement Policy in Health Care[179] suggest that certain

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[176] *See id.* ¶¶ 7-8.

[177] Horizontal price fixing, that is, agreement on price among a group of competitors, has long been held *per se* unlawful under the antitrust laws. *See, e.g.,* FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411 (1990); Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982); United States v. Trenton Potteries Co., 273 U.S. 392 (1927). The Supreme Court has nonetheless recognized that not all agreements among competitors that literally set prices violate these laws. The rule of reason has been applied to such agreements when they are reasonably ancillary to pro-competitive integrations. *See, e.g.,* NCAA v. Board of Regents, 468 U.S. 85 (1984); Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918). *See also* David A. Balto, *Cooperating to Compete: Antitrust Analysis of Health Care Joint Ventures*, 42 ST. LOUIS U. L.J. 191 (1998) (discussing legal standards and mode of analysis). Thus, we examined possible efficiency justifications for the Parkside pricing arrangements.

[178] *See Urological Stone Surgeons* ¶ 8.

[179] *Reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,153 (Aug. 28, 1996).

forms of global billing arrangements may be permissible,[180] and the price setting by Parkside may have appeared to be part of a global billing arrangement. However, the "global fee" established at Parkside merely aggregated three uniformly necessary inputs to a single medical procedure (professional charge, anesthesia, and facility fee) — where the usage, costs, and relative proportions of the inputs do not vary substantially from case to case.[181] Thus, the "global fee" used at Parkside is unlike arrangements in which health care providers, for a fixed, pre-determined "global fee" (sometimes called an "all-inclusive case rate"), agree to provide all needed services for a patient's complex or extended course of treatment, such as cardiac care or cancer treatment, and the providers share substantial financial risk and provide incentives for them to determine and use the most efficient combination of treatment inputs for each case.[182]

3. Litigation Settlements

Sensormatic. On occasion, merger investigations also secure evidence of illegal activity that requires additional enforcement action. One such case is our *Sensormatic* enforcement action. Sensormatic is a major manufacturer of antishoplifting devices. In 1995, we challenged Sensormatic's acquisition of Knogo, another producer of antishoplifting devices.[183] The case was settled with an agreement that Sensormatic would not acquire certain intellectual property rights of Knogo. During the investigation we secured evidence that Sensormatic and Checkpoint, the other leading manufacturer of antishoplifting devices, had entered into an agreement to refrain from comparative adver-

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[180] *See* Statement No. 8, 4 Trade Reg. Rep. at 20,816.

[181] *See* Urological Stone Surgeons, ¶ 8.

[182] *See* Statement No. 8, 4 Trade Reg. Rep. at 20,816 n.32 (describing permissible global fee arrangements).

[183] *See* Sensormatic Electronics Corp., FTC File No. 951-0083 (Apr. 6, 1998) (complaint) *available at* <http://www.ftc.gov/os/1998/9801/sensorma.pkg.htm>.

tising. The two firms have over seventy percent of the market. Back in 1993, the two firms had engaged in fairly direct comparative advertising: a particular Checkpoint ad suggested Sensormatic's devices damaged CDs and video cassettes. Sensormatic responded with a lawsuit alleging that the advertising was false and deceptive. The parties settled the litigation by agreeing in part to refrain from comparative advertising.[184]

This agreement harmed competition by restricting comparative advertising. As many Commission enforcement actions have demonstrated advertising plays a vital role in a competitive marketplace. Comparative advertising in particular can convey critical information to inform consumers. As the Supreme Court observed in *Indiana Federation of Dentists*,[185] agreements not to compete with respect to information provided to consumers "impairs the ability of the market to advance social welfare by ensuring the provision of desired goods and services to consumers at a price approximating the marginal costs of providing them," and limits consumer choice by impeding the "ordinary give and take of the marketplace."[186]

YKK. Sensormatic is not the only enforcement action that involved behavior surrounding an attempted settlement of litigation or threatened litigation. A few years ago the Commission entered a consent order with YKK (U.S.A.) Inc., a manufacturer of zippers and related products.[187] The complaint alleged that an attorney for YKK sent a letter to the president of Talon, Inc., a YKK rival, accusing Talon of engaging in "unfair and predatory sales" tactics by offering free zipper installation equipment to buyers of zipper parts and requesting that Talon "take immediate action to cease offering" such free equipment. At a subsequent meeting, the YKK attorney allegedly proposed to a Talon lawyer that both firms refrain from offering free equipment to custom-

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[184] *See Sensormatic Electronics Corp.* at ¶¶ 8-12.

[185] FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986).

[186] *Id.* at 459 (internal quotations omitted).

[187] *See* YKK (U.S.A.) Inc., 116 F.T.C. 628 (1993).

ers.[188] Although the parties in YKK did not enter into an illegal agreement, it was the threat of litigation that was used as the club to attempt to induce the agreement. Such an agreement to cease discounting would have been illegal as horizontal price fixing, and the threat of litigation would have offered no protection to the illegal agreement.

4. Factors Influencing Case Selection

Because our merger workload has almost tripled in the last few years, the FTC needs to be selective in deciding where to use our nonmerger resources and what types of cases to bring. The following factors are among those we consider when deciding whether to go forward with a nonmerger investigation.

First, what is the likelihood of ultimately bringing an enforcement action? The Commission cannot afford to investigate cases where the preliminary facts do not suggest a likelihood that there is a violation of law. Thus, we carefully analyze both the facts behind a complaint and the legal theory before committing substantial agency resources. The statistics suggest we are on track. In over seventy percent of the formal nonmerger investigations completed in the past three years, we have found a law violation and secured relief.

Second, what is the impact on consumers? As in all of our enforcement efforts, we must ask how consumers will benefit. The benefit need not be as substantial as in *Toys R Us*, where millions of consumers purchased the relevant product, or in *Summit* where millions of consumers potentially faced overcharges. Sometimes, we bring cases in relatively small markets, as in many of our health care cases, where the impact of a local price fixing conspiracy is smaller in comparison but can be substantial for the affected consumers.

Third, are we sure that the potential case involves an antitrust issue in the first place? Some matters that are

[188] *See id.* at 629.

presented to us in the guise of antitrust complaints turn out to involve, not competition issues, but, rather, questions under contract or intellectual property law. This may be true, for example, where a manufacturer has cut off a distributor, who may have had an express or implied supply contract, in order to adopt what it regards as more efficient distribution arrangements. Without evidence that the termination injured competition, the dispute should be handled by the parties themselves.

Fourth, what is the deterrent and precedential value of the case? Sometimes we investigate and bring cases not simply because of the immediate market impact, but also because our enforcement actions help clarify the law for others. Enforcement actions, such as *Parkside,* will apply fairly straightforward concepts of joint venture law to somewhat new market environments. Other cases, such as *Stone Container* [189] or *Dell Computer,*[190] provide guidance in areas such as invitations to collude or standard setting, where there is relatively little case law. In both types of cases, the enforcement action goes beyond the specific case by helping to clarify the law and guide private actors. Settlement of conduct cases in areas where there is little judicial precedent can be of value to lawyers counseling their clients. For that reason, we continue to put more details about our factual analysis and legal theories into Commission complaints and into analyses to aid public comment.[191]

In a time of limited enforcement resources, we need to find ways of being more effective. One way is to work with other enforcement bodies wherever possible. In our *American Cyanamid*[192] case — involving price fixing in agricultural chemicals — the state attorneys general did much of the leg work. There will be cases like that in the future. A

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[189] Stone Container Corp., FTC File No. 951-0006 (Feb. 25, 1998) (consent order), *available at* <www.ftc.gov/os/1998/9802/9510006.agr.htm>.

[190] Dell Computer Corp., 121 F.T.C. 616 (1996) (consent order).

[191] *See, e.g., Stone Container,* FTC File No. 951-0006; American Cyanamid Co., 123 F.T.C. 1257 (1997) (consent order).

[192] *See American Cyanamid*, 123 F.T.C. at 1257.

second way of husbanding scarce resources is expediting the administrative process. As described below, the Commission streamlined that process a couple of years ago with the expectation that an administrative decision would be issued within one year after a case is filed.

I. Myth # 9 — The Supreme Court's *Khan* decision suggests that forms of minimum resale price maintenance may be legal.

In *State Oil Co. v. Khan*,[193] the Supreme Court unanimously reversed its 1968 opinion in *Albrecht*,[194] and held that maximum resale price maintenance was no longer *per se* illegal. In some respects the result was not surprising, since the FTC and Justice Department filed a joint amicus brief suggesting reversal.[195] The agencies' brief, quoting the Supreme Court's decision in *ARCO*, observed that "the manufacturer's decision to fix a maximum resale price may actually protect consumers against exploitation by the dealer acting as a local monopolist."[196] Thus, it was our view that in the vertical *maximum* price fixing context, the *per se* rule could be anti-consumer and ought to be changed. Moreover, the *per se* rule had little effect on government enforcement, since the antitrust agencies had not committed any enforcement resources to challenging a vertical maximum resale price maintenance arrangement in recent memory. Finally, as to *Albrecht*'s premise that maximum price fixing could be used to disguise arrangements to fix minimum prices, the Court noted its belief that such conduct, "as with the other concerns articulated in *Albrecht*—can be appropriately recognized and punished under the

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[193] 522 U.S. 3 (1997).

[194] Albrecht v. Herald Co., 390 U.S. 145 (1968).

[195] *See* Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Reversal, *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (No. 96-871) (supporting reversal).

[196] Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 343 n.13 (1990).

an be appropriately recognized and punished under the rule of reason."[197]

While some may suggest that the Supreme Court's opinion may open the door for the repeal of the *per se* rule against vertical minimum price fixing, such an assessment is premature and overly generous.[198] The *per se* rule against vertical minimum resale price maintenance has existed for over eight decades.[199] The Supreme Court has declined the opportunity to reverse the *per se* rule as recently as its opinion in *Monsanto Co. v. Spray-Rite Service Corp.*[200] The Supreme Court's reasoning in *Kahn* is heavily based on the economic effects of maximum resale price maintenance, and

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[197] *Kahn*, 522 U.S. at 11-12 (citing, *inter alia*, Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1490 n.17 (1983) [hereinafter Pitofsky, *Defense*]).

[198] Two commentators have examined the implications of *Khan* for the minimum price rule. Although they note that some see *Khan* as a possible starting point for eliminating the *per se* rule against minimum price fixing, these authors ultimately conclude that *Khan* standing alone is unlikely to have that effect in the near future. *See* Roger D. Blair & John E. Lopatka, *The Albrecht Rule After Khan: Death Becomes Her*, 74 NOTRE DAME L. REV. 123, 175-77 (1998)

[199] *See* Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752, 761 (1984) (referring to "concerted action to set prices" as "hav[ing] been *per se* illegal since the early years of national antitrust enforcement" (citing Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 404-09 (1911))). Antitrust courts apply one of two methods of analysis to determine whether an agreement unreasonably restrains competition. Some categories of restraints, such as horizontal price-fixing (see, e.g., *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 354 (1982)) and market-allocation agreements among competitors (see, e.g., *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49-50 (1990) (per curiam)), have been conclusively presumed to unreasonably restrain competition without a study of the market in which they occurred or an analysis of their actual effects on competition or their purpose. Such agreements are characterized as *per se* illegal. The standard for analyzing the effect on competition of most restraints, however, is the rule of reason, which requires an analysis of the restraint's effect on competition in a relevant market (see, e.g., *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977)). For a comprehensive treatment of the *per se*/rule of reason distinction, see 7 PHILLIP E. AREEDA, ANTITRUST LAW ¶¶ 1500-11 (1986).

[200] 465 U.S. 752 (1984).

there is general consensus that the economic effects of minimum resale price maintenance are profoundly different.[201] Most important in this regard was the Court's observation that the "interpretation of the Sherman Act . . . incorporates the notion that condemnation of practices resulting in lower prices to consumers is 'especially costly' because 'cutting prices in order to increase business is the very essence of competition.'"[202] Thus, a rule that prohibited maximum resale price maintenance would be contrary to the purpose of bringing lower prices to consumers. A rule prohibiting minimum resale price maintenance is not similarly infirm. Finally, the prohibition of minimum resale price maintenance rests in part on a concern over facilitating or concealing horizontal collusion, concerns that are not present in the maximum resale price maintenance context. It is also notable that although there were several amicus briefs filed by various interest groups, none of them suggested that the application of the *per se* rule to minimum resale price maintenance should be reversed.[203]

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[201] *See, e.g.*, 8 PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1637b (1989); 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶ 760b2-760b3 (1996); Pitofsky, *Defense*, *supra* note 197, at 1490 n.17. In particular, any discussion or agreement concerning price among competitors has always been viewed as a matter at the very center of antitrust concern. *See, e.g.*, 7 AREEDA, *supra* note 199, at ¶ 1637c n.11 ("[C]ompetitors have so strong an incentive to escape price competition that it is exceedingly dangerous to allow them to discuss and come to any kind of consensus about price."). The prohibition of vertical minimum price maintenance rests in part on concerns about facilitating or concealing exactly such horizontal collusion. *See, e.g.*, *Dr. Miles Medical Co.*, 220 U.S. at 407-408; Pitofsky, *Defense*, *supra* note 197, at 1490-91. Purely vertical, maximum price agreements, on the other hand, present little or no similar danger. Moreover, in the case of vertical minimum price fixing, suppliers' stated concerns (such as inducing dealers to provide adequate point-of-sale services) could often be addressed directly in a distribution agreement without reference to price (by, for example, requiring the distributor to provide a certain level of facilities or services to its customers).

[202] *Khan*, 522 U.S. at 22 (quoting *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)).

[203] There were twelve amicus curiae briefs filed in *Kahn* by various private interest groups.

One can expect the Commission to enforce the *per se* rule against minimum resale price maintenance. The Commission certainly has brought traditional resale price maintenance cases, but some of our more important enforcement initiatives involve more novel arrangements. For example, sometimes a manufacturer may attempt to effectively establish resale prices through incentives rather than through an old fashioned resale price maintenance agreement. In these cases the question is not whether there is an agreement, but whether the agreement fixed the resale price or price levels. This issue shows up in the contrast between the treatment of traditional cooperative advertising programs — which are analyzed under the rule of reason — and schemes in which dealers are explicitly paid to adhere to a particular price or price level — which are not.

In 1997, the Commission challenged such a rebate scheme in *American Cyanamid Corp.*[204] Reflecting the cooperative relationships between the FTC and the states, all 50 states and the District of Columbia announced their own settlements with American Cyanamid at the same time.[205] In that case, American Cyanamid had established a rebate program in a $1 billion agricultural chemical market, reflected in written agreements with its dealers, that paid a substantial rebate for each resale of crop protection chemicals at or above floor prices.[206] American Cyanamid had set wholesale prices equal to the stated minimum prices, so the dealers lost money on every sale below the specified price. In the Commission's view, as the complaint alleged, the program amounted to a *quid pro quo* between American Cyanamid and its dealers, under which American Cyanamid explicitly promised to pay dealers in exchange for ad-

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[204] 123 F.T.C. 1257 (1997) (consent order). In part, the consent order prohibits American Cyanamid from conditioning the payment of rebates or other incentives on the resale prices its dealers charge for American Cyanamid products.

[205] The multi-state task force obtained a settlement valued at $7.3 million. *See id.*

[206] *See id.* at 1258.

hering to the suggested price.[207] That was an agreement on price or price level.

It is important to note that *American Cyanamid* does not take issue with other cases addressing dealer assistance programs, including cooperative advertising and discount pass-through programs.[208] In traditional cooperative advertising programs, manufacturers help dealers pay for advertising or promotion but add the condition that in the advertisements supported by the manufacturer, the dealer cannot include any price advertising unless the prices are at or above suggested levels. These programs are unlikely to raise antitrust concerns as long as dealers are free to price at whatever level they choose when they buy their own advertisements.

J. Myth # 10 — There is no need to worry about administrative litigation with the FTC; it will take years for them to litigate and even longer for them to issue a decision.

The pace of administrative litigation at the FTC has often been criticized. Because of that criticism Chairman Pitofsky formed a task force, under the leadership of then-General Counsel Stephen Calkins, to suggest reforms of the administrative litigation process. The task force suggested several reforms which were adopted by the Commission in September 1996.[209] The reforms established shorter deadlines, streamlined pre-trial discovery, and sped up the trial itself. In most cases, the amendments require the Administrative Law Judge ("ALJ") to issue an Initial Decision

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[207] *See id.* at 1267-68.

[208] *See* 6 Trade Reg. Rep. (CCH) ¶ 39,057 (May 21, 1987) (stating FTC's position that cooperative advertising programs that restrict the price a dealer can advertise should be judged under rule of reason). *See, e.g.*, P.D.Q., Inc. v. Nissan Motor Corp., 577 F.2d 910, 917 (5th Cir. 1978) (conditioning participation in cooperative advertising program upon use of manufacturer's suggested resale price as subject to rule of reason).

[209] *See FTC News Release, FTC Announces a Set of Procedural Rule Changes Designed to Streamline Administrative Trial Process*, Sept. 18, 1996.

within one year after the Commission issues an administrative complaint. The preliminary results suggest that these reforms show promise.

The *Toys R Us* case is a good example. As discussed above, the case involved issues of vertical and horizontal collusion, market power, and intriguing issues of legal interpretation. The time from the issuance of the complaint in May 1996 to the decision of the ALJ September 1997 was sixteen months.[210] This included a very tough discovery schedule, which produced more than 9500 pages of transcript and 2600 exhibits, forty-three days of hearings, and numerous motions. The result was a very thoughtful 126 page opinion.[211]

The procedural reforms have speeded pretrial proceedings and led to more timely resolution of cases, as well. For example, in the first merger case litigated under the 12-month rule, *ADP-Autoinfo*, the ALJ scheduled the trial to start about six months after the complaint was issued. After about four months of pretrial proceedings, and with trial imminent, the parties sought a settlement, and the case was removed from administrative litigation and settled. The first antitrust case for which trial has been completed under the rule, *Summit/Visx*, the substance of which we have already discussed,[212] was brought to trial much faster than past practice would have predicted. The complaint was issued on March 24, 1998. Trial commenced on December 14, 1998 and closing arguments were completed on February 24, 1999; as of early March 1999, the Initial Decision was pending. This represented a commendably speedy trial of a complex matter. Although the new rule has not resolved all concerns, it nonetheless has had an obvious

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[210] The case was litigated before the new procedural reforms were implemented, so the 12-month rule did not apply.

[211] *Toys "R" Us., Inc.*, Dkt No. 9278 (Oct. 13, 1998) (Final Order), *available at* <http://www.ftc.gov/os/1998/9810/toyspubl.pdf>. The Decision and Order have been appealed to the United States Court of Appeals for the Seventh Circuit. Toys "R" Us., Inc. v. FTC, Dkt. No. 98-4107 (7th Cir. filed Dec. 7, 1998).

[212] *See supra* notes 162-67 and text accompanying.

effect in accelerating administrative litigation at the Commission, and respondents cannot expect that their day of reckoning will be long in coming.

In addition, the Commission has been far more diligent in issuing opinions on a timely basis, as a consequence of some other reforms. In two of the three litigated cases decided most recently — *California Dental Association*[213] and *International Association of Conference Interpreters*[214] — the Commission issued its opinion within four months after the case was argued. In the third and most recent such case, *Toys R Us,* the Commission's decision was issued eight months after oral argument. These time intervals represent a significant improvement from the time where these decisions could take up to one to two years following the Initial Decision.

Does this mean there has been sufficient progress? Probably not. We continue to evaluate how to improve the process of administrative litigation.

IV. CONCLUSION

The recent increase in merger activity has made this a very interesting and challenging period at the FTC. It has also led to some faulty assumptions about how the Commission carries out its statutory responsibility. This Essay has demonstrated that these new myths are largely unfounded — recent enforcement actions have built on traditional doctrines and old realities in antitrust law. While we have not prevailed in all of our enforcement endeavors, we believe that we have preserved the vitality of antitrust law in a changing economic environment. Our enforcement actions have been consistent with the FTC's goal of assuring that consumers receive the benefits of a competitive marketplace.

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[213] 121 F.T.C. 190 (1996).

[214] 123 F.T.C. 465 (1997).