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1996
ANTITRUST LAW SECTION SYMPOSIUM

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January 25, 1996
New York Marriott Marquis

NEW YORK STATE BAR ASSOCIATION
ANTITRUST LAW SECTION

ANNUAL MEETING

Thursday, January 25, 1996
New York Marriott Marquis
New York City

New York City

Section Chair
ALAN J. WEINSCHEL, ESQ.
Weil, Gotshal & Manges

Program Chair
PETER E. GREENE, ESQ.

Skadden, Arps, Slate, Meagher & Flom
New York City

Dinner Speakers

CHARLES E. BIGGIO, ESQ.
Antitrust Division
United States Department of Justice
Washington, D.C.

WILLIAM J. BAER, ESQ.
Director
Federal Trade Commission
Washington, D.C.

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New York City — Brussels

Speakers: **Charles E. Biggio, Esq.**
Antitrust Division
United States Department of Justice
Washington, D.C.

William J. Baer, Esq.
Director
Federal Trade Commission
Washington, D.C.

SECTION CHAIR ALAN J. WEINSCHEL, ESQ.: I would like to welcome everybody to the Annual Meeting of the Antitrust Section of the State Bar Association. I'm Alan Weinschel. I am the Chair of the Section. The first order of business for today is to drum me out of office. We're going to elect new officers. The nominating committee has come up with a report which I will present. Under our bylaws the officers are elected by a quorum of those present at the meeting. So you all have disproportionate voting influence, since there's only a fraction of the Section present today. In any event, the nominating committee presents for your consideration the following slate, and I think the easy way to do this is simply vote on the slate. And if there are nominations from the floor, which are permitted, you could raise your hand after the nominating committee slate is presented. The slate is for Chair—and this is for a one-year term, a change in our prior practice; we've gone back to one-year terms for the officers and Executive Committee—Ned Cavanagh for Chair. Ned, if you want to raise your hand so people know who you are. Barry Brett for Vice Chair; Mike Malina of Kaye, Scholer for Secretary. And for the Executive Committee, the officers, myself for Executive Committee, Walter Barthold, Lloyd Constantine, Steve Edwards, Larry Fox, Peter Greene, our program chair today, Pamela Jones Harbour, Steve Houck, Bob Hubbard, Norma Levy, Bill Lifland, Ken Logan, Mike Malina and Vernon Vig. Are there any nominations from the floor?

Having heard none, can I see by a vote of hands those in favor of the slate presented by the nominating committee?

Any opposed?

The vote is unanimous.

Congratulations to the new officers.

I'd now like to turn the podium over to Peter Greene, who is a partner at the Skadden, Arps firm, which is well-known to all of us. Peter has done yeoman's work in putting together today's program, which is truly a great program. This morn-

THE ANTITRUST YEAR IN REVIEW

WILLIAM T. LIFLAND, ESQ.

MR. LIFLAND: Thank you much, Peter. I have here several copies of a list of cases, about 40 cases that might be worth your having so that it will be easy to pick out the cases you're particularly interested in.

Well, 1995 could hardly be described as a banner year for antitrust. There were no Supreme Court opinions reshaping a portion of the law and developments in the lower courts, as the cliche goes, were evolutionary rather than revolutionary. And if you were asked to describe a trend in the law, you might say that 1995 saw a continuation of a longer-term trend toward deprivatization—deprivatization in the sense that the influence of private litigation as distinguished from the influence of the activities of the public agencies has tended to wane somewhat. Now that is not to say that there are not some very important private litigations pending before the courts; there are. And some of them involve a very great deal of money and important issues as well.

On the other hand, when you take a look at where the initiatives are coming from and where the new law is being made, it appears to be more on the public side. At the same time the courts appear to have been imposing on private plaintiffs difficult hurdles to overcome, and in this past year particularly in the area of proof of anticompetitive effects and antitrust injury. We will come back to those in a moment.

First, as to government initiatives. There were two new sets of guidelines published in 1995. There are references to them in the list. One dealt with international operations, and it replaced the 1988 considerably more voluminous set of guidelines; the other deals with the licensing of intellectual property.

Now, following the tradition of the Merger Guidelines and of the 1993 and 1994 Health Policy Statements, these guidelines are joint guidelines of the Federal Trade Commission and the Justice Department, thus giving them perhaps a greater cache and possibly discouraging counsel who wish to maneuver their case into the most sympathetic agency from finding his way around the provisions of some of the guidelines. The International Operations Guidelines primarily touch on issues of jurisdiction and comity, effects of foreign government involvement, including sovereign immunity, compulsion, acts of state and also petitions to government. By and large these guidelines contain a convenient collection of the applicable statutes and treaty references, and they contain relatively few surprises. The examples that are given toward the latter part of the guidelines are very interesting and definitely worth reading.

The Intellectual Property Licensing Guidelines may be somewhat more controversial. They deal with licenses of patents and copyrights and trade secrets, not trademarks. And of course they replace the portions of the 1988 International Guidelines that dealt with these subjects.

They state that they embody three principles. The first being that intellectual property for antitrust purposes is just like other property. The second being that the agencies, while they recognize a division of authority in the cases, apply no presumption of market power from the possession of a patent or copyright. And the Guidelines also recognize that licenses are in general procompetitive in the sense that they enable a licensee to operate in areas that were previously reserved to the owner of the property.

Now, the Guidelines also state that field of use and territorial exclusivity provisions can create incentives to invest and avoid free-riding and, accordingly, be procompetitive. Now, of course, giving territorial exclusivity to licensee A may involve imposing territorial restrictions on licensee B, so these types of restrictions are also necessarily recognized as potentially procompetitive.

Now, one controversial provision in the guidelines is the endorsement of the concept of a separate relevant market for technology and R&D. And this will be the subject of another speaker's talk later today, so I will not get into it beyond saying that it seems to be a step backward from the effort to get away from the notion that a relevant market may not really be the relevant market, because it may contain submarkets. That concept has introduced a considerable amount of imprecision into the law, and we may be drifting off in that direction, again with the notion of technology as distinguished from product markets.

Now, moving from these policy statements to other government initiatives, perhaps one of the most dramatic was the Microsoft consent decree. Now, I know everyone is aware of that from the very extensive reporting the subject got. Just let me mention that after the Antitrust Division and the District Court had their stand-off and the court decided that it did not have the information on which it could find that the public interest would be served by the entry of the decree, there was an appeal, and the Appellate Court reversed the District Court ruling with an order to enter the decree. But it said in the course of its decision some very interesting things. It said that a district court should be wary of exceeding its constitutional role by becoming a prosecutor.

In this case, as you will recall, the District Court felt that the government should have treated the subject of what is known in the jargon as vapor ware. That is a product which is not ready for sale being announced with the result, of course, that competitive products may not be purchased by consumers who would prefer to wait for the preannounced product. The D.C. Circuit said the District Court should confine its attention to matters actually raised in the complaint; it should give deference to the government's prediction of the effect of likely remedies for the practices listed in the complaint, and its own initiatives ought to be largely in the area of dealing with ambiguities or difficulties in implementation which it finds in the settlement as proposed.

Now, this role for the court is, of course, much narrower than the District Court had originally thought. It is certainly more conducive to preserving the bargains that are made in settlement negotiations, and this, of course, will generally be applauded by the antitrust bar. But it may not give as much basis as courts would like for making the finding that a particular settlement actually does advance the public interest.

In other areas where deprivatization has occurred, I think many of us would say that perhaps the most significant has been with respect to mergers. Again, other people will be discussing mergers later, so I will be very brief on that subject. It has long been clear that the public attorneys general and the Federal Trade Commission are the most likely litigants in merger cases, if there is to be any litigation at all. With relatively few exceptions, private parties do not have standing to challenge these transactions. And this, of course, is one of the reasons for which the bar has paid so much attention to the government's Merger Guidelines.

Also of importance are the consent decrees which are negotiated between the parties and entered when a deal as presented appears to raise serious issues under the Guidelines. And even more important to some people may be the reasons for which transactions have been permitted as submitted without restructuring.

Now, it's no longer surprising to find out that restructuring may be very substantial, involving a great many properties and money, or that it may take place by divesting properties of the acquiring company and not just properties that are to be acquired in the transaction.

There are references in the materials to a couple of Justice Department press releases, Kimberly-Clark and U.S. Bancorp, both examples of very substantial restructure, and bilateral restructure: in Kimberly-Clark, five plants, as well as certain brand names; U.S. Bancorp, 26 branches with over half a billion dollars in deposits. But those cases are noted here not so much because of the nature of the restructuring, although that is interesting, but rather because the investigations that led to the restructuring were not just Justice Department investigations. They were joint investigations with state attorneys general: in the case of Kimberly-Clark, the Texas State Attorney General; in the case of U.S. Bancorp, the Washington State Attorney General. And hopefully this practice will tend to avoid situations which have occurred in the past, where the federal authorities have cleared or modified a transaction only to have it then challenged in court by a state.

The outline also lists a number of FTC settlements in merger cases. And the reason these are listed is that the transactions were such that the FTC concluded that antitrust problems could be avoided by divesting assets which were primarily intangible rather than tangible. In the *IVAX* case the divestiture was primarily of license rights, a customer list. And right, they were research materials because the acquired firm was working toward development of orthopedic finger joint implants which were not being widely developed. In *Lockheed* the property involved were releases of contractual exclusivity rights. In *Boston Scientific*, technology licenses for imaging catheters. In *Upjohn*, technical assistance and related assets were to be divested with respect to colorectal cancer remedy, as to which there was very little ongoing research.

Now, in considering these issues there is one thing that I should point out. That is that the information that you get from these press releases together with the supplementary materials that are placed on public record is often on the thin side. It does not compare with the information which you would get if the transaction were litigated before a court or litigated before the Federal Trade Commission. As you know, Federal Trade Commission opinions are complete to a fault. They sometimes give you much more information than you really want to have. But the important thing is that you do have the opportunity to try to understand the transaction.

Now, in a sense deprivatization involving administration of the law by a cadre of experts has a great deal to be said for it. But the administration of justice can receive a setback if the experts do not fully explain and justify their decisions. Now, particularly when the decision is to take no action, the amount of explanation which is now available to the bar is very, very thin indeed, and something really ought to be done in this area. It's understandable that considerations of confidentiality as well as burden will influence the government, but these problems are dealt with when it is necessary to litigate a case, and it is not clear why they cannot be dealt with when the decision is to settle the case or not to proceed at all.

Now, moving to the other side of the deprivatization phenomena, the respects in which court decisions have dealt with plaintiffs' burdens, the outline lists a number of cases that deal with anticompetitive effects and antitrust injury. Opinions often deal with both subjects, and occasionally the terminolo-

gy is confusing. Here we are using the words "anticompetitive effects" to deal with the plaintiff's obligation, where it exists, to prove that the challenged conduct, in addition to hurting him as a competitor, also hurts the state of competition in the marketplace, as for example by substantially reducing the number of competitors or their ability to operate effectively. "Antitrust injury," on the other hand, appears to be used by the courts to describe a much wider range of conditions, and sometimes to be used interchangeably with the broader term "antitrust standing."

Now, turning first to anticompetitive effects. I will not try to go through all these cases, but I will focus on the *Doctor's Hospital* case in the Ninth Circuit. In that case a hospital challenged its expulsion from a preferred provider organization and its replacement by a larger hospital. And the Ninth Circuit observed that there was no evidence that, as a result, the cost of medical services had gone up in the area or that the number of physicians had gone down; hence, no proof of anticompetitive effects.

The Second Circuit's *K.M.B.* case is also a very interesting one. That was a case where a distributor claimed that a manufacturer wouldn't deal with him as a result of objections from competing distributors. Now, it was the kind of case that the plaintiff's counsel usually feels good about. First, there were tapes. The tapes were of conversations indicating that the supplier was concerned that he was acting illegally. There were also customer affidavits, 12 of them, to the effect that customers preferred the combination of the supplier's product and the plaintiff's service. And everyone who has ever tried to go out and get customer support for his client's position in litigation and deal with the customer's reluctance to get involved in something of that nature will recognize that this was no mean feat. But the plaintiff lost. The court said that it had shown only a de minimus effect on competition. It had shown impact, of course, on itself, but not on competition generally.

Now, this may suggest as a practical matter that proving an adverse effect on competition in this type of case may require a good bit more. It might require a potential customer survey; it certainly ought to require expert economic testimony, and possibly even discovery from competitors who may not be that cooperative.

Now, turning to the antitrust injury cases. As we mentioned a moment ago, they are a mixed bag. They seem to involve a number of different kinds of situations. One is the type of situation where the underlying antitrust violation is doubtful. In one case a medical board withheld its certification from the plaintiff doctors who were psychiatrists, and the Seventh Circuit said that this action did not seem to appear to reduce output or increase price, since the plaintiffs continued to practice their preferences. Indeed, it suggested that the result of certification might be to cause these psychiatrists to increase their fees and therefore increase prices in the relevant market, rather than decrease them. Consequently, the court ruled that there was no antitrust injury. As I said, you might conclude that the Seventh Circuit was ruling that there was no violation.

Now, there are a couple of cases in that list, the Second Circuit *Anaren* and *G.K.A.* cases, in which the court points out that the plaintiffs' injury, if it existed, was derivative from injury to a customer or a supplier. There are also some cases indicating that the plaintiff was not operating in the market where the alleged anticompetitive effects occurred. This was true in the legal case of the Ninth Circuit, also true in a number of the cases involving employees.

In *Gallant*, the employee was said to lack standing when he claimed that he was fired for complaining about price fixing. In another employee case, *Donovan*, the employee was fired, allegedly because his employer was losing sales from his former employer who had a policy of not purchasing from companies where its former employees worked, and held no injury. In the *Roman* case, however, the employee was ruled to have properly alleged antitrust injury. His claim was that there was a no-switching agreement between airplane manufacturers, as a result of which he could not get a job in another one after he left his first one. Now, even though injury was alleged when the case is tried, and it's necessary for the plaintiff to prove anticompetitive effect, if it is; then, of course, that may be a more difficult problem for him.

Finally, the Seventh Circuit's *Blackburn* case is what most of us, I think, would think of as a more classic no-injury case. It was also an interesting case to the bar because it involved the breakup of a law firm. And at the time of the breakup, and I believe this was a firm that specialized in personal injury cases, it was agreed that one of the breaking segments would advertise in a certain area, and the remaining ones would advertise outside that area. And later problems under this agreement arose, and it was challenged in the court, one of the groups saying that it was illegal as a division of markets. And the Seventh Circuit agreed with that, said it was illegal, but because it was the kind of agreement which would have tended to improve the performance of the plaintiff, since it tended to insulate them from competition, there was no antitrust injury.

Now, in the time we have left I would like to focus on a couple of areas which are traditionally not the primary areas for the government to be interested in and, accordingly, where private litigation tends to be more important.

The first of these is predatory conduct, and particularly pricing. I am sure that most of us recall that Wal-Mart's pricing policy was challenged in its home state, Arkansas, by a group of local retailers who claimed that it was violating the

state sales-below-cost statutes. Well, last year that case got up to the Arkansas Supreme Court, and the lower court decision finding Wal-Mart liable was reversed. The Arkansas Supreme Court said that Wal-Mart's activities were conventional loss leading, undertaken only for limited periods. It stated that in these circumstances no inference of intent to destroy competition, which was required under the statute, could be drawn from Wal-Mart's conduct, even though that conduct included in-store price comparisons with neighboring stores. And Wal-Mart's conduct also included geographic discrimination to meet competition in the various areas where it operated. The Arkansas court pointed out that the sales-below-cost law had been enacted to deal with unusual forms of distribution, and that if the legislature wished to outlaw conventional loss leading operations, it ought to do so more specifically. Now, as a result of this decision there may be fewer of these cases, and certainly those that do exist will be brought outside Arkansas.

Under the federal law, the difficulties of proving predatory pricing claims have turned out to be very great indeed. One such case was *Advo* in the Third Circuit. There the claim was that a distributor of circulars through mail was being faced with below-cost competition from newspapers who preprinted the circulars and delivered them through newspapers. The court said that there was no proof that the circulars distributed by the defendant were being distributed below average variable cost. It pointed out that the plaintiff's expert could only estimate the average variable costs of the defendant, and to some perhaps even more significant factor was that the low barriers to entry made it unlikely that recoupment could be achieved, which as you recall was one of the essential elements of a plaintiff's case laid down in the Supreme Court's *Brook* decision.

Now, there was an interesting case in the Ninth Circuit involving discount gasoline sales; that case is the *Rebel* case. And the Ninth Circuit there said that the Sherman Act claim had not been proven because market power was needed to prove a Sherman Act predatory pricing claim. On the other hand, it was possible that a Robinson-Patman claim might be made out, because market power was not necessary to be proved in that case. I believe the Supreme Court has just denied *certiorari* on that case.

In the *Israel* case, which is listed, the Seventh Circuit threw out a predatory pricing claim simply on the basis that recoupment was unlikely, noting that the recoupment had to be recoupment through supra-competitive prices.

Now, the *Health Consultants* case, which is listed, is not a pricing case, but it involves the kind of conduct that was treated in the Supreme Court's Kodak case a couple of years ago, *Image Technical Services v. Kodak.* In that case, the plaintiff, who was an independent repair service for copying equipment, claimed that Kodak had attempted to monopolize the service business, and in particular had engaged in tying agreements with respect to parts which were not otherwise available. The tying agreements provided that the owner of the equipment would not sell parts to independent service operators; Kodak itself would not sell such parts. And the net effect of these arrangements was claimed to be to monopolize the service business.

Now, that particular case, the *Kodak* case, went to trial during 1995, and there was a verdict for the plaintiffs, approximately $25 million. But what may prove interesting to us is that when it finally went to the jury, it was not submitted as a tying case but was rather submitted as a monopolization case. I suspect that the plaintiffs' lawyer decided that it would be much simpler for the jury to work its way through monopolization instructions than through the sometimes arcane tying rules.

Now, the *Health Consultants* case is a very similar case, and one of the more interesting parts about it is that it arises under state law; in that case, Nebraska law. So that we may see more of those cases being tried in the state courts.

Now, the discrimination cases are of course going to be treated in the next segment of the program, so I will not deal with those, except that I just can't resist discussing one of them very briefly. In the great state of Maine, the legislature enacted a law at the insistence of car dealers, that when warranty repairs were necessary the car dealers were to be reimbursed at their regular retail rates, rather than at the lower rates that the automobile manufacturers were accustomed to paying. And in response to this initiative the Ford Motor Company increased the prices of its cars to dealers in Maine. And since these dealers were, of course, mostly the same people who performed the warranty repairs, the dealers took offense at this, saying that the money that the legislature had intended to put in their pocket was being lifted out by this unfair price increase. And it was doubly unfair, because those dealers who happened to be next to the New Hampshire border were being charged more for their cars and had to charge customers more for their cars, giving the New Hampshire dealers an advantage, and this discrimination violated the Robinson-Patman Act.

Well, the First Circuit said first that the Maine statute did not require the automobile companies not to raise their prices to recover their extra costs. It also said that the Robinson-Patman Act was not violated in a situation where a manufacturer increases his price to recover an increased cost just in that area; that that is exactly what the cost justification proviso permits. It's the only case that I think I have ever encountered where there has been a *per se* cost justification defense proved by a court. But undoubtedly, Irv knows about it now.

Finally, just a brief word about labor. There is a case going to the Supreme Court, *Brown v. Pro Football*, and it involves

the NFL's ceiling on the salaries of practice squad players. As I'm sure many of the people in the room know much better than I, the NFL has a classification of players, certain players who serve on practice squads primarily to warm up the A team so to speak, and they are eligible as replacements in certain circumstances. The NFL had a ceiling, I think at one time it was a thousand dollars a week, for the salaries that were paid to these players, and that has been challenged over the years in the courts. The NFL and the players association held collective bargaining negotiations, reached impasse. After impasse, the NFL teams imposed such a ceiling.

Now, the ceiling had been contained in pre-impasse proposals, and accordingly was viewed by the court, lower court, as within the collective bargaining process. And the court ruled that the imposition of the ceiling after impasse was for that reason within the nonstatutory labor exemption and, not an antitrust violation. It also ruled that the imposition of the ceiling had no level of affect on the competition within the NFL, for whatever that is worth.

Well, the Supreme Court is going to decide those cases. And whatever it decides would of course enlighten us for the future. And it may also have some bearing on cases which the Second Circuit has recently decided involving the National Basketball Association.

There were two cases decided in 1995 in which the Second Circuit for all practical purposes—and I realize I'm overstating this a bit—stated what are we doing here; these are labor matters, not antitrust matters. And in one of the cases in which the plaintiff claimed that he was being boycotted by the member teams for his union activities, the Second Circuit stated that Congress in its labor policy had meant these matters to

ROBINSON-PATMAN: FUNDAMENTALS AND PRACTICAL CONSIDERATION

PROGRAM CHAIR PETER E. GREENE: We are particularly fortunate this morning in that we are going to hear an awful lot about Robinson-Patman. The title is "Fundamentals and Practical Consideration." My guess is, knowing one of the speakers and somewhat about the other, we are going to move very quickly beyond the fundamentals. And for any of you that have had the opportunity or experience in dealing with the day-to-day issues that arise in the Robinson-Patman area, I think that you will share my view that it's very complicated. The issues are very vexing sometimes, and they come up with tremendous speed and have to be resolved just as quickly. So I think we are very fortunate today to have two people that have a wealth of day-to-day experience in handling these issues.

Bob Marin is the general counsel of Matsushita. I think more of us are familiar with the name Panasonic. As any consumers product company, they get involved regularly in R-P issues. He knows the area backwards and forwards, inside out.

All of us have heard Irv Scher speak on R-P at one time or another. There is probably nobody that knows as much about R-P or has as much experience as Irv.

The way I understand they are going to split this up is Irv is going to start, and Bob is going to comment. Though I think they'll be happy to accept questions at the end of their talk. Thanks very much.

MR. SCHER: Thank you very much, Peter.

The way we are going to do it is, as Peter said, I'm going to sort of go through the areas, and Bob will add comments where it's particularly relevant to inside counsel who, of course, are on the day-to-day firing line under this statute.

It's good to know that there are 30 lawyers interested in the Robinson-Patman Act in New York City. So welcome. I thought it would be foolish to talk about fundamentals really, and what we are going to do is presume that you know the fundamentals and sort of deal with many, many topics in the form of sound bites, which is a popular term when you're on a microphone these days, and sort of what's really happening or what's key to these areas, rather than going through the fundamentals.

For example, the first question might be why are we spending an hour and a half on the Robinson-Patman Act when there are so few cases? That is not really correct, but there's two answers to that question. The reason we are spending the time on the Robinson-Patman Act is those of us who do give antitrust compliance talks from time to time realize that although we start and emphasize the grand jury problems and horizontal price fixing and then when we ask our clients if they have questions, their questions invariably are Robinson-Patman Act questions.

Out in the field, particularly for consumer products companies but even industrial products, Robinson-Patman is a day-to-day concern of the sales force and the marketing force, and because the customers of the United States are enforcing the statute. Maybe not through too many lawsuits—although there are more than 4,000 under the Robinson-Patman Act right now in the drug industry alone—but threatening suits, demanding equity, claiming they are going to switch suppliers unless they get better treatment. And it forces our clients, if we are sellers, sales forces to be very attuned to the statute, to its requirements and to its defenses.

There are minimum government risks. I think we all know that. The last Robinson-Patman Act case brought by the Federal Trade Commission was brought in December 1988, which is now seven years ago. And I call it case; it was six cases. They were brought under six different dockets, but they were consolidated, because it's essentially the same case against six publishers. And that case supposedly settled a couple years ago, but we haven't heard from the FTC since. No cases after that through the entire Bush administration and even through the Clinton administration. Word of investigations, but no cases after three years—we have three years of the Clinton administration? Yes. So where is the Robinson-Patman Act at the FTC?

Now, insofar as the Department of Justice is concerned, many people don't even realize that the Department of Justice has jurisdiction to bring a Robinson-Patman Act case, much less that they haven't brought one for the last 40 years. They do have jurisdiction to bring Robinson-Patman Act cases, but as I said, they haven't brought one for 40 years. So we don't see it on the federal side.

On the state side—I seem to fall into these things—I recently had a state AG Robinson-Patman Act case. The states do have price discrimination statutes, not all of them. New York is one that doesn't, but most states do have price discrimination laws. But rarely are they enforced. Interestingly, they are not only not enforced by the governmental authorities, the AGs, but not in private suits either. You rarely see a state price discrimination act suit brought by private parties.

But nevertheless we do have to worry about the Robinson-Patman Act from a private standpoint. As I mentioned, thou-

sands of cases are brought in the drug industry. You might say why if thousands of cases have been brought in the drug industry I haven't heard about it? The reason is it's difficult, if not impossible, to get a Robinson-Patman class action certified. But as you'll see as we go through our little sound bites here, there are so many little individual issues in Robinson-Patman cases that any class action that gets certified is either defense counsel's fault or clearly the judge's fault. It just shouldn't happen. So because of that in the drug industry, where there are massive concerns about prescription drug price discriminations, what the plaintiff bar did is bring thousands of individual cases and have them sit on the side, as a few of them have tested out as test cases.

MR. MARIN: If I can interrupt for a minute. When I got the call and was asked to participate in this, I said to myself why does anybody want to hear about the Robinson-Patman Act? And I thought through when does the Robinson-Patman Act really come to the surface in my practice? And, you know, there are a number of instances, but what's interesting to me is that the Robinson-Patman Act becomes an issue for a company like ours, or at least from my company, most often in what I'll call the whistle-blower kind of situation.

What is that? Well, there are two different categories of whistle blowers: There is the salesperson who says you've discriminated against my customer and in favor of some other salesperson's customers, and it's caused me commissions or caused me not to meet my quotas and that's why I'm at risk of termination. Now that's fairly easy to handle. But then there is the employee who may or may not be a salesperson, who may be in the credit department or some area that's peripheral to sales and who is not performing and who knows that in the current situation all corporations are looking for dead wood to eliminate and try to reinvent themselves. And they see the handwriting on the wall, and they know that there have been price discriminations, price differences between customers. So they write a letter to the chairman of the company or the general counsel or somebody, and they say I want to bring to your attention this illegality, this Robinson-Patman Act violation; it is a violation of public policy. When you go to discipline this person or demote the person or terminate the person, they say, "Ah, retaliation."

That's really the place where the Robinson-Patman Act comes up most frequently in my practice. Of course, it also comes up in threats by one customer who learns or believes that our company is giving a better price to another customer. And it invariably comes up in either a dealer termination situation or in a bankruptcy kind of situation where you've got somebody who is going out of business and he's just looking for claims, if there are any differences in price and he can ascertain or if he can get by a motion to dismiss—you know—Robinson-Patman claims can be very difficult from a discovery perspective.

So while Irv is absolutely correct, that you don't see an awful lot of litigations, and most of the Robinson-Patman claims that we see in litigations are really subsidiary to other issues, it is there.

MR. SCHER: And by the way, on Bob's point, although most courts have said that terminated employees don't have a claim in this area, in I think December of '94 the District Court in Maine allowed a terminated sales rep alleging a retaliatory discharge for not playing along with a Robinson-Patman violation, said he had standing.

MR. MARIN: Yes, I'm not worried about standing under Robinson-Patman Act. I'm worried about the wrongful termination suit.

MR. SCHER: But this guy was allowed to sue under the Robinson-Patman Act. Now, it was a district court decision, and I have my doubts about the validity of the decision, particularly since the court stressed the risk of criminal violation if the plaintiff acceded to the scheme. And I've had problems finding out what criminal violation would have been involved.

In any event, the risks. When are there suits beyond just complaints? Plenty of complaints out there by customers: I want equity; I want the same thing my competitor is getting; how come he is able to sell at this low price. This is the way they get around Sherman Act problems. How come he is able to sell at this low price, and I can't? He must be getting a better price than I am getting. That's the day-to-day problem. It's not litigation.

When is there litigation risk? In this area I have found, and Bob may want to add something to this, the litigation risks are the former customer, the terminated dealer who used to bring a resale price maintenance case, we are aware of the law in that area, now brings a Robinson-Patman case for the time before he was terminated. The financially distressed customer, and particularly the customer who goes into chapter 11, is a major Robinson-Patman plaintiff these days. Those, I think, are the two largest areas of risk. Because when you're dealing with customers on a regular business relationship day-to-day, they scream, they shout, they say, "I'm going to buy elsewhere," but they don't bring Robinson-Patman cases. That's very rare. However, if it's a terminated customer or financially distressed or bankrupt customer, that's different. The other real risk area is trade association. You've got to have your clients, if you're a seller in a Robinson-Patman sensitive industry, their antennae have to be up with respect to trade associations of smaller customers or smaller distributors or distributors in an industry

where there's a major shift from two-step to one-step distribution.

The distributors trade association and the book industry cases have been brought by the American Book Sellers Association representing the small book sellers claiming that the chain bookstores were getting better prices. So watch those trade associations that build up treasure chests to bring lawsuits. The court here in the Southern District allowed standing for a trade association, interestingly, only seeking injunctive relief, not damages. Not being a buyer, obviously the trade association couldn't obtain damages, so they only sued for injunctive relief.

Bob, do you want to add anything there?

MR. MARIN: Well, only that we haven't experienced the trade association case. We have experienced the other kinds of cases that Irv mentioned, including the very rare situation of a current customer suing for price discrimination, claiming price discrimination, which makes life a lot more complicated than if you're dealing with somebody who is no longer doing business with you or where you don't have ongoing issues.

We try from an in-house perspective, of course, not to win cases; we try to avoid cases. Robinson-Patman Act cases are very difficult for a plaintiff to win, but they can be very costly for a defendant if you get to the discovery stage. What we try to do is we try to make sure that no one feels that their ox is gored. And if no one feels that their ox is gored, and if a customer base generally feels that they are being fairly treated, you should be able to avoid most of the Robinson-Patman Act claims.

The danger is if the market shifts while you're not looking, so that, for example, your customers who are reselling to a customer base, that customer base shrinks, so suddenly customers of yours who weren't in competition are now in competition with each other—you're going to have a problem. So it's very important to have a good understanding of the dynamics of the marketplace that you're dealing with.

MR. SCHER: Okay, let's spend some time on the jurisdictional elements of the statute, because a Robinson-Patman Act case, if it gets by a Rule 12(b)(6) dismissal motion, can become very expensive, not just because of the lawyers that have to be involved, but the economist who generally has to come in and damage expert who may be an accountant or with an economics company. The expenses of these cases can be enormous in determining who the competing customers are and what the various prices have been, and are they really competing with each other in the resale of merchandise. It becomes quite an expensive case in the discovery stage. So if you can get rid of the case—again, I'm talking now to defendants—forgive me, because that's the point of view I come from under this statute—if defense counsel can get rid of this case at an early stage, he's really done a service for his client.

Keep in mind, by the way, there are two important exemptions under the statute that you should never forget. One is the charitable institution exemption: sales to schools, colleges, libraries, hospitals for "their own use." That's exempt under the Robinson-Patman Act. Similarly, direct sales to the federal government or a federal government agency—I'm using the word "direct," because a sale to a distributor who resells to the government entity is not exempt under the Robinson-Patman Act. There are ways to avoid that problem, and we'll get into that. Insofar as sales to state agencies are concerned, the Supreme Court ruled five to four that they are the subject of Robinson-Patman Act when the state agency is in competition with the private sector. So I don't know how they would rule today, but when last we looked there wasn't an automatic exemption for sales to state agencies.

Now, the jurisdictional elements. There are a lot of hurdles that a plaintiff has to get over in a Robinson-Patman case. It's not like price fixing. You know, in a price fixing case the question is: "Did you do it?" In a Robinson-Patman case there are many hurdles for a plaintiff, and there are jurisdictional hurdles. Again, when you're counseling a seller, keep the commerce clause requirement in mind under the Robinson-Patman Act. You know, other than hospitals, it's rarely an issue under the Sherman Act. But in the Robinson-Patman Act, there is an absolute requirement that one of the two sales being measured, either the higher sale or the lower sale, must cross, actually cross, state lines. So home-based sales into one state either by you, your client or manufacturer or the distributor, if you're representing a distributor, aren't subject to the statute.

Issues come up on foreign sales. Export transactions are not subject to the statute. Keep that in mind. Often clients will ask you about transactions into Canada. Your client's transaction from the U.S. into Canada are not subject to the Robinson-Patman Act. Indeed, your client's sales to a distributor for resale into Canada aren't subject to the Robinson-Patman Act. The statute only applies to sales for use or resale domestically, right in the statutory language.

So the commerce issue can become important, particularly in export and import transactions. On import transactions, Bob's company has the experience there. The Third Circuit ruled that import transactions coming in from Japan, the Robinson-Patman Act couldn't compare prices in Japan with prices to the United States; only discriminations between customers in the United States were subject to the Robinson-Patman Act.

Let me go to price, the other requirement. There's got to be a discrimination in price. If you have one price to all of your

customers, no matter what level of trade they are on, or even if they are consumers, the statute isn't implicated. So if I sell for a dollar to wholesalers, retailers and consumers, I may have engaged in economic discrimination, but I haven't violated the Robinson-Patman Act because there's only one price. There's no discrimination, as amazing as that might sound.

I had to argue a case before Steve Breyer, and he asked me about the economics of my position. And you know, I had to say to him, "I've never heard a judge ask me about the economics of a Robinson-Patman issue." He didn't like when I said that, but in any event, just looking at this requirement of the statute, you've got to have a discrimination for it to apply at all, a price difference shows you the soundness of the economics of the statute. Now, price, keep in mind, includes not just the invoice price as such or the price for the article but terms and conditions. And terms and conditions can be very important.

Somebody asked me before, "Can you name a case in which the plaintiff actually won and got treble damages?" Well, one case in which a plaintiff actually won and got treble damages actually involved a freight discrimination, and the discrimination in the freight resulted in that customer losing important business. It was a distributor reselling to retail chains, and free freight to certain retail chains was at issue. The District Court and Court of Appeals saw discrimination and found liability for freight discrimination.

Credit. Some of you may not talk to your credit managers or credit people much, but credit is an area in which there are Robinson-Patman risks. Happily for the defendants in this area, however, the courts have allowed legitimate credit differences, as long as there are legitimate business reasons for the differentiating credit terms you have to particular customers.

MR. MARIN: The best way for a defendant, a vendor, to deal with that, in my experience, is to make sure that structurally within the company the people who are responsible for the credit decisions are different from and report to different people than the people who are responsible for the sales. Because if you give the sales manager responsibility for making a credit decision, he's going to use credit as a sales tool. And once you start using credit as a sales tool, you're in the soup. If you separate that out, and you've got the salespeople reporting up to some sales management, and you've got the credit people reporting up to some financial management, the bean counters aren't going to let credit be used as a sales tool. Credit is going to be used as a tool to make sure you get paid. As long as credit is used as a vehicle to make sure you get paid, you should be okay.

MR. SCHER: That's a good rule of thumb, I think.

Now, let's go to the next jurisdictional element. You've got to have different purchasers. The statute talks about discriminations among different purchasers. That means a number of things. First, nonsales transactions are not subject to the Robinson-Patman Act. This means that a licensing arrangement, a legitimate consignment arrangement, leases, an agency arrangement aren't subject to the Robinson-Patman Act. And there are industries out there that have used licensing arrangements rather than sales transactions to avoid Robinson-Patman Act issues.

Query: One area that's interesting—I didn't have to say this ten years ago—is computer software. When you think you buy computer software and you look on the back and it says this is a license, I don't know if—I mean, nobody has ever knocked at my door to get back my software as a consumer. I always worry since it's a license I might get that knock at the door some day. But there's a case out there involving Microsoft in which the court said that licensed computer software is not subject to the Robinson-Patman Act. Query—whether the decision is correct, I mean, is it really a license of the product as distinguished from a license of the program? Is the program part of the product, or can you separate them out and say, well, maybe the software program was licensed, but I paid $89.95 for my Windows 95 upgrade, and as far as I'm concerned I bought it. Let me say it is an unsettled area, and I wouldn't be too flippant about saying that the transfer of one thousand Windows 95 units is not a sales transaction.

Bob, do you have anything on that topic? You may have had the issue.

MR. MARIN: Well, it's a confusing issue, and I think you look at it and clearly it's a sales transaction, and it's called a license because they are trying to prevent you from taking this software, duplicating it and handing it over free to other people. But analytically, if things like economics make any difference—and maybe they do, maybe they don't, I don't know—it may depend on what Steve Breyer says, it is a sales transaction. And I think conservatively you have to analyze it that way.

MR. SCHER: I'm thinking of this program of the Robinson-Patman Act in cyberspace. That's the one area that hasn't been covered yet.

You also have to have two sales by the same seller to two purchasers. We don't have a blackboard—it is hard to do Robinson-Patman without a blackboard or overhead. But envision in your head the same seller has to discriminate between two purchasers, okay. That means that despite the letters you get sometimes saying "you're refusing to sell to my client, that's a Robinson-Patman Act violation," it isn't. A refusal to deal cannot violate the statute. If I say, "I'll sell to you at a dis-

criminatory price" and you turn me down, we did not violate the Robinson-Patman Act in that transaction. We've got to have actual sales occur.

Now, the area where same seller or two customers—let's start with two customers—comes into play the most is in the area of intraenterprise transactions, a sale to an independent customer and at the same time a contemporaneous sale to an owned customer. Either it is an owned distributor or an owned retailer when the Robinson-Patman Act applies, if we were stupid enough to make that a sales transaction rather than an intracorporate transfer without an invoice.

Three circuits have used *Copperweld*, the Sherman Act *Copperweld* doctrine, to say that those sales to subsidiaries aren't subject to the Robinson-Patman Act. The Sixth Circuit and the Eighth Circuit in direct holdings and the First Circuit in dictum in the *BMW* case, which involved a different issue. So three circuits will apply the *Copperweld* doctrine here, and you don't have to worry about sales to your owned customers.

Frankly, I believe that the *Copperweld* doctrine addresses different issues, but it would seem that you can certainly argue that this transaction doesn't have economic significance, so that aspect of *Copperweld* you could certainly import into the Robinson-Patman Act. It is really just an internal transfer.

Now, those other circuits that haven't adopted this per se *Copperweld* rule, most of them too have adopted an absolute rule, without referring to *Copperweld*. The only circuits that haven't, as far as I can tell, haven't adopted an absolute rule saying that a sale to a subsidiary isn't subject to the statute are the Ninth Circuit, and our own Second Circuit hasn't done it yet. In fact, Judge Motley has out and out rejected it. And in the circuits that haven't adopted that rule, in those few circuits, they'll take a look at the economics of the situation: Does that subsidiary have control over who to select as customers? And if they see those economics, that the owned subsidiary really has total freedom, they are going to say it's a separate customer.

Now, I can't give you a case in which that's been found on the merits, but I've got a 12(b)(6) ruling saying those are the facts we are going to look at. I guess the cases get settled at that point. So here in the Second Circuit you have to put a little asterisk. It's possible that there could be a problem on a sale to a subsidiary. Keep in mind if they want to look at *Copperweld*, that was a 100 percent owned subsidiary in the *Copperweld* case. But who knows. In counseling I generally don't worry about sales to subsidiaries. You don't have any sales to subsidiaries, do you? You only have the other issue I'm now going to pick up.

MR. MARIN: We have both issues and sometimes sales to affiliated companies that are 100 percent owned by our parent that owns us 100 percent. But one thing that Irv said earlier is absolutely true, and that is, you can't analyze these without a piece of paper and a diagram or a blackboard. Because each corporate structure has its own little nuances, and you have a whole bunch of different issues, and you've got to lay it all out and figure out who is buying from whom, who is selling to whom, and figure out what the answer is after that. For the most part, unless you do it very, very foolishly, there should be a way to have your intracorporate transaction take place with very minimal R-P risk.

MR. SCHER: Well, the separate seller area, however, the next one I want to mention, is now a real problem. The question of whether you're a subsidiary or you're a corporate affiliate, which is really where the problem is in our multimedia age, is today a problem. Let me give you a for-instance. I happen to see somebody in front of me who has this problem. A for-instance: We have a conglomerate—a media conglomerate selling a CD-ROM product let's say, or one of its subsidiaries produces a CD-ROM product. This particular CD-ROM product now gets sold by its video company, its video affiliate, which is totally separately managed and operated. Its book publishing operation, which is a separate corporation totally managed and operated, and who did I leave out? Let's say—it may have a software company, it may have a music company, we might have up to four all selling this multimedia product. Each is a separately incorporated, separately managed company selling to its own customer base. Each believes it can decide its own pricing. It's got whatever this multimedia product is, and it is going to come up with its own pricing. Unfortunately, down at the retail level if they are selling directly to retailers, all these retailers are competing with each other. So the question is, can each of these separately operated, separately incorporated, separately managed companies come up with its own pricing structure, or is the parent up there going to be responsible under the Robinson-Patman Act for everything that they do?

Now, in every circuit except the First Circuit the rule was that, under the fact pattern that I just gave you, no Robinson-Patman concerns, because each company is deciding who to sell to, the prices to sell at, invoicing on its own and getting paid on its own. They are separate sellers, although part of the same corporate conglomerate.

Unfortunately, the First Circuit a couple of years ago in a decision by a little-known judge who is now on the Supreme Court, Stephen Breyer, said that's wrong and said that since the transactions from the parent to each of the subs isn't subject to the Robinson-Patman Act under *Copperweld*, which is a Sherman Act decision, then the first sale outside the corporate entity, the corporate conglomerate, is a sale by one company. And he ruled that as a matter of law. And his reasoning was

Copperweld, which really applies to a totally different issue, in *Copperweld* the question is: Can they conspire with each other in their joint dealings? This is a question of should there be vicarious liability in their separate dealings? So that part of his decision I believe was wrong. But beyond that, you know, he was looking for sound economics. And it seems that why should a parent have to supervise the day-to-day activities of these separately operated companies. But nevertheless, Judge, now Justice, Breyer, ruled that the statute applies because they could possibly do this to evade the statute. So rather than say, "I want to look at the facts," which is the usual rule in parental liability for activities of subsidiaries, he adopted a per se rule. So in the First Circuit at least, the rule is you got a problem in my multimedia illustration.

Bob.

MR. MARIN: Tell us again what the context of that ruling was? I mean procedure?

MR. SCHER: Oh, it was a 12(b)(6) motion.

MR. MARIN: Okay, so I feel a little bit better.

MR. SCHER: It was a 12(b)(6) motion, but nevertheless he decided it is a rule of law, disregarding the other cases, because he wanted sound economics under the Robinson-Patman Act. Now, do you see this as a real problem? Are you just disregarding the decision?

MR. MARIN: Well, I don't—I'm not disregarding it, but I'm not sure I know how to deal with it. Because from a real world practical perspective, you can't go to the corporation—in my case, I can't go to top management of my company's parent in Japan and say there was this First Circuit 12(b)(6) ruling, and by the way, you have to change your whole divisional autonomous divisional structure because you're subject to some crazy lawsuits in United States.

MR. SCHER: And this is a real problem not just for foreign corporations but any corporation that has separate subsidiaries that operate their own operation for particular sales and then the parent does its own selling to another customer base and it's the same product.

Of course, there are a few ways to avoid the problems, as long as we are on it. How do you avoid the problem? Goods of different grade and quality. I haven't gotten to that yet. But we are not about to do that in my multimedia example certainly. Goods of different grade and quality is one way. And another way is availability, the concept of practical availability. Which in my multimedia example is also difficult, because we've set up these whole different distribution schemes, and we really don't want the customer base of our company A to be buying from our company B that happens to be a better pricing structure to its customer base. But availability sometimes is the way out. If the company offering the lower price is available to those people who want to buy at the lower price, then you avoid the Robinson-Patman Act.

I'm ready to ask if there are any questions, but why don't we wait until we are over to pick that up.

Okay, anyhow, so that's that question. Now, keep in mind on this question also of separate purchasers there's the contemporaneous sales issue. You have to be selling to customers during the same market, so to speak. If I sell to somebody, let's take automobiles, the 1995 model during that period, before the 1996 comes out, and then the 1996 comes out and my price changes for the 1995, the customer who bought the 1995 technically one day earlier wasn't buying in the same market. Now, there is another defense under the statute for changing conditions, and that might apply here as well. But I'd argue also that the sales weren't contemporaneous; they were in two different markets, so they weren't really two purchasers buying in the same market or in the same marketplace.

MR. MARIN: We are also going to get into like grade and market issues most likely.

MR. SCHER: Well, no, it is the same car, but my price for the '95 car changed when the '96 came out. And the guy that buys the '95 the day before starts screaming. Now, maybe we have got a real business problem there, but technically under the Robinson-Patman Act we will have two defenses. One is the changing conditions exemption, which I won't mention anymore today, and the other is the contemporaneous sales issue.

MR. MARIN: At some point there you're going to have a close-out situation. Right, well, that's also subject to the changing conditions defense.

MR. MARIN: Right.

MR. SCHER: Okay, a problem that's coming up I find more and more, at least in my own practice, is the standing of the indirect customer. You're selling to a distributor and then a retailer brings the case, because his direct buying competitor is getting a better price. Again—I know he's making a quizzical look—I don't have the blackboard. I have dual distribution, I sell direct to some retailers and I sell through distributors to others. The question is whether the customer of the distributor has standing to bring a Robinson-Patman case. And the rule, in quotes, is that he doesn't, and the only circuit that seems not to have adopted that rule is our own Second Circuit. Which in a case in his industry, but involving his competitor, Sony, decided that we are going to have to look at facts here. What was intended? Were they really trying to hurt the retailer customer

of the distributor? If so, maybe we will allow that customer to have standing. Other than that court, the rule in most—not most, I think all the other courts—is that retailer customer of the distributor doesn't have standing. On the other hand the distributor has standing to bring a case if the price to the direct buying retailer was lower than the price to him. Because there was a discrimination, not among competing customers, but if as a result the distributor now selling at a higher price to his customers, those customers lose business to the direct buying retailer who is buying at the favored price resulted in them buying fewer products from the distributor, now the distributor brings a Robinson-Patman Act case. And believe it or not, he had one like that down in, was it Kentucky—Louisville?

MR. MARIN: Yes.

MR. SCHER: Where that was the exact claim. The distributor claims that the direct buyer is getting a better price; I have to sell at a higher price to my customers, they buy less from me, I've got standing. And the courts have ruled that the distributor has standing in that kind of case. So what's the answer? Make sure that their direct buying retailer doesn't get a better price than the distributor.

MR. MARIN: Irv, what about the situation where the price is not the same to the direct buying retailer and the distributor; it's a little bit lower to the distributor?

MR. SCHER: I don't think they have a claim.

MR. MARIN: It's not one price now. Economically, there's no way that the distributor—because you're only giving him 50 cents less on a $100 product.

MR. SCHER: I haven't seen that one.

MR. MARIN: Neither have I. I don't want to give anyone any ideas.

MR. SCHER: It is a discrimination, and the favored customer is saying he hasn't been favored. I would rely on dictum in the Supreme Court *Hasbruck* case in which the Supreme Court said that functional discounts aren't required under the Robinson-Patman Act. So that the distributor who got one cent better wouldn't have a claim under that dictum in the *Hasbruck* decision.

Okay, go ahead, Mike, ask a question

SPEAKER IN AUDIENCE: Suppose you have the chains buying at a price that's as good or better than the distributor who is distributing to retailers who are competing with those chains?

MR. SCHER: Then the distributor has a claim if it is a better price to the direct buying retailer, and there's plenty of law out there on that.

MR. MARIN: The question was as good as or better. That's two different questions. As good as, there's no price discrimination.

SPEAKER IN AUDIENCE: Okay, but you have another question here on the secondary level, of course, because then you've got the buyer, the retailer who is buying through the distributor, who is at a complete disadvantage to the chains.

MR. SCHER: That's where I started saying he doesn't have standing except possibly here, if somebody could show that he was being targeted. And I think that's an impossible burden of proof for a plaintiff. Okay, again, I'm sorry, we don't have a blackboard on these dual distributions.

SPEAKER IN AUDIENCE: Suppose in the *Kraft Phoenix* case, where you have some control over the distributor and an indirect buying retailer, it is now then—

MR. SCHER: That is the indirect purchaser doctrine. That's a different issue entirely. And only my friend Scottie would bring up a 1942 case. There are more recent cases on the indirect purchaser doctrine.

In that situation the argument by—you see it doesn't come up under those circumstances, because the situation—let me tell you the situation he's raising. I've got a situation in which I'm dealing through distributors, but I have direct dealings with the distributor's accounts; I'm giving them additional rebates, or I'm just dealing with them as though the distributor doesn't exist. Under those circumstances we collapse the distributor, as if I'm selling directly to the distributor's customer. But the claim there is usually not by him; he's the favored customer in the indirect purchaser cases. The claim is by the other guy in those cases. And you do see indirect purchaser cases from time to time, so you've got to say to your client: Be careful. If you are using a distributor between yourself and the retailers, you're usually not going to have a Robinson-Patman problem there because the distributor is deciding his own prices. Be careful when you go by him and have direct dealings with his accounts, because people bring indirect customer claims, trying to make believe the distributor has collapsed into the retailer, and you're really the seller to the retailer, so you're responsible for his price.

MR. MARIN: Assume direct dealings on co-op advertising; don't put yourself into that situation.

MR. SCHER: Not in a 2(a) case because under 2(d), strangely, he's your customer because of the *Fred Meyer* decision in the Supreme Court. So 2(d) and 2(e) it is different. We are talking about price now. You're expected to go direct to that customer on advertising and promotion.

MR. MARIN: But my point is you are going direct. You are having some direct dealings, they may not be 2(a), they are 2(d) dealings, but because of the *Fred Meyer* guidelines you may be forced to have some direct dealings. That should not be enough to collapse.

MR. SCHER: It shouldn't, but there are some plaintiffs out there who try to use that.

SPEAKER IN AUDIENCE: He just brought up a point. Let's assume on the promotional allowances you're having direct dealings with the retailer customer.

MR. SCHER: Shouldn't be enough.

SPEAKER IN AUDIENCE: With the retail customer, but you don't monitor it properly; he ends up with a better promotion. Isn't there an overpayment situation there, and then 2(a) comes into play?

MR. SCHER: No. Well, you have a *Hasbruck* problem. I wasn't really going to talk about *Hasbruck*, that's a Supreme Court decision in which supposedly the house to the wholesaler—again we have got a situation where we are dealing direct and then through wholesalers. We have dual distribution. Here the direct buyer claims that his competitor, who is buying through the distributor, is getting a better deal, and the distributor of course is buying at a lower price. Normally that's no problem because the distributor isn't competing with the direct buying retailer customer. But the *Hasbruck* case has the direct buying retailer customer arguing that there's such a low ball price to the distributor that he's passing it through to his customers, and they are killing the direct account. That is what *Hasbruck* was about. And under those circumstances the Supreme Court said he's got a claim. He's got a claim. And I mean it could be done not just with price; it could be done with promotional allowances or what have you. But here the customer of the distributor is allegedly the favored customer, and the direct account brings the case. It's a very rare situation, and that was even noted by the Supreme Court in *Hasbruck*. And the way to avoid it, again, is if the distributor is an available supplier to that direct account. Now if I'm representing the manufacturer, I'm off the hook because that account didn't have to buy directly from me. He could have bought from the distributor and gotten the same deal that the customer of the distributor was getting. Now in that same case I was discussing, that *Caribe BMW* case, the First Circuit Breyer decision, that was an issue there, too, because the direct account was bringing the case and relying on *Hasbruck*. And on that availability point that I'm mentioning, what Breyer said in the context of 12(b)(6) is the following: The direct buying customer said he didn't realize that if he had bought from the distributor, which happened to be an owned distributor, he would have gotten the better deal. So Breyer said, okay, it is going to beat a 12(b)(6) motion. But if the evidence shows that he knew or should have known he would have gotten the favorable price by buying from the distributor, arbitrage so to speak, he's out.

SPEAKER IN AUDIENCE: I don't think we are on the same wavelength on this one here. I'm raising a hypothetical where you are directly dealing on your promotional allowances, let us say with two retail customers, okay, retailers.

MR. SCHER: Which the law says you should be doing.

SPEAKER IN AUDIENCE: Absolutely. Now, one of the retail customers somehow or another does not comply, and he's giving you information which leads you to give him an overpayment—I'm not saying overpayment, but more promotional allowances than he's entitled to, and you have not policed it sufficiently. Now I think under the law that ends up really being an overpayment and, you're now into a 2(a) situation as opposed to a 2(d) violation.

MR. SCHER: Right, but that has nothing to do with dual distribution.

SPEAKER IN AUDIENCE: I'm not talking about dual distribution.

MR. SCHER: I was discussing dual distribution, so I presumed your questions were on point.

SPEAKER IN AUDIENCE: No, the gentleman next to you was bringing up the question about 2(d), and you could get into a problem area with 2(d) on that basis.

MR. SCHER: That's absolutely correct.

The next area is services. Services aren't subject to the Robinson-Patman Act. So those of you who sell advertising or have clients that sell advertising or TV time or don't deal in commodities, the Robinson-Patman Act doesn't apply to that. Now, some of the state price discrimination laws do apply to services, but frankly, I'm unaware of any decisions in which discriminations on services even under state price discrimination statutes have been found to be violations. So services, if your client sells services rather than a commodity, the statute doesn't apply.

Now, you have many situations, particularly in commercial and industrial industries, where you have mixed sales, and the question there is, is it a sale of a service with products thrown in, or is it a sale of a product with services thrown in? When what essentially I'm selling is a product and I'm also providing services, the Robinson-Patman Act is going to apply to that, and that's where the cases come down. But if I'm selling a service but as part of this I may sell you some kind of

items that fix your equipment that uses my service, let's say parts, the Robinson-Patman Act won't apply to that transaction. The courts will take a look at the dominant nature of the transaction. Is it the sale of services with parts, or is it the sale of a product with services?

You haven't had any problems there?

MR. MARIN: No.

MR. SCHER: Like grade and quality is the other element. And a lot of companies are run on the basis of like grade changes—changes in grade and quality to avoid Robinson-Patman problems. And of course I mentioned earlier, this is one way to get off the hook on these intraenterprise problems, which is you've got a separate affiliate that's going to be selling products through a separate chain of distribution. A way to avoid Robinson-Patman is to have that company selling a product of different grade and quality from the product that the parent is selling or the other affiliate is selling. How do you change grade and quality? The rule of law is easy. It's got to be a physical change that affects the marketability of the product. That's the legal standard. What is a physical change that affects the marketability of the product is a factual issue. That's going to differ from product category to product category.

MR. MARIN: That's a lot easier analysis in traditional hardware kinds of product sales than it is in the multimedia products that I was referring to earlier.

MR. SCHER: It is easy in his industry. For example, if you or I are a consumer going shopping to compare television sets in a market from a particular vendor, you'll see that the Wiz has item B2675 and Tops has B2674; they look quite similar, and you know the question is are they of different grade and quality? Cosmetic differences are insufficient. It has got to be a physical difference that affects the marketability, what I'm willing to pay for the two to be different grade and quality.

MR. MARIN: Yes, I have seen one or more of my competitors have multiple television lines that so far as anybody in my engineering department can figure are different only in model number and color. And I don't think that that's a difference in grade and quality. But who am I to say.

MR. SCHER: But like grade and quality happens to be a way that companies truly have operated to avoid the Robinson-Patman Act. So you've got to keep it in mind in counseling in this area.

Okay, we are done, and gee it only took us 50 minutes to get through the jurisdictional stuff.

But frankly, we only have two other areas that I really have to cover that are really important, like the areas I just covered, which are important because they are 12(b)(6) motions. Those are jurisdictional elements. If they are missing, cases get thrown out at the 12(b)(6) level. And you know, if you're looking at a complaint, and you don't see any one of those elements, don't say it's technical. Some judge may look at it and say it is technical. Judges have different views of this statute or views of what has to be in a complaint. But if you do your research, you're going to find cases out there that are going to throw out Robinson-Patman cases because they didn't allege a commerce, as simple a proposition as that. And maybe they didn't allege commerce because they don't have it. So look at those jurisdictional elements.

MR. MARIN: Just watch out for the state price discrimination law as well.

MR. SCHER: Yes. Well, if it's a service, I don't worry. If it is a sale of a service, I move to dismiss. No way I'm going to move to dismiss that proposition.

MR. MARIN: But when you talk about commerce, you may get yourself out of the federal Robinson-Patman claim, but you may still have a state claim you're dealing with.

MR. SCHER: That's true. Good point. Is anybody interested in primary line? If you're interested in the primary line, meaning a suit by a competing seller, your client's competitor claims you're engaging in a price discrimination and he's getting hurt, or you are engaging in promotional allowances and he is getting hurt. Your client, the supplier's competitor.

Well, from the standpoint of promotional and advertising allowances, it's my understanding at least, that they are only secondary line claims. That your competitor has no standing to sue you over a violation of 2(d) and 2(e). There's a case or two out there that say that, but it hasn't reached high levels. But I don't believe that a competing seller has a claim for a violation of 2(d) or 2(e), advertising and promotion. On the other hand, he does have a claim for discriminatory price, a 2(a) violation. However, the Supreme Court in the *Brook Group* decision a couple of years ago almost made the Robinson-Patman claim as difficult to win in this area as the claim under section 2 of the Sherman Act. The Supreme Court again refused to say what cost is. But it did say the sales have to be below cost, whatever that means to the Supreme Court. Most of the circuits require putting that line at marginal or average variable, as they do under Sherman 2, in the Robinson-Patman Act case as well. So that creates a tremendous burden on a plaintiff.

But more than that, the *Brook Group* case, which was a Robinson-Patman case, said that the plaintiff is going to have to show a reasonable probability of recoupment. Under Sherman 2 he's got to show a dangerous likelihood of recoupment. Under the Robinson-Patman Act, which is a different statute, he has got to show a reasonable probability or a reasonable possibility of recoupment, that after the discrimination

ends, he will have knocked you out of the box essentially and can recoup everything he lost during the price war.

Okay, here is the plaintiff sitting next to me; I'm coming in with low ball pricing and I'm killing him, and for him to bring a Robinson-Patman Act case today after *Brook Group*, he's got to show once that price war ends and you're dead I'll be able to raise my prices and recoup under the Robinson-Patman Act a reasonable possibility. I frankly don't care what the standard is. Soon as I see the word recoupment, I think that plaintiff should go to another lawyer to bring his Robinson-Patman case, if he came to me to bring it. I just cannot believe, with maybe a few exceptions, in the entire economy that a primary line Robinson-Patman case can be successful after *Brook Group*.

Now, this *Rebel Oil* case that Bill has cited is one of the cases last year, the Ninth Circuit, and that case said, well, it is possible. Bill, I don't think they went beyond that?

MR. LIFLAND: No.

MR. SCHER: It is possible. That's all the Ninth Circuit said. I was amazed to see a decision even saying that. The case obviously must have been instituted prior to *Brook Group* when it was brought. But I'm not seeing primary line Robinson-Patman cases.

MR. MARIN: And from a counseling perspective, I have never told any business person in any of the companies that I counseled that the Robinson-Patman Act has anything to do with these primary line cases, nor can I think of any reason that I would impart that information to them. I talk about Sherman 1, I talk about Sherman 2 and I talk about predatory pricing, but I never mention the Robinson-Patman Act.

MR. SCHER: So that's all I want to say about that. Now, there are these state below-cost-sales statutes, but the question is who has standing under these state below-cost statutes, which don't require—at least I haven't seen recoupment required yet under one of these statutes. And their definition of cost is interesting, because it is invoice cost plus 6 percent, which is more than fully allocated cost.

In fact, his partner wrote an interesting article about the *Wal-Mart* decision in Arkansas. But the state below-cost statutes, it's my understanding, that other than the attorney general, the only parties with standing are competing customers. So these are cases that aren't at the manufacturer level. These statutes are designed at the customer level. Because when you read the statutes they talk about invoice price; the manufacturer doesn't have an invoice price. It is the distributor and the retailer who have an invoice price. They go off at invoice price plus 6 percent. These statutes are designed to protect the customers. They are secondary line statutes, so the cases are brought by competing customers or the state attorney general, if there's one willing to take the political hit for suing somebody who is pricing too low.

Mike.

SPEAKER IN AUDIENCE: We have an experience right now, we have a case in California which does have some litigation under their below-cost statute, and it is a primary line case, all right. And what has happened here is we brought on a motion that says there's recoupment under the statute that was knocked out. The court stated they have to show intent, but recoupment under the federal statute is not in the California statute. But we have a primary line case. We are being sued by—

MR. SCHER: A competing supplier?

SPEAKER IN AUDIENCE: A competitor of ours.

MR. SCHER: Because even the California statute talks about invoice price. What's the invoice price?

SPEAKER IN AUDIENCE: No, this dealt with legal advertising, bidding for legal advertising in the city of San Francisco, and it is a primary line case.

MR. SCHER: Well, a problem that we all have in this area of ours is the various state statutes and the special state statutes that you find in the various areas, including in particular in this area. There are a lot of special industry state statutes in this industry, in this area, like the milk industry for example, and other industries. And you always have to take a look. But if you're representing a client in one of these special industries, I think you're pretty well aware of these particular problems.

California is a world unto itself. It is a wonder world. And you know they have that beautiful section 17,200 and 500 of the Business and Professions Code, which is great for us New York lawyers, because it takes us into California a lot, whereas we never would be there for cases. It's like their version of section 5 of the FTC Act. It covers everything. It is just a wonderland of litigation. And you know, I like it because it gets me to L.A.; it gets me to San Francisco. But supposedly they are getting more conservative out there, and they got more conservative under their sales-below-cost case in this *Western Union* that I think your firm had. Barbara Reeves brought it for Western Union, and it involved money transfers.

MR. GREENE: It was the appellate court.

MR. SCHER: The appellate court said we are going to look at the market basket. Even though they talk about sales below cost of any article, they define article to mean more than article. They covered the entire product line. And if you're selling below cost, when you look at the entire market line involved, it is not a sales below cost. A great decision for

defendants. Congratulations for that one. It is like the Rule of Reason; it is not in the statute, but it is there. So that was a good result.

On secondary line, you know, there's very little injury to competition in customer cases. You know, defense counsel will raise it, but it's not the area where you think you're going to win, because it's possible, if it's a long-standing discrimination, if it's products for resale, and these customers compete with each other. The so-called *Morton Salt* inference comes into play, and that's not an area you're going to win in unless you get some very enlightened judge. Perhaps you're going to win in the D.C. Circuit, because they have really done away with *Morton Salt* in the D.C. Circuit in the *Boise-Cascade* case by looking at what's actually happening in the marketplace. So it does away with the whole—you know, marketplace reality trumps inferences, essentially the D.C. Circuit said in the *Boise-Cascade* case. But generally, injury to competition in a customer case is not the battle ground.

The battle ground comes up in the customer case if they have gotten by all of these hurdles and proving they have had actual injury. Because if they are going to treble damages, which is where the action is, they have got to meet the requirements of section 4 of the Clayton Act, actual injury, and they have got to show a causal connection between the discrimination and their injury. And most courts, including Stephen Breyer in this area, say you're going to have to show that you lost business as a direct result of the discrimination or that you had to reduce your prices in order to be competitive with the favored customer. And if you can't show either of those, you're out under section 4 of the Clayton Act.

Now, Bob, do you have any views on this one?

MR. MARIN: No, we are already in litigation at this point, so I'd leave it to you.

MR. SCHER: Well, this is the battle ground, actual injury, and this is also why these cases are so expensive. Because defense counsel are going to find out who are the competitors, what were they competing for, were they buying contemporaneously at the same price, were they truly competing for this business, and what's the reason they lost the business. Did they lose it because of the price, or did they lose it, as most defense counsel argue, because of mismanagement, which you see in Sherman Act also. But here it is a liability question. It's a liability question in the Sherman Act area, too, I would say. But Clayton 4 has really become the problem zone for plaintiffs who can successfully negotiate all of these other hurdles. And it's all of these hurdles, including this one, that makes Robinson-Patman litigation such a rarity, except in those situations I'm telling you about. You know, I've terminated a customer, and now I sue him for goods sold and delivered. Now he's going to raise the Robinson-Patman Act despite all of those hurdles. Or they are in chapter 11, and the trustee in bankruptcy is saying what have I got? What kind of sales do I have? Now he's going to bring Robinson-Patman claims even though he has all those hurdles to cross.

MR. MARIN: Except in those situations you very often get an opportunity, because your disfavored customer is going to complain to you, and you're going to have to make some decisions. One decision is just a purely commercial decision of whether you're willing to loose the business from this favored customer. But you're also going to have an opportunity to go back and look at actually what is happening and possibly say, well, gee whiz, maybe obviously we are not violating law, but maybe there is some inequity here and we will give you an additional discount.

MR. SCHER: Bob is making a real good point. This isn't like price fixing. In price fixing you wake up one morning and your client has been sued and your client says, "I don't know why they sued me. Well, there is a DOJ or FTC investigation going on, maybe that's why I got sued in this class action or whatever it is." But here in the Robinson-Patman Act you get a lot of advance warning, a lot of advance warning. As he is saying, other than the situations I mentioned, customers don't bring Robinson-Patman Acts. They yell and scream and shout. And they want equity. And when you're dealing, for example in an industry—and this is a case I haven't even mentioned—industrial product. Industrial products you're usually dealing with powerful buyers. You know, your customer is General Motors or it is IBM, and you know General Motors isn't going to bring a Robinson-Patman Act case against some supplier of parts or components. General Motors, learning that Ford got a better price than General Motors the next time will just buy from a different supplier of parts, and that keeps the supplier of parts honest in his dealings with General Motors and Ford, because he knows that's what's going to happen. And I'm using these hypothetically, of course. Or if General Motors wants to keep buying from that supplier, he's going to make that supplier make good on whatever that discrimination was, either by some additional monies or in the future some additional discount.

So when you're dealing in these industrial products areas and these questions come up about components and ingredients and raw materials under the Robinson-Patman Act, the reason there's such little law out there is because those guys know how to take care of themselves without going into court, which I think was one of your points.

MR. MARIN: Yes.

MR. SCHER: Competitive bidding. Let me just mention competitive bidding. It is a good news/bad news situation

under Robinson-Patman Act. Competitive bidding is subject to the Robinson-Patman Act, but it also has a built-in meeting competition defense. The meeting competition defense, which I'm going to spend a couple of minutes on, requires a knowing meeting of competition. If you're meeting competition, you're okay. If you beat the competition, the defense doesn't apply if you knew you were beating competition. Now, in a competitive bidding situation you're trying to beat competition, but unless some hanky-panky is going on, you don't know if you're beating competition until after you got the bid. And even then, you know, if they open it up, then you'll know. But if they don't open it up, you still don't know if you actually beat competition. And the cases indicate in those situations that there's a meeting competition defense.

Now, the problems on competitive bidding that I have seen come up when I'm dealing with a client who has a distribution network or distributor network who are bidding on things. And the distributors come to my client and say we are bidding on this major project and we need some help, and the client comes to you and says, you know, there's a guy, a distributor out there who really is loyal, this guy loves me and concentrates on my product, and I really want him to get the bid. Do I have to offer it to distributor B and distributor C as well? And of course you have to answer, unfortunately, under this statute if they are bidding on it and they are your customers, and you don't give them the opportunity to get the lower price you're giving to distributor A, there's a Robinson-Patman claim there.

I've had personal experience in that, in litigation no less, in which the client offered the special incentive to distributor A, he got the bid. It was a major bid. And then distributor B, who didn't get the opportunity, brought a Robinson-Patman case. There were contemporaneous sales, not for this bid, but there were contemporaneous sales going on. There are cases out there if you don't have contemporaneous sales, you don't have a problem.

So now you got a problem there. How do you avoid it? Meeting competition. You are not going to be the only company bidding on that project. Or your distributors aren't going to be the only ones bidding on that project. And indeed, in the case I had the competing bidders were other brands who were bidding direct, my competitors bidding direct, so the so-called *Rebel Oil* problem doesn't come up. You're only allowed to meet your own competition, not your customer's competition.

So here is the situation where I've got a client who doesn't have the capability to sell to 2,000 K-Mart stores across the country, but he's got a distributor out there who can do it. And the distributor says, "I also happen to be a manufacturer, and if you would sell your product to me for K-Mart, I'll get the private label business from K-Mart as well. And the competing suppliers here are two competitors of my client, my supplier client." And the distributor says to me, "If you can give me 10 percent, I'll get the business." Now, I'm meeting competition. I am meeting the competition of my competing suppliers. Under those circumstances, I can offer the 10 percent to distributor A and tell B and C, sorry, you're not getting it, and I'm okay under the meeting competition defense. I hope you all understand that. That's a situation where even though it is my distributor who is asking for the lower price, I'm meeting competition with my competitor in giving it to him, and therefore the meeting competition defense applies.

Now, how do you avoid the blind-side problem? The blind-side problem is A comes to me and says, "I want to bid on this huge project, give me 10 percent and I can get it. Now, you don't know, I mean, are you required now to send out a message to all other distributors? By the way, we don't have a meeting competition defense here, okay—by the way, anybody who wants to bid on this project, let me know and I'll give you 10 percent." Or can you just give the 10 percent to A and not worry about B and C? Well, in the case I'm talking about, the supplier didn't know that B and C were out there bidding on it and he got sued by one of them and lost $1.4 million; in that case plaintiffs won.

The way to avoid the problem outside meeting competition is to have your client in his price list to distributors say: "If you need assistance, you know, on a particular project, see us and we'll try to work it out for you." That has made the 10 percent available to them. It also avoids Judge Breyer, and I didn't know it was available to me 12(b)(6) motion, because you have now told them it's available, and that's the way you avoid the problem.

Okay, we have 15 minutes. I'm not going to talk about the cost justification defense, because usually it is not available. Here the First Circuit went another way in another case in the *Arcadia* case, which is a wonder. The Robinson-Patman Act is really fun because you get wondrous decisions from time to time. In this case the First Circuit sort of sensed that maybe there's a cost justification defense there and threw the plaintiff out. That's not the way courts—certainly not the FTC—usually go under the cost justification defense. It is an affirmative defense, and it has to be proven by the defendant, and it is a difficult case to prove. It becomes a battle of accountants again, and it is expensive. And you're always counseled to do your cost justification before, not after. Because if you do it after, you've got to reconstruct market conditions as they were during the period of the discrimination. But the defense is they are meeting competition.

I've really discussed already the advice I would give on meeting competition, and let me just cover two areas. First, this lawful/unlawful question. Can you meet unlawful compe-

tition? Well, the fact is that the Supreme Court developed that doctrine that you can't meet unlawful competition when raised as a defense in a price fixing case. You know, if you're all engaged in a price fix, the Supreme Court has said more than once—I think at least three times—you can't use the meeting competition defense for the reason that you talked to your competitor about pricing. That defense isn't available. And the lawful/unlawful dichotomy, if you go back to its development, you will see came up in those kinds of cases. The lower courts tended to bastardize the defense, but the last time the Supreme Court looked at it, I thought that they were going to throw it out, except in the context of price fixing. The *Falls City Vanco* case left it hanging by a thread, saying that the plaintiff has the burden to prove that the defendant knew that the competition he was meeting was in fact unlawful. That should be an impossible burden for the plaintiff to meet. And because of that I personally in my counseling don't worry about the lawful/unlawful dichotomy.

MR. MARIN: The way I look at it is I have enough trouble figuring out whether my price is unlawful. In no way am I going to try to figure out whether my competitor's price is unlawful.

MR. SCHER: Mike.

SPEAKER IN AUDIENCE: Well, it doesn't really get down to a good faith test because there are suppliers out there who have been told by various customers that I have documents here that show what the prices are to me, and you can almost visualize, you know, what the lawful prices and what the unlawful prices are. And it is really becoming a good faith test on whether you made a good faith effort to show that you're meeting a lawful price as opposed to an unlawful price.

MR. SCHER: I'll tell you this, if my customer is willing to hand him that invoice that shows that that price was lower than my client's price for the competitive item, I'm going to let him meet that competition, attach that invoice to his meeting competition form and relax.

MR. MARIN: Absolutely.

SPEAKER IN AUDIENCE: What about the round robin argument that the Commission was using?

MR. SCHER: We had defenses. We don't want to get into that; that's a different program. All I'm saying, you know, we are talking here about counseling, and you can't let your client go out of business because he's not allowed to meet unlawful competition. And essentially, one of my heroes won the case on this, the *Calloway Mills* case in the Fifth Circuit. Paul Wernke defended that case in the FTC, and the FTC is saying that is unlawful and Paul Wernke said it was self-defense, and that's what the Fifth Circuit adopted. It is self-defense. You can't counsel your client out of losing business because you think maybe his competitor is not selling legally. And I would tell you take a look at the *Manco* case and see the kind of burden of proof that they are giving the other guy, the plaintiff in that kind of case.

The other thing I want to mention is verification. I mean you've got to verify. Which really goes into Mike's point; your client must take steps to verify meeting competition. And you know, you have those forms, and we have found that—maybe Bob wants to say something here—sometimes the forms are more of a penalty than assistance. If you've got the form and nobody is filling it out, it really doesn't help you in an actual litigation.

Bob.

MR. MARIN: Forms are a great idea except that you have to constantly keep after people to remind them what the forms are all about. I've had the unfortunate experience of being in a situation where somebody got the bright idea that they should destroy these forms once a year. It's a constant battle to make sure that people understand what the nature of the form is.

When I counsel on meeting competition, I usually say, "Look, why would you give somebody a lower price?" And usually you would give somebody a lower price because of competition. You don't want to give away money, and most times you really do have some sort of a good faith belief. And it is articulating that, and it is getting it down into the form so that if there is a claim a few years hence, you've got something there. It rarely gets into a courtroom situation.

I like to have the form because if somebody threatens me with a Robinson-Patman Act claim, I want to be able to hold my head up high and say, "Yes, there were price differences, but these were absolutely justified." But those forms, God help us all, to keep after the people who have the responsibility to fill out and maintain the forms you know, it is paperwork. They just don't want to sit down and fill out the form. I've had calls from people asking, "What am I supposed to write down; what are the facts? I don't care."

MR. SCHER: The answer to that is you should make the form really simple. If you can, do it on one page where they just check boxes.

MR. MARIN: Well, that becomes too formalistic. You've got to have some place where they do more than check the box.

MR. SCHER: They have got to say what it was they were meeting and what it was they offered, so unfortunately you can't just check the boxes. But to the extent you can, have checking boxes; and to the extent you can, get your client to

make it the responsibility of someone to make sure the forms come in. But you can't run a business on meeting competition. There's an absolute defense. Clients sometimes get amazed about that. I can meet competition with customer A, but I don't have to meet competition with customer B. That's what the defense is all about. But you've got to fill out the form, and you've got to keep—the meeting competition offer can only be in effect for only so long as your competitor is continuing to offer the lower price. Now, that requires that from time to time you've got to go back to the customer to get them to confirm again that the price is still in effect. The problem in many consumer products industries with power buyers is once you give that power buyer the price reduction, there's no way you can take it back. So you're going to have to come back every year and get him to confirm again that it is still there. So if you've got a four-year document retention program where the origination is now gone, at least you should have an annual, or what have you, repeats.

MR. MARIN: Well, if you're not selling fungible goods that don't change from year to year, that's a little bit more difficult. If you come up with new models every six months or every year and you have new prices on those new models, then you're going to have to have a price negotiation with the customer anyway, and that's the time to put that all on the table.

MR. SCHER: We could stop now, or let me just mention something on 2(d), because some of you may still have questions. Let me just mention on 2(d) and 2(e), where the action is right now on advertising and promotional allowances is in slotting allowances where there's no law. And there's a footnote by the FTC in its revised guides saying don't discrimi-

MERGER LAW:
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HORIZONTAL EFFECTS ISSUES: IS BIG BAD? UNILATERAL POWER; GAME THEORY MODELS, PRODUCT MARKET ISSUES, AND NON-MARKET DEFINITION FACTORS

PROGRAM CHAIR PETER E. GREENE: This afternoon I think we have a really interesting program, and we might as well get it started because we have a lot to cover. Right now we are going to talk about horizontal mergers and some of the new areas and new theories that are being explored in that area, in that subject.

We have a different format than I think is typical in these conferences. We are not going to have just speeches. We have what's designated as a speaker and a commentator, and I have not worked out with either of them how they are going to organize this, which shows my preference for chaos. In any event, they are going to do it as they do it. I think it will be terribly interesting.

We have Michael Weiner, one of my partners at Skadden, Arps, who in the past few years has done some of the major horizontal trust cases, like the one we spoke about this morning, the Scott-Kimberly-Clark matter was his area. And his commentator, and I hope they mix it up pretty well, is Bobby Willig. Bobby is a professor at Princeton and a former department attorney general. I don't know precisely what Bobby's view on this is today, but suffice it to say he had a major input into the Merger Guidelines, whether he still agrees with them or not. But maybe we will find out in a few moments. Michael, maybe you can start off and maybe you can go forward as you two have arranged.

MR. WEINER: I'm going to be speaking mostly about unilateral effects and game theory. I just want to point out before I get started that I spent a couple of days in Mexico at the ABA midwinter meeting, and I just got back Tuesday about 2:30 in the morning. I've been suffering from unilateral effects ever since then. So if I go running out of here you'll at least know why.

There's no doubt that we are in the midst of a surge of merger activity in the United States today. In the U.S. alone deals ran at a pace of more than a billion dollars a day throughout 1995. The *New York Times* reported in early November that 1995 U.S. acquisitions totaled $363 billion, and that surpassed 1994's record of about $347 billion, and I can think of a few billion dollars worth of deals that happened in the last two months of the year.

While the vast majority of those deals raised no significant antitrust problems, it bears noting that one of the current trends in business strategy is for businesses to focus on their core strengths. This strategy is reflected in corporate implosions and also drives corporations towards horizontal mergers, either to obtain true synergies or efficiencies or so-called market synergies, some added degree of market power.

In the banking industry, for example, there has been a recent run on mergers for some of these reasons. In the face of this merger wave or at the same time there's also been a new approach to merger enforcement even where the market structure is not inherently suspect. What forces are behind this revival link to a couple of factors. First of all, the movement away from the Chicago School. No longer is this unquestioned acceptance that the marketplace is self correcting. The second factor that I'll point to, more attention is being given to market power derived from nonstructural market imperfections. For example, product differentiation, the presence of information gaps, control of unique assets permitting firms to charge prices above variable cost. While there's still a concern about market power, by focusing on groupings of products in different shaded product markets, there may be a new focus, if you will, on product power.

A couple other factors I'll point to as an overview. First, the return to an antitrust platform supported by social and political considerations. We seem to be passing through an antitrust environment that supports concerns that our free economy may be in danger because of the increasing threat of economic concentration by corporate mergers, and rejects the Baxterian presumption, if you will, that most acquisitions are pro-competitive, or at least not anticompetitive.

Finally, one other factor. By highlighting the roles of information and the dynamic nature of business decision making, game theorists are helping us understand more fully the competitive impacts of investment decisions, research and development programs and contractual provisions. But I'm going to focus my remarks on two observable differences from prior enforced methodologies. First, the new emphasis on localized unilateral effects in differentiated product markets and second, the application of game theoretical constructs to analyze the likely competitive consequences of a proposed transaction.

Let's go to the new focus on unilateral effects. Start with a speech that Deputy Assistant Attorney General Carl Shapiro delivered this fall at an ABA program in Washington. During that speech Carl candidly admitted that antitrust economists' legally imposed need to define markets creates what he called a quest for the elusive bright line. He bemoaned the fact that the need to classify products as in the market or out of the market necessitates a black/white characterization of what may be a gray world. Carl also admitted that economists are ever tempted to jump to the bottom line. Since market definition, market shares and market concentration are merely means to the end, he said, of evaluating the effects of challenged business conduct, there is a natural tendency to skip the so-called intermediate steps and go right to competitive effects.

Perhaps Bobby would like to comment later on whether we can just prudently skip market definition. Is the law all wrong, should we just be going to the bottom line?

In any event, this desire to skip the legal elements of a section 7 case is probably less intense in the case of a merger among suppliers of homogeneous products. In that context there is still a tradition of linking market structure to performance, and measuring market shares and concentration is still generally accepted, as I understand it. Although virtually all markets involve some element of product differentiation, even in classic homogeneous goods markets such as the market for bananas or for a specific chemical compound, producers often attempt to differentiate themselves based on quality, reliability or customer service. Even though there is some element of product differentiation in almost all mergers, the desire to skip to competitive effects is stronger for economists, I'm told, in markets that involve differentiated products. In speaking about differentiated products, what we are talking about here, it might be useful to bear in mind a couple of examples from recent enforcement actions. The ones closest to my heart are facial tissues or baby wipes from the Kimberly-Clark-Scott paper deal; white bread from the Continental baking deal; pens in another close one, *United States v. Gillette*; ready to eat breakfast cereal from Kraft General Foods. Alternatively, when I think about differentiation among a geographical dimension, think about physical facilities that distribute or deliver goods or services such as supermarkets, gas stations or branch banks where differentiation may be based on location. I am told that economists have long realized that firms selling differentiated products have some market power in a tactical economic sense, although typically not enough to rise to the level of monopoly power. The Merger Guidelines, and I believe Professor Willig, teaches that a firm has unilateral market power if it can raise price above the competitive level without inducing customers to reduce their purchases to a degree that makes the price increase unprofitable.

PROFESSOR WILLIG: Well said, counselor.

MR. WEINER: As you said in your 1991 Brookings paper on merger analysis, industrial organization theory and the Merger Guidelines state that a unilateral effect would arise when a merger between sellers of close substitutes impels them to raise prices profitably whether or not rivals in fact follow. Carl Shapiro's speech this fall confirms it is this type of analysis, rather than an examination of possible post-merger coordinated effects, that is the focus of differentiated products mergers at the Justice Department. And based on my experience in the Kimberly-Clark-Scott paper deal, that seems to be the case. They just don't care as much about coordinated interaction in a differentiated products market unless there's a real history of collusion or there's something there that is really unusual about that market. In addition, if you take a look at an article that Ross Starick and Steve Stockton wrote in the 1995 issue of the *Antitrust Law Journal*, it seems that at least some people at the Federal Trade Commission agree that unilateral effects analysis is central to the assessment at the FTC of mergers of firms in differentiated products markets.

Let me turn now and tell you a little more about Carl's speech. I'll describe the methodology that will be employed at the Antitrust Division in quantifying the unilateral effects of such a merger. Then I'm going to try to put that methodology in a little bit of context and make some observations about how this type of analysis has fared thus far in the courts. And along the way I'll try to raise some questions that we can stick to Bobby, who is going to be commenting on this analysis really separately from what I've got to say, which will be impeccable.

PROFESSOR WILLIG: Cross-examination, counselor.

MR. WEINER: We will see about that.

We have got a four-step analysis in Carl's speech for estimated close merger prices. A couple of qualifiers to begin with, this type of analysis applies when firms independently set uniform prices for their branded products, to the extent that firms engage in price negotiations on a customer-by-customer basis or engage in other forms of price discrimination, then find another model. This methodology won't work. Justice Department also believes that while this analysis may be only as good as the available data, even when there are limited quantitative data, theses four steps that I am going to tell you about can provide some "very helpful" rough predictions. I'm not so sure about this.

For the economists in the audience, what I'm told those four steps are designed to do is to estimate the post-merger Bertrand equilibrium in prices accounting for the new market structure in which some brands are jointly owned that had been previously independent and accounting for the new cost struc-

ture of the merged entity. For the rest of us, here are the four steps.

Step number one. Calculate a diversion ratio. That is, if you hypothesize a price increase of say 10 percent for brand A, what fraction of the sales lost by brand A due to this price increase would be captured by brand B. This diversion ratio is related to the cross elasticity of demand between the merging brands. If the unit sales of the merging brands are equal prior to the merger, the diversion ratio from brand A to brand B is equal to the cross elasticity from brand A to brand B, divided by the own price elasticity for brand A.

To give you an example. The brand A own price elasticity demand is 2; the cross price elasticity of demand from brand A to brand B is .5; the diversion ratio is .5 over 2, or 25 percent. In other words, 25 percent of the unit sales of that are lost by brand A in the event of a price increase will be captured by brand B.

All right, how does this work in practice? Let's talk about Kimberly-Clark and the white bread merger. In both of these cases there was extensive data derived from checkout scanners at retail locations, and those data allowed the Department, by making various assumptions about the structure of demand, to calibrate a complete model of industry demand which was then used to predict the likely post-merger price increases. Okay, fine, but what did they really do? I don't know, because both matters ended with consent decrees, and we never got to test the evidence in court. We may never know exactly what they did, but I think undoubtedly the Division was influenced by the writing of Professor Jerry Hausman and others who have developed a three-stage system to estimate the own and cross elasticities of demand for use in the analysis of differentiated products mergers, and of course the Department of Justice. Jerry Hausman had to point out he was Carl Shapiro's professor, and he also taught Greg Werden, so undoubtedly they were influenced by what Professor Hausman had to say.

In the Hausman model—and I'll give you some clue, and basically part of this stuff that Carl is telling us about is the Economists Full Employment Act, I think—but in the Hausman model demand is sort of into three levels generally based on recognized demand segments or prior knowledge or some other factor. For example, if you're looking at a beer merger you may have a top level that's demand for beer as a product; you may have a second level that's demand for light beer or premium beer or microbrews; and you might have a third level which would be the demand for a given brand of beer. If you take a look at a large amount of data that you can get from a retail scanner, where it is available, you can make some econometric estimates for the demand equations of each of these three levels of demand, and the results can then be combined to get some elasticity estimates.

There are some limitations. For example, there are some limitations in the multistage model. While it allows for unrestricted substitution within a segment, there are some restrictions on the price responsiveness of brands in different segments. For example, the price of, let's say, Sam Adams beer in the premium segment is raised, the model assumes that all brands in a different segment, say Heineken and Corona in the imported beer segment, are affected equally. While in fact consumers may view Heineken or Corona as closer substitutes to Sam Adams, and there may not actually be an equal cross elasticity there.

So what if this kind of scanner data isn't available? Well, according to the Justice Department, when the hard data are scarce, there are still some less sophisticated and less complicated approaches to estimating unilateral competitive effects—for example, relevant consumer survey data. There may be consumer surveys that, although not as detailed and accurate in actually seeing what's happened at the checkout counter, may be used to help estimate the diversion ratio. If surveys aren't there, then the Justice Department says we will look at qualitative information, company documents. This is starting to feel familiar to the lawyers here. They will look particularly at if are there any company documents that are relevant to estimates of consumers' first and second choices among brands. Even if you don't have any survey data or qualitative company documents, Carl even suggests that if none of the brands in the market are especially close or distant from each other—a footnote, he doesn't really tell us how to assess whether they are especially close or distant from each other—but even in those circumstances you just look at market share. Market shares can be helpful, he says, in the first step calculation of the diversion ratio.

To give you an example, brand A has a 25 percent market share, brand B a 15 percent market share. If you increase the price of brand A, the diversion ratio calculated just on the basis of the market share is going to be 20 percent. How did I get that? It is 15 of brand A's market share over 75, which is 100 percent, the whole market, minus brand A's 25 percent, 15 over 75, 20 percent.

One other footnote to that, that's also limited to the case where in response to the price increase in brand A, few customers of brand A just stopped buying. If it's the case that consumers of brand A were just to reduce their overall purchases in the market, then the diversion ratio is going to be lower than it would in the case in which they stopped buying altogether.

So under this analysis if the merging brands are similar in characteristics, or if they have large shares within a broader product category, the diversion ratio is likely to be high. This analysis means that a merger is not necessarily immunized if the merging brands are not close next substitutes. The diver-

sion ratio may still be high enough to cause problems under the rest of the analysis if you're talking about brands that are second closeups, or third close substitutes. Little bit different than the Merger Guidelines. We will come back to that in a few minutes. But step one, just to recap, is come up with a diversion ratio.

Step two: Calculate a predicted price increase. In step two I'm going to take the diversion ratio along with the pre-merger gross margin and, with a formula I'm about to give you, calculate a rough prediction of the post-merger price increase for the merging brands.

Okay, I'll give you the formula, but let me point out that this formula admittedly relies on the assumption which is that consumer demand functions exhibit constant elasticity over the relevant range of prices. This means that whether—and I'm sure I'll be told if I am wrong—that regardless of whether the price increase is 10 percent or 50 percent, the cross elasticity is going to stay the same. That may be a strong assumption in this regard, but we will see. In English, that means that people's willingness to pay more for the same product remains constant regardless of whether we are talking a 5 percent increase or a 30 percent increase. And while this constant elasticity has been used by economists in estimating demand, I question whether it makes much sense to do that, and at least to what extent reliance on that assumption skews the result in cases where there is more of a linear demand rather than constant elasticity.

In any event, the formula states that the predicted post-merger price increase is equal to the pre-merger percentage markup, times the diversion ratio, divided by one minus the pre-merger percentage markup, minus the diversion ratio. For example, if the pre-merger percentage markup—let me tell you how we get there, that's just price minus incremental cost. So if the pre-merger price is $100, the cost per unit is $60, the pre-merger markup will be 40 percent or .4. If you have a diversion ratio of .2, that is in response to a price increase in brand A, 20 percent of the lost sales are captured by brand B, then the predicted optimal post-merger price increase would be .4 times .2 over one minus .4 minus .2, or .8 over .4 at 20 percent price increase.

If we don't have constant elasticity of demand, then I think what this formula will do is overestimate the post-merger price increases. But I have some other problems with the formula as well. Let's suppose that the pre-merger percentage markup is 80 percent, and the diversion ratio between the two merging brands were .3, that is 30 percent of the sales lost from the price of brand A goes up or are captured by brand B. Then in calculating the post-merger price increase the denominator is going to be negative: One minus .8, minus .3 equals minus .1; the numerator is going to be .8 times .3 or .24. So that means literally that we have got a post-merger price decrease of 240 percent. That can't be what Carl is trying to get at.

PROFESSOR WILLIG: Back to law school.

MR. WEINER: Well, I've actually talked about this with Carl, and he thought that was a very good observation. And it was a good observation, and he said, well, actually what happens when the denominator gets close to zero, the whole thing is whacky, and we have to sort of look at this more. Maybe it means that my hypothetical is proven, that A and B don't compete in the first place, but I'm not sure. Well, maybe my hypothetical, the 80 percent markup is just too high, and somehow my hypothetical facts skew the result, well, I don't think so. If you look at how you calculate pre-merger markup, you can have very high markups. Take, if you just subtract that incremental cost, take pharmaceuticals, you've got the high prices of pharmaceuticals, which are explained in part by the huge R&D costs—well, R&D is probably not going to be characterized as incremental cost. You are going to have a very high markup there, and I don't think it is implausible at all to get to a negative number in the denominator.

In any event, Carl's speech mentions that steps one and two will always lead to an interim prediction that prices will rise after the merger if brands A and B compete with each other. That may be consistent with fundamental oligopoly theory, but it is important to look at what happens here. Without defining a market the Justice Department is going to be able to point to a *prima facie* violation in nearly every merger involving differentiated products. It is going to be up to the parties, through steps three and four, which I'll get to in a minute, to overcome that *prima facie* argument of a price increase.

Steps three and four—well, step three accounts for product repositioning and entry; step 4 accounts for efficiencies. Okay, I'll deal with these together. If brands can be repositioned through design changes, revised marketing strategies or otherwise, or if brands can enter the market and there are not significant sunk costs associated with such entry, it doesn't take a long time to reposition or re-enter, then the impact of the price increase from steps one and two can be overstated. In fact, the threat of repositioning or entry close in product space to the merging brands could in fact deter the increase in the first place. Similarly if there are merger specific cost savings, they can also offset the incentives to raise price. And steps three and four are similar to the types of arguments that counsel have been making for years under the Merger Guidelines. In Kimberly-Clark-Scott, for example, we argued, albeit unsuccessfully, about the likelihood and significance of entry in the baby wipes business where we suggested that the maker of Pampers by a little company called Proctor & Gamble was an unlikely entrant in the baby wipes business, which had recently entered in Europe, and that the threat of entry by P&G

would offset any price increases from steps one and two. We also pointed out that there was a relatively rapid turnover in the market. Babies outgrow diapers within three years or so; there are 10,000 new babies born every day, a whole new group of consumers coming on stream. But nevertheless, those arguments didn't persuade the Justice Department to forget about the competitive effects in the creation of a company with about a 60 percent market share.

In any event, let me raise some additional questions about methodology. First of all, what about market definition? What about market share? Doesn't it matter anymore? If this is the way to analyze mergers in branded products markets, and if so many markets do involve brands, is the Justice Department moving to an approach in which the definition of a market is no longer useful? What's the final result? Suppose that a merger between brands A and B would lead to a 5 percent price increase for A. Is that enough of a basis to seek to block a transaction? What if the predicted optimal price increase is 2 percent or 10 percent? We need some more guidance on that criteria.

Some more questions: What about the 35 percent test in the Merger Guidelines; doesn't that still act as a screen for when the unilateral effects considerations become important, or are they ignoring what Bobby wrote about in the Guidelines in the 35 percent standard?

PROFESSOR WILLIG: It wasn't my number.

MR. WEINER: In the Guidelines, even above the 5 percent threshold, you were okay if you were not merging first and second choices. The Guidelines state that substantial unilateral price elevation in a market for differentiated products requires that there be a significant share of sales in the market accounted for by consumers who regard the products of the merging firms as their first and second choices. Now we need to worry first and third, fourth or maybe even fifth choices. And doesn't all this assume that people switch because of price and price alone? What if there are other reasons for switching, for example, on the basis of style or features or reliability? So how does this methodology allow to you account for price nonconsiderations?

I'm running a little bit late. But to get this thing going, I'm going to skip the context as far as how this type of analysis is doing in the courts. Well, the short answer is not very well. A very interesting opinion to look at is Kimba Woods' opinion in *New York v. Kraft General Foods*. The other case I was going to talk about, if you want to look at them, are *Pennsylvania v. Russel Stover Candies* and *United States v. Gillette*. But I think I'm going to hold off on game theory, because I've raised a few questions, and I think Bobby wants to tell me how I'm totally missing the point. But why don't you respond here.

PROFESSOR WILLIG: Sounds like an economist trying to talk Latin about *stare decisis* or something. Different language. No, actually I just got off the witness stand in Canada, and I've been looking for a chance to cross-examine some lawyers and turn the tables, but I think today is not the day. Michael actually gave you, I think, a very straight rendition of Carl's speech and what some of the implications might be for our analysis of mergers.

I am going to try to criticize Carl's speech from the point of view of the good old days when the Guidelines were still the Guidelines and the Bush Administration . . . never mind. But Carl is a fabulous economist; there's no doubt about it. And he's always been a favorite colleague of mine, and I've never really caught him doing anything wrong analytically. I've caught him wrong in a few cases when we were on opposite sides of things, but in terms of methodology he's terrific. And in a sense there's nothing wrong with what he is doing here.

What he is accomplishing is helping us as a profession to focus on a new idea, a new little tool, these diversion ratios. And I think it is a helpful addition to our vocabulary, both counsel and economists. But as usual, when it is time to learn about a new tool, the danger is to over use it and to over emphasize it and to forget the old tools and to forget how limited the new tool might be in the broader range of considerations. But I do think the diversion ratio is a neat tool, and I'm pleased to have that new phrase in my vocabulary, especially since Carl cites me on it. But I think it is very dangerous to put undue emphasis on it in the context of a real merger case. Let me highlight some of those reasons with the time that I have.

On the subject of Jerry Hausman, however, since Carl was his student, I think it's important to note that the toughest critics of any professor, rightly so, are that professor's students. Because the young always like to rebel against the old, but also because the students know the minds of the professors very well, having seen them stumbling around the classroom for lecture after lecture. So those who know Jerry's work the best, I think rightfully so, are his best critics.

Let's see if I can get to what I think are the fundamental questions for policy. Michael, you've raised them very well. First, can we skip market definition? Is it really okay to do that? Does it make sense for the underlying purpose of antitrust policy? And second of all, the even more fundamental question: Is it true that all mergers are bad, or all mergers in differentiated product industries where clearly there is some diversion between virtually any pair of products? If one were to take this new so-called analysis seriously as a narrow framework, one would have to conclude that virtually any merger will be driving up prices, at least through the first two steps of the chain of analysis, and therefore at least shift presumption, shift burden or maybe lead to an adverse conclusion for the

parties. Would that make sense as a matter of antitrust policy, and is that really the conclusion of the analysis anyway?

In both cases I think the answer is a resounding no, we cannot skip market definition. It still is the right first step, to be sure. Although tastes will differ about which you literally do first and second in terms of the big ideas, market definition clearly does and should still come first. And second of all, of course, all mergers in differentiated product markets are not bad. In fact, there are certain indications from the usual line of analysis that would suggest inferentially we can tell they are good. Even if we cannot actually prove the specific efficiencies, we can still deduce them from the minimal aspect of any possible market power effects given the correct course of analysis.

But let me take the example that you were trying to pull out of the speech. Suppose there is a serious diversion ratio for products with serious markups, and provided the denominator doesn't drive you crazy, which I guess it really could, especially if your analysis were not actually as accurate as we would hope it to be, then there would be the suggestion that in fact if you were to raise the price of that first product, that in fact you, the merged firms, would make a little extra money, and that should be of concern because that will harm the consumers.

The Guidelines tell us we are not to just look at some hypothetical price rise, but we are supposed to look to profitable price rises. So imagine for a moment—and I should be careful since my favorite drink was not available in the back—Coke and Pepsi. I have to be careful because there are some real life cases in this business, and I may be involved. But think of Coke and Pepsi, and just imagine for a moment they were virtually perfect substitutes. And suppose Coke and Pepsi were considering merging or we were thinking about analyzing such a merger, and we were to ask the first 5 percent test. Would it be profitable? What would happen if the price of Coke were driven up? And an advocate of the new approach would say, oh, my God, there's a huge diversion ratio, everybody is going to immediately divert from Coke to Pepsi. So oh, my goodness, if we apply the methodology suggested in this new framework, we would be very, very alarmed about the merger, that means an enormous price rise, maybe an infinite number if the denominator spins out of control, so we have to jump up and down and stop the merger right away.

Can we end the analysis right there? Does that make any sense whatsoever? And the answer I hope to persuade you of immediately is plainly no. Because suppose you were the marketing official of the new firm that controlled both Coke and Pepsi. You start raising the price of Coke, everybody jumps over to Pepsi; where is the extra money to be made? What's the markup on Pepsi? Well, to say it is virtually the same as you used to be making on Coke, Carl would assume symmetry in the paper by the way, so the fact that you just moved everybody out from Coke to Pepsi, there's no way to make more money.

So what might you do? What is the concern that a proper enforcement official would have next? The proper concern, as well articulated in the small print of the Guidelines, is to imagine that you now control both brands and you do a profit maximizing shift in both prices, taking into account the knowledge that you would have of the movement of consumers back and forth. So you raise the price, and that would be profitable in this scenario of both Coke and Pepsi. That would be your consideration, not just the price of Coke alone, because everybody will escape to Pepsi immediately.

All right, well, now how do we test mentally or on the data the profitability of a rise in the price of Coke together with, coupled with a rise in the price of Pepsi? Can you do it merely with a diversion ratio, Dr. Shapiro, wherever you are? Of course you can't. Because what matters then is the diversion from both Coke and Pepsi together to wherever consumers will go. Can we know the answer to that question, how many will desert to yet other brands or other beverages? Not unless we ask the question. And so it is plainly inadequate to simply ask the question, "How many consumers will move from Coke to Pepsi?" without also moving to the next question, "How many consumers will move from Coke and Pepsi together on a profit maximizing hypothetical rise in the prices of both Coke and Pepsi by a single unified decision maker?" I.e., what's next? Will people go to root beer? Will people go to cherry cola? Will people go to Dr. Pepper? Will people drink iced tea? Where will we go next? We have to continue iterating through that whole change of thinking until we find a domain of products over which the profit maximizing hypothetical monopolist will indeed find it profitable to raise the price of Coke by 5 percent, or Pepsi, together with whatever other price increases would be optimal for that hypothetical monopolist.

Does that sound a little familiar? Only to a few of you. There will be footnotes, but that is the now standard definition of the market definition process. You can't just focus on a diversion ratio out of the context of the surrounding options and still reach a correct result. So yes, diversion is perhaps an illuminating addition to the vocabulary of the usual process of market definition, but it is absolutely inappropriate to stop with simply the paring up of the two brands that are the possible subject of the merger. Oh, I like that. So market definition just simply cannot be skipped.

That immediately brings a route into the second big question, which is: Are all mergers bad? What about it? Suppose it were the case that people would very much divert from Coke and Pepsi together to a whole variety of other drinks in the

event both of their prices being raised to some extent. But suppose the price of Coke, you know, if the new hypothetical monopolists were to control both brands, suppose there would be some very small de minimus opportunity to raise price of Coke alone without bumping into those surrounding brands? So the relevant market would still not be Coke or Coke and Pepsi, because the Guidelines would say move on until you get to the 5 percent rise prize. But if the new monopolist hypothetically confined attention to Coke alone, there might be half a percent price rise that would be profitable in and of itself. And the Guidelines would essentially throw that out and say drive on to the broader market if the 5 percent price rise needs it.

But why not just stop with the narrow universe on the theory that even a half a percent price rise is bad news for consumers? And of course it would be. Well, there are two, I think, powerful answers to that. First of all, if we knew that the only effect of a merger, the only negative effect of a merger would be the possibility of some literally de minimus price rises, then it doesn't take the hard-hearted competition enforcement agent to say, oh, consumers can stand it. That's not the right answer. One right answer is, oh, businesses are most likely not going to be motivated to undertake the kind of dislocation, pain, payments to lawyers, payments to economists, heaven forbid, just for the opportunity to raise price a smidgen. We can infer that that's not the motivation for the deal from the fact revealed from the analysis that the price elevation would be de minimis. Instead, one can reliably, I believe, infer that there must be sound business rationales such as efficiencies, ultimately inuring to the benefit of social welfare and consumer welfare from the fact that the analysis shows, if it does, that the market power effect is really small. Even though we can't rule it out entirely, the fact that it is confirmed to be small allows us to infer, even though we cannot directly prove efficiencies, and so our view is most likely the net effect of the deal is going to be positive on the public. I think that's valid reasoning, and that's part of what has motivated the 5 percent threshold throughout the entire history of the Guidelines for those who were pushed on to think about this more explicitly.

Another point in the same direction, Michael, as you mentioned, the constant elasticity of demand assumption, which Carl owns up to and is troubled by. It's interesting to pursue what becomes of the efficiencies side of the analysis under that same unrealistic hypothesis.

And it is kind of neat, I just had this as a final exam question for my kids. If you have a constant elasticity of demand, and you're a monopolist or you have substantial market power, then a decrease in your marginal cost, your incremental cost has extremely high power in inducing a decrease in price by a profit-maximizing monopolist. So for example, if your elasticity of demand is constant at two, and you experience a 5 percent decrease in incremental cost as a result of the synergies from a merger, the prediction of the theory of constant elasticity of demand says that price will be driven down by 10 percent for a 5 percent fall off in marginal cost. So the efficiencies become high powered in the same model that makes the anticompetitive effects extra high powered.

Now, it is true moving from constant elasticity to linear or changing elasticity framework will mitigate the anticompeti-

VERTICAL EFFECTS:
DEJA VU ALL OVER AGAIN:
GATEKEEPERS, FORECLOSURE, FIREWALLS AND RAISING RIVALS' COSTS

MR. GREENE: What we are going to do now is switch over to vertical issues. Maybe if we could switch a few speakers around, and hopefully, Bobby, you can stick around a few minutes and kibitz.

We have two really terrific speakers. Dale Collins, a partner at Shearman & Sterling, has been involved in the antitrust world a long, long time and has participated in many, many of the major merger transactions that have taken place in the last ten years, and I know he's thought very seriously about these issues. He's going to be the speaker and talk about some of the new theories, or we will find out what Dale says, maybe not so new theories in vertical transactions.

The commentator on Dale's speech is going to be Professor Janusz Ordover from New York City University. Again, I think many of you are familiar with Janusz. Janusz is also a former Department Assistant Attorney General. He, too, is responsible to some extent for the Merger Guidelines, so you can either praise him or hold that against him, as your preference may be.

Again, we haven't rehearsed this; I have no idea how or if they have organized this. So we will see how it goes.

MR. COLLINS: I would like to tell you to begin with that Janusz and I have spent hours and hours and hours working this up so it goes smoothly. And I don't know what I'm going to do.

Obviously, we haven't talked to one other at all about this, but this is an issue that we both know pretty well, Janusz much better than I. So I'm sure every time I go wrong Janusz would correct me. And indeed, what I would really urge you to do, Janusz, is do not wait to the end to correct me. Correct me when I get it wrong the first time. That basically goes for everybody else here. When you hear something that I do wrong, please stop me at that point. It will drive the reporter crazy, but rather than have me sit up here and talk to you 15 or 20 minutes or whatever it might be, I'd rather have you ask questions if you don't understand what is going on or if you think I've got it wrong at that point.

Okay, vertical mergers. I thought originally what I would do is just give you a quick survey of the cases, the investigations in vertical mergers, but then after thinking about it and going over the consent decrees and the like over the last couple of days, I decided if we started now we would probably finish sometime about this time tomorrow, if you really tried to dissect the cases. So I'm not going to go through a litany of the cases for you. I'm going to concentrate on a couple, but I'll tell you about those in a second.

But first I would like to make some preliminary observations about vertical mergers. First is vertical mergers have long been regarded as less problematical than horizontal mergers, and let me tell you why what's true, and then I'll tell you why I think that's changing. There are really three reasons why that initial perception arose. One is that the efficiencies in vertical mergers appear to most people to be more apparent than the efficiencies in pure horizontal transactions. Obviously that generalization is not true in every case, but in most cases people can imagine why vertical mergers would have efficiencies, and they have a little more trouble finding the efficiencies in the horizontal mergers.

The second point, which is very similar to the first one, is that antitrust law has very much been, at least in recent years—recent meaning since 1950s—has been a subject that placed a lot of emphasis on rivalry. And again, horizontal transactions eliminate rivalry; they eliminate the rivalry between the merging parties. Vertical mergers don't. That's another reason why you might think that horizontal transactions might be more problematic than vertical mergers.

And there's a third reason which I think had its ascendancy in antitrust law more in the '80s or so, and that's the single rent theory. The idea if you had market power, you could extract the rents that were associated with that market power with or without vertical integration. And if you had already extracted it, you vertically integrated, there wouldn't be any increase in the market power. So again, the merger itself shouldn't cause a problem. And those are basically what I think are the three reasons that have historically been accepted as justifying the view that vertical mergers were not as problematic as horizontal mergers.

Now there's one exception in this, at least as far as the law is concerned, the enforcement practice is concerned. That is, there was one case where vertical integration played a significant role, and that's the *AT&T* case. And although that case was not a vertical merger case, you can easily imagine the hypothetical situation or factual one in which AT&T arose from the vertical integration from amounts to a long lines company and equipment company and local monopoly loops. So the same kinds of theories apply in *AT&T* as a monopolization case you can imagine applying in vertical merger cases. And if you think about the *AT&T* case, the kind of theories that sort of drop out of that—well, the theories in particular that dropped

out of that case were theories of anticompetitive harm that depended on the foreclosure of access by long distance provider to the monopoly loop. In other words, the local monopoly loop forecloses AT&T's long-distance competitors from getting access in the loop and therefore getting access to customers. If you had a big enough monopoly at the local loop level, you wouldn't have any competition at the long-distance level because they couldn't get customers, except for private ones.

Then there is the flip side, and that's foreclosure of access by equipment manufacturers, if you will, of the vast bulk of equipment purchasers, which are again the local loops; they just refuse to buy. The local loops refuse to buy from anybody other than AT&T.

The third theory that sort of came out of the *AT&T* case is this vertical integration could be a vehicle to evade rate regulation. And indeed those kinds of theories and a few more were dropped under the 1982 and 1984 DOJ Merger Guidelines. And in particular, there were three theories of anticompetitive harm that were recognized in those Guidelines that applied to vertical mergers.

One was a barriers to entries theory of which there were basically three elements. Okay, one, which you know is a critical distinction from what we will get to in the present day, is that the barriers to entry that had to be created in order to have an anticompetitive harm needed to be such that necessitated two-level entry. What happens, if you created a barrier at one level, and someone wanted to get into that, to get into that level, they'd have to enter now at two levels rather than at one level. Presumably that would make it harder to enter. And the second element, if you had a performance problem in the target market, okay, then increasing the difficulty of entry by requiring two level entry would lessen the likelihood of entry, which was the anticompetitive effect. So that's the straightforward 1982-1984 Guidelines theory for barriers to entry.

There was another theory which I think probably arose as far as the lawyers are concerned out of some investigations that the Department was doing in the wholesale and retail gasoline markets in the late '70s and early '80s. They thought vertical integrations there could somehow or another facilitate cartelization of the market. The idea being that even though—well, the idea is this: At the wholesale level, you couldn't really observe the transaction prices that your competitors were charging because people were cutting deals all the time with retailers. You could observe what's going on at the retail level, in other words, the retail prices downstream. Because all you had to do is drive around and look at the posted prices on the pumps. But unless you had a big private investigation force watching the trucks that drove up to the retail stations, you couldn't figure out who was supplying the retail stations. So if you could figure out who was supplying the retail stations, you could infer what the wholesale prices were by observing the retail prices. That was the Division's theory. They never brought a case on it, but they looked at it long enough. And what vertical integration can do is it basically aligns the wholesalers and the retailers, and presumably the retailers are going to buy from their wholesaler affiliates. So now, if you align the wholesalers and the retailers, you can observe the retail prices, at least—you can observe them anyway, but now you'd know who was supplying them. And you could have some hope that you could infer what was going on at wholesale level, so if there was a cartel at the wholesale level you might be able to detect whether or not they were cheating. And that was the whole idea.

The third theory, of course, was the evasion of rate regulation. Those were the three historical theories of the '80s, basically none of which were applied during the '80s except in the *AT&T* case. And I think for the most part nobody even looked at it. They were in the Guidelines, but nobody did anything about them.

Now, as far as the states and private plaintiffs were concerned during this time, they faced a different kind of problem. They found that the courts in the 1970s, the later 1970s and early 1980s, were pretty hostile to vertical mergers. So now we have the situation where the federal enforcement agencies weren't really interested in vertical mergers that much. So if somebody was going to carrry the ball, it was going to have to be the states and private plaintiffs. And they were having trouble because of the hostility of the courts. Now the courts were hostile largely because of the vertical theories being brought up at the time were based on the old 1960 theories of vertical foreclosure, where very small foreclosure shares were sufficient to give rise to an anticompetitive effect at least under those 1960 cases. And the late 1970 and early 1980 courts just didn't believe that. They were just tossing out the cases right and left to the extent those cases arose. And it didn't take long for the plaintiffs to catch on, and they stopped bringing the cases. So we got this dearth of cases, and that's true of the '80s.

So then what happens? Well, of course not much happened for about ten years, and then things started to happen. And they started to happen in the early 1990s. Let me suggest three reasons why they started to happen in the 1990s. The first reason I think was the issuance of the 1992 Guidelines. When I say that it is not just the issuance itself, but it's all the thinking that went behind it and for that matter even some of the predicate thinking that went into building the Guideline.

Here is what I think happened in the 1992 Guidelines what I consider really quite a fundamental shift, and it has already been touched upon in what Michael and Bobby have said. And

that is that—let me distinguish the 1982 and 1984 Guidelines from the 1992 Guidelines. The 1982 and 1984 Guidelines were very much directed at passive collusion as the anticompetitive problem. There was a unilateral effects sort of recognition in the 1982 and 1984 Guidelines, but those were basically merger to monopoly cases, and they couldn't be ignored because of the statutory language in section 7. But by and large, the way the Department and the FTC conceived merger enforcement or the theories of harm in merger antitrust analysis, they were all passive collusion theories.

The 1992 Guidelines changed that. Okay, the 1992 Guidelines looked at unilateral effects as well as passive collusion. And you know, as we have already discussed in the last panel, unilateral effects don't have to be market wide. The anticompetitive unilateral effects can occur in a very local neighborhood around the products of the merging parties.

Now, as these theories of unilateral effect and the Guidelines basically derived from the ability of firms and differentiated products markets to manipulate the residual demand that those firms face, you can imagine that there should be a similar theory, if you could manipulate the costs that your rivals faced, at least the close rivals, to the products of the merging firm. And I think that's the focus, when you start taking the local effects from the unilateral effects of the Guidelines and basically translating those from the demand side over to the cost side pretty quickly gives you an idea that there could be a theory behind competitive harm when small changes in costs facing rivals were affected by merger. And that's basically the raising cost to rivals theory. So that's one thing that happened. Okay again, the unilateral effects theory basically brought attention or focused attention on small, if you will, small anticompetitive effects around local areas in a market. And once you accepted that for problems with demand, you could also accept it for problems with cost.

Okay, the second thing that happened, I think—although people usually don't think about it in this context is that the single rent theory, the idea that you could basically suck up all the rents if you had monopoly power, and you didn't need vertical integration to do it, this whole notion that you could capture all the rents was really undermined by the *Kodak* case. I mean the economists knew that all along, but the lawyers, it really didn't hit them until the *Kodak* case came around. And the *Kodak* case largely stands for the proposition that even if in principle you may be able to develop schemes that would allow you to suck up all the rents, in practice you may not be able to. Indeed, that's the reason why *Kodak* ultimately had its summary judgment motion overturned.

And the third thing that happened, and I think this is probably more at the FTC than anyplace, was one of the efficiencies that everybody usually associated with vertical mergers, the so-called elimination of double marginalization—that's where you have a company at the upstream level mark up its product to reflect its local monopoly power and then sell the product to company downstream that also has local monopoly power and market power in its market, and again, you know, a tax on another markup reflecting its monopoly. And it turns out, that if you integrate those two firms, you can eliminate one of those markups. There's nothing really controversial about that.

What's particularly interesting at the FTC though is that the FTC looked at that, and they said well, you know, when you do that you not only eliminate the markup basically in the vertical transaction, you often times will effectively raise the price of the products on the downstream level to which the upstream firm is selling. You can think that that's going to happen in part because typically what happens, as an empirical matter, is that the acquisition of the downstream firms are to the larger more powerful downstream firms that have the more elastic demand curves. And as those elastic demand curves are in effect taken out of the market through vertical integration you bypass the price system. What's left is a less elastic market downstream and a higher price. At least that's what a lot of the people at the FTC thought.

So those three things now start to point out that there could be problems with vertical mergers. And as I said, now we have got a couple of theories rather than theories we just had with the Guidelines. We not only have the facilitating collusions theory, which I said under the Guidelines was present but never used to the best of my knowledge. At least not until the '90s. Now we have a foreclosure raising rivals' cost theory that appears to be cognizable. We still got the evading rate regulation, but I think for AT&T there isn't a case on a that. And as you'll see in a couple of minutes there's sort of another theory starting to creep in, which is sort of unfair competitive advantage, which I think has real problems as far as giving rise to anticompetitive harm. But I think some of the people in the enforcement division have trouble figuring that out. So those are the theories.

Now, what are the cases? What I would like to do, if I've got the time, is discuss—and Janusz you're not correcting me on all the things I've said wrong.

PROFESSOR ORDOVER: It is too many problems.

MR. COLLINS: I would like to discuss three cases. I would like to discuss 15, but I'll only discuss three. They are the *TCI* cases, the *Eli Lilly PCS* case and its predecessor investigation, at least one of them, and finally the *SGI* case, okay. But I'm going to do them in a minute apiece. Or I could quit here.

MR. GREENE: No, why don't you do your cases, and then we will just run a little longer. Because I think I see Janusz scribbling away.

MR. COLLINS: Why don't I stop at this point and let Janusz say what he has to say?

MR. GREENE: Whichever way you guys say.

MR. COLLINS: Well, we will do two out of the three. Let me try to run through at least one of the cases that Janusz was in, okay. I guess if we had to do two of the three, we can get one of your cases. That's the *TCI* cases. *TCI*, I like to think, kicked this stuff off. The *TCI* cases started off with the thinking of a not so young and even less intelligent lawyer with some really, really bright economists. Right, Bobby?

PROFESSOR WILLIG: Which was which?

MR. COLLINS: Well, the economists were young and very bright, and the lawyer wasn't. Now really three of these cases—and I'll try to address each one of them really quickly. The first case was a private monopolization case that was precipitated by Viacom attempting to get Paramount. There was a competing bid that came in on the side that you may remember from QVC, and one of QVC's major shareholders was TCI. Okay, now TCI really has two arms to it. Well, it basically serves about 40 percent of the cable homes in the United States through local cable franchises, which are essentially monopoly franchises or at least they were at the time. And they also do a lot of programming services. Paramount has a studio that provides input to the programming services, and Viacom had some of its own programming services as well. And Viacom wants to put them to the studio assets of Paramount, and so does the TCI-QVC group.

What Viacom alleged in its private complaint was really basically an analogy to the *AT&T* complaint. Okay, it analogized the local cable monopolies to the local telephone loop monopolies. And said that if you had a monopoly at the lower level and it was big enough, you could foreclose it to competitors upstream of your integrated affiliate.

What's really interesting, I think, about the TCI theory—which by the way nobody bought—was that because of the public-good nature, if you will, the joint-cost nature of the programming inputs that are supplied downstream to the cable television franchises, if you can restrict the large amount of cable access to a large number of cable television franchises to your unintegrated competitors, that's going to reduce their revenues. And since they are basically showing or offering for sale the same programming at zero marginal cost to all viewers, that decreases the revenues they have to invest in programming; presumably it decreases the quality of the programming, and ultimately hurts consumer welfare. As I said, nobody bought that. We tried.

Now, that theory was not only bounced around in court, that was bounced around at the FTC by the people that were vigorously prosecuting the Viacom's interest in all this. The FTC didn't buy that theory, but they bought a different theory which was also a vertical theory. And this theory was that Paramount produced motion pictures, and Paramount sells those motion pictures to lots of their licensees and lots of different people, including first-run movie-driven programming services like Showtime and HBO. Showtime, by the way, is owned by Viacom; HBO is owned by Time Warner. And there are programs or there could be programs like that that TCI through its Liberty Media operations could run.

Now, my first theory was sort of an input foreclosure. The people down at the bottom, the monopolists down at the bottom wouldn't let the guys at the top sell to them. This one is now an output foreclosure; the people at the top producing first-run movies are not going to sell them to TCI and Liberty's buyers. And the FTC did buy that one. Well, they did, they got a consent decree, right. They forced a consent decree onto the TCI people, that where the relief was that if QVC, which was really the bidder for Paramount, was to be successful, then TCI, which is where the problem arose, would get out of the QVC consortium. Now that consent decree was ultimately withdrawn before it was accepted, because QVC didn't win Paramount; Viacom did.

There was a third *TCI* case, which I won't go into too much, but which basically adopted the first theory, the original monopolization theory, and that was the TCI/Liberty consent decree that the Justice Department had. I think it was the case—someone correct me if I'm wrong—that the only vertical case that the Justice Department has brought outside the telephone industry is the *TCI/Liberty* media case. Am I right on that?

SPEAKER IN AUDIENCE: No.

MR. COLLINS: Which one?

SPEAKER IN AUDIENCE: There's that software case, isn't there, Dale, involving the graphics.

MR. COLLINS: No, the FTC got that one.

SPEAKER IN AUDIENCE: Are you sure?

MR. COLLINS: Yes, yes, I did that one. The vertical case there, that was—it is kind of interesting. In any event, most of the Justice Department's attention seems to be focused on telephones.

SPEAKER IN AUDIENCE: *AT&T*, *McCaw*.

MR. COLLINS: That's not a telephone case.

SPEAKER IN AUDIENCE: Yes, it is, but it is not the—

MR. COLLINS: *TCI, Liberty Media, MCI, McCaw* and *AT&T*.

So anyway, those are the *TCI* cases. Now those cases are all types of foreclosure cases. They don't have to be foreclosure in the sense that they are preclusive foreclosures. Not that you couldn't continue to have, for example, a first-run movie station, movie programming services without access to the TCI's downstream cable monopoly distribution systems. But the quality of the services certainly could be diminished, and therein lies the anticompetitive harm. So you don't need two-stage entry anymore, like the Guidelines would say, at least that portion of the Guidelines. Something less than a requirement for two-stage entry, nevertheless, gives rise to an anticompetitive effect, or so found the Department.

Now the next case, the final case I'll talk about—I won't talk about the *SGI* case, which is one of my favorites; I'll talk about the *Eli Lilly-PCS* case.

This one really reverts back to the old facilitating the horizontal collusion theory that we saw under the Guidelines, which was never used. In this case—probably everybody here knows the facts of this. But in this case what we have are drug manufacturers sort of sitting at the top, and although this isn't quite accurate, it will work for this purpose. There's a group of companies that act pretty much as distributors, which are called prescription drug managers. And what would happen or what was happening in these cases is a drug manufacturer would integrate with a prescription benefit manager. Now, these prescription benefit managers—there's really three of them that are of interest: there is Medco, DPS and PCS—they cover a phenomenal number of lines. In other words, the plans, the health benefit plans to which they provide prescription drug services cover a huge number of people in the country. So the idea being that if you don't have access, if you're a drug manufacturer and you don't have access to a Medco or a DPS or PCS, you would have a large number of people who are basically foreclosed from purchasing your product. It is not really technically true that they are foreclosed. They could go out and purchase it with their own money, but they wouldn't be reimbursed for it. And there is a foreclosure theory that is underneath all of this, but I don't want to talk about the foreclosure theory. I don't have enough time. I want to talk about a different theory. This is an information transfer theory.

Now, in this case, just like I mentioned about the wholesale gasoline people, you couldn't really see their prices very easily because there are all sorts of discounts underneath the table being cut. The same thing is exactly true with these drug manufacturers and the prescription benefit managers. Because they cover so many lives and so many of the beneficiaries of these plans are out purchasing prescription pharmaceuticals, the pharmaceutical companies actually have a considerable amount of power to negotiate prices with the drug manufacturers. I mean, it would take me another ten minutes to tell you why that's true. Because these are prescribed drugs and why in the world would these people have power to switch, but they do. Take that on face. And what the FTC was concerned about originally—let's take the very first one of these transactions, which was the Merck-Medco deal.

In that situation this is what the FTC saw as far as the information was concerned. We have an upstream company, a drug manufacturer, that buys one of these downstream companies which is an important channel of distribution for basically all of the upstream company's competitors. So now what's going on or what the FTC thinks is happening, you've got the competitors up here, whose prices you didn't see, now bidding in this case to Medco, okay, the downstream prescription benefit affiliate of Merck. A concern was raised, well, wouldn't this give Merck some sort of unfair advantage if it basically could figure out what prices were being bid by Merck competitors to this extremely attractive distribution outlet that Merck now owned.

Now, at the end of the day the FTC decided there wasn't a theory there to bring. I think one of the reasons why they decided that was they couldn't figure out what the price effect would be in that situation. Because even if Merck—first of all, there's a serious question of whether or not the information that Merck would learn from these bids had any meaning to it, either because, number one, Merck already sort of knew the prices from its own market intelligence, or number two, the prices themselves were strategic. I mean, the companies could know, because the bidding companies out here, Merck's competitors knew or could presume that some of the information that the bid prices that they would put into Medco would be leaked up to the Medco's manufacturing affiliate. And knowing that they could play games with the prices they bid, particularly if they had competitive products with Merck, and operated on the assumption that Merck would always win the day anyway. You would expect that to be true, since there should be marginal costs pricing transfer between Merck and Medco anyway.

So anyway the Merck-Medco deal was allowed to go through, and the next one that came along was also allowed to go through, and that was SmithKline and DPS. The third one—I think the politics are very interesting. I'm absolutely convinced—I had nothing to do with this deal—that at the time FTC, watching Merck-Medco and SmithKline-DPS, decided that the pharmaceutical industry was reorganizing and the FTC wasn't playing a part of it, and they needed to play a part. So

the first thing they did was kick the old investigating staff that had done Merck-Medco and SmithKline-DPS off of the Eli Lilly-PCS transaction and put a new staff in. And which I'm also basically convinced was also directed to find a case to bring. And they did.

But here they had different facts. And the different facts were, unlike the Merck-Medco situation, in which the prices, if you will, were only going one way, Merck's competitors bid down to Medco—and we will assume there's no firewall under the confidentiality provisions in these contracts were being breached, which of course they weren't. Medco was learning information about its competitors' prices, but the competitors weren't learning anything about Medco's prices, because they were now by assumption unintegrated drug manufacturers. But that market situation was no longer true by the time you also had the SmithKline-Beecham deal and now the Eli Lilly deal.

Now you've got at least three major drug manufacturers, each of which had integrated downstream prescription benefit managers, and they could learn the prices at least about each other. And there were, I would imagine—I don't know this for a fact—some classes of these therapeutic equivalent drugs in which these three manufacturers, or at least two of the three, collectively had a pretty large share. So you could imagine there might at least be some information being transferred.

Now I'll leave it at that. And that only tells you there was information transferred. That doesn't tell you there's an anticompetitive effect from the transaction. You have to go through quite a lot of analysis to conclude that that information is going to result in a likely anticompetitive effect. I personally don't believe that the Commission had that theory. And I think what they did instead was they were able to convince the parties that it was just much to the parties' benefit to sign the consent decree that would provide a firewall on this information transfer than it would be for them to continue to fight the case.

Now, why would it be in the parties interest? First of all, it is expensive to fight these investigations. But the parties, on the other hand, are often times saddled—saddled is the wrong word—the parties are often times confronted with contracts by these third-party unaffiliated suppliers that have themselves basically contractual firewall obligations in them. I know from the Merck-Medco experience that as soon as Merck-Medco announced the deal, all of the third-party drug manufacturers basically called up Medco and pointed out the provisions in the contract that say you can't disclose any of the information that we are providing you to anybody. And we are going to interpret that to mean if Merck becomes your parent—and oh, by the way, even if that's not true now, it will be true in the next contract we do with you. So I think that the harm, the injury, if you will, that a company like Eli Lilly took by accepting a firewall provision was pretty small and therefore was willing to do it.

Indeed, what you'll find in many of these cases—you'll find it in things like *SGI* and I'm sure in many others—is that the relief that's being sought in these cases often times are congruent with the commercial self-interest of the merging parties. So they are willing to basically buy off on the consent decree without really fighting it very much. Now, that's point number one.

Point number two is it that the complaint is an entirely different story. What the parties are always interested in is: What does the consent decree mean to us? What kinds of restrictions are going to be imposed on us? To the extent the complaint is not operational in that sense, and it's not, they don't care that much about the complaint. Moreover, the agencies are very, very protective about not negotiating the terms of the complaint with the parties. Often times they don't even let you see the complaint until almost the last minute. And I've yet to see a client who says, "Well, I really like the terms of the consent decree, but I'm not going to go forward with the consent decree; we are going to litigate instead," because they don't like the terms of the complaint.

So the agencies can always roll the parties on the language of the complaint. I think they do as a practical matter. If you take a look at a lot of these complaints, there's even a couple of dissents, at least on the Commission side on this. You will find that the complaints in many cases grossly overreach what the investigations have shown. I think even some of the commissioners believe that to be so. You see kitchen sink allegations go into the complaints. If you study the complaints carefully and compare them to the relief being granted, you'll find that there's lots of things being complained about that the consent decrees don't address at all.

So you can't tell too much about the facts of any given situation by going and taking a look and seeing what those complaints say. As I said, you'll see that the complaints in many cases have far overreached what the facts would really allow an objective person to conclude. But there's really no way to stop that, other than the good faith of the agency. Though parties, it's certainly not going to matter with them.

So with that, thank you very much.

PROFESSOR ORDOVER: Thank you. I think I have a very illuminating run through of much of the current thinking on vertical issues. I will try to be brief.

There are two very interesting anecdotes, just to get us going. One, when we issued the 1992 Guidelines, I said to Jim Rill, "Why don't we take on the vertical guidelines next?" He said, "I am out of here if you are crazy enough to do it. So stay

around." So I stayed around, but not even long enough to even entice anybody into thinking that we could negotiate agency vertical merger guidelines with the FTC. And I think that you will not see joint agency vertical merger guidelines any time soon, I don't think.

The second anecdote was when Ann Bingaman was asking me about whom I would recommend for the Deputy for Economics, I said, "Well, you've got to have someone who understands intellectual property and someone who understands vertical issues," and I thought that Rich Gilbert was the person. And, well, I think Rich did very well at least on the intellectual property side; who knows what he thought about the vertical issues.

But it is quite true that over the last five years I think the vertical issues have become extremely important, partly because, as they have pointed out, economists have been chipping away at the traditional view that vertical integration or vertical issues are really a bunch of nonissues or issues that are limited to fairly contrived market scenarios, such as AT&T vertical control over at least three stages of the telecommunications market: equipment, transmission, as well as the local loop. How many instances are you going to find that seem to approximate that scenario. On top of that, the market being of course overlayed by a tremendous amount of totally distortionary regulatory intervention, such as price regulation or rate of return regulation, which economists have known for a very long time creates all kinds of peculiar incentives to act in a potentially anticompetitive manner, vis-a-vis horizontal competitors at any stage of the particular game.

So that was a very contrived setting, and much of the economic thinking I think in the '80s went to try to understand whether that setting was the only one in which vertical integration or vertical issues are really nonissues, or whether there is a broader scope of such circumstances.

And I must confess that Bobby Willig and I had some hand in arguing that in fact in the broader set of cases, broader set of market situations you are going to find potential problems.

Remember, as we went into the 1980s following all the triumphs of the Chicago School of Economics, there was really this notion there was only one monopoly profit to be had, and therefore whatever reasons there were behind vertical integration or vertical restraint, can think of as mergers by contract as opposed to by ownership, that these explanations all went to attempting to solve some sort of market failure along the vertical chain. How could you make more money by restraining or by acquiring somebody with whom you dealt either as a distributor or someone who was buying inputs from you and so on.

Well, over time, economists, myself included, and especially my work with Bobby, who I can say has been the most fantastic collaborator over the last 15 years—I think we are celebrating our 15th anniversary of thinking together, so we are going to go out and drink afterwards—have really thought about what are the problems of that basic fairly intuitive approach. I think it makes sense to say, you know, what kind of additional market power are you going to get by buying or restricting someone who is not in a competitive relationship with you. And we tried to relate that to what I consider to be the paramount question that you always have to ask yourself in a vertical integration contract or a contract that involves some sort of vertical restraint. And that is: Why is it that a simple—I won't call it simple-minded—but why is it that the simple theory of a single profit or a single monopoly rent, why does it fail? Why is this, you know, sort of price squeeze notion that we always thought underlies a lot of it, how come it just doesn't work?

There are a variety of instances why it may not work. The familiar one of course is the one that was underlying a lot of the AT&T thinking, the thinking behind the AT&T consent decree and the ultimate breakup. And that is in the prospect of rate regulation, where there is some kind of regulatory ceiling on prices coupled with rate of return regulation, that in that case of course all the bets are off. In fact, you may have very strong incentives to discriminate vis-a-vis your competitors in order to build up your physical base of capital in which you are allowed to earn this rate of return.

Now, as we went on another possibility arose, which is the one that I think is a very dangerous one. And that is by vertically integrating or vertically contractually restricting your distribution chain, you are able to engage in additional price discrimination downstream. And whether or not *ITS v. Kodak* case, that's what it is all about, and I can debate that later on, the more you think about this case the more you realize that the initial theories that underlaid the appeal in that case were just total nonsense. So the plaintiffs were clever enough to concoct a theory of surprise, which they sold the Justices on, saying that Kodak in fact changed the nature of the vertical relationship by stopping selling parts to the ISOs and as a result of that was able to exploit these poor owners of Kodak equipment who were the installed base, and therefore were subject to exploitation through higher prices of parts.

Of course, there was absolutely no evidence of anything like that. But why not? It is a good theory. And Professor Salop, who crafted it, is obviously as good an economist as they come, and the theory made a lot of sense. In fact, justice was totally inconsistent with facts in the case. And I should know the facts, since I did consult for Kodak. Unsuccessfully.

In any case, if you look at the facts in this case, what really comes to mind is that the effects of these kind of restrictions or the potential for vertical merger is really to enable you to exploit whatever differences there might be in the downstream elasticities of demand among the different customer groups. That's the point that Bobby and I made 15 years ago, and that's the point that Marty Perry made also when he tried to discuss the reasons for our co-op integration into different parts of the downstream market, which is bauxite or aluminum, precisely because of these differences in elasticities downstream.

Now, how you feel about forcing vertically integrated firms to open up itself or to sell to competitors downstream, or how you feel about vertical mergers that have this possibility of enhanced price discrimination very much depends on how you feel about price discrimination as a potential recognizable antitrust problem. I happen to feel or think that enhanced price discrimination, to the extent that it is an issue, I think it is a relatively minor issue. I don't think that one should try to force firms to deal with their competitors just because some competitive—some price discrimination that it is going to be possible in the absence of such transaction will be made possible. I believe that to be a very bad assumption or very bad predicate for antitrust action. Especially in those circumstances in which price discrimination may be a necessary prerequisite for earning enough return on your upstream investment to finance that investment in the first place.

And since we have allowed Jerry Hausman's name here many times, I would like to refer you to his work with Matthew Mason, whose name I don't want to mention, on the fact that in industries in which R&D is critical to competitive success, downstream discrimination may in fact be absolutely necessary in order to motivate these upstream R&D investments in the first place.

So again, the more you are thinking about interplay between R&D and incentives and how they relate to each other in vertical circumstances, the more you should feel the way I do, which is to say, let's leave price discrimination alone and worry really about potentially harmful effects that may arise in a vertical case, both as a contractual vertical integration—integration by a contract or integration by acquisition.

So as we went on, other theories cropped up. And of course the one that seems to have captured everybody's attention is raising rivals' cost, which is a theory that Bobby and I sort of expressed in some fashion and then was given the catchy phrase by Steve Salop in his work with Shefman and others.

The basic idea is again what Dale said, which is that if you can control the vertical chain somehow, you can make it more difficult for your horizontal competitors to participate in the market on par with you. Whatever that may mean. Maybe you'll deny them inputs at a competitive price. Maybe you are going to thin the input market so that the remaining unintegrated sellers of the input will in fact be able to raise the price to the unintegrated downstream firms because you are going to remove some portion of the supply from the market. Now, of course you're going to be removing yourself from the market which may have a countervailing effect. You yourself are a large buyer, so your demand is off and you are now self providing. And the question is: What will the rest of the market do on the input supply part?

If I can speculate, I think that the raising rivals' cost literature and its predecessors really were not at all thinking about the fact that '82-84 Merger Guidelines were basically focused on collusion with some footnote to the unilateral effect. I think that literature was very much motivated by trying to react to, at least on my part, to the Rita Turner views of what predation is all about. And Rita Turner, if you remember the good old days, 1975, in her historical paper focused precisely on price predation. They thought that this is something potentially possible; you have very strict rules for price predation, and that's all we have to worry about.

Many people, myself included, and many others subsequently began to think that perhaps there are other ways to disadvantage your rival. And the emergence of the raising rivals' cost literature and some of the work that Bobby and I did were really motivated by trying to understand whether there are some other ways in which you can harm your competitors without necessarily going through what we all agreed is a fairly unproductive way of slashing prices with the hope of recouping the lost profits 5 or 10 or 15 years down the road. The question was: Is there a way to harm your rivals without really losing too much money in the process? In fact, potentially not having to recoup it at all.

So I don't know whether the enhanced concern with the unilateral effect in the 1992 Guidelines, which actually featured that unilateral effect is one as one of the components of the analysis, or whether it is a slowly catching up of the enforcement with the theoretical musings or maybe profound thinking of antitrust economists on how these vertical issues actually really do shake themselves out in this complicated market in which we are observing vertical mergers and in which we are observing contractual restraints that, of course, are ubiquitous.

So if I were to speculate, I would think that it's not only the economists making headway in the Division or at the FTC, but also this new vigor to find some cases. You know, you really want to show something that you are doing, enforcing the law. Mergers, horizontal mergers, you do so much by consent decree. They are not visible things. Yes, we have done 500 hor-

izontal mergers already; can we move on and try to show how clever we are, how smart we are, how we can understand the anticompetitive effects of nonlinear pricing in the software market by going after Microsoft for example. Can we explore the frontiers of economic thinking. It is a challenge.

I don't know how Bobby felt, but when I was in the Division and you had to look through another merger, horizontal merger, it got pretty boring in the end. And it was always, "Can we think of something new?" just for the sake of making yourself entertained. So I'm sorry about it, but at your expense, at taxpayers' expense I was trying to expand my horizons. But I believe this is truly to some extent what is going on. And we have all this new learning in antitrust; we have the substantial overcoming of the views of the Chicago School of Economics that the 1980s generated, and now the same literature obviously developed.

What can we do with it? Can we do anything? It is basically fishing for a place to apply. It's unfortunate, but it's true. And I think that's the intellectual challenge that keeps people going in their enforcement thinking, the way perhaps one wants to build up on the unilateral section of the Guideline trying to understand how that works in a more concrete way, the way Carl Shapiro did it in his speech and was discussed in a very clear way in the private session.

So where are we all over this? I think that all of your clients will have to be prepared to deal with vertical issues in many, many ways. Whether you think you have a simple horizontal deal and vertical issues are going to crop up, if you happen to have an active R&D program, there's going to be feeding into your downstream market into the future. And the Justice Department maybe less than the FTC will say, well, what about these R&D issues, intellectual property, after all, is an input into your downstream competitive prowess. It is going to affect future market condition. It is going to affect entry. It is going to have profound implications on how these markets work. And we are going to try to see whether or not we can find some clever ways of applying this intellectual property thinking, vertical integration thinking, into your sets of facts.

Obviously, the same set of issues now are all over the place, because now the talk is about network industries. Now, what does that mean? It means that a bunch of things hooked up together and that people like to have these networks, and therefore a big issue is: Should you let me into a network or not, and on what terms? *ITS v. Kodak* you can think of it as being a network of unrelated Kodak copiers out there that people wanted to be let into to repair. You have hardware-software problems in computers. You have operating system software-application software problems.

All of these are built around the notion that what the people really want is some combination of inputs, a combination of elements, not just one element at a time. And every time you are going to have a transaction that raises these kinds of concerns, you're going to find yourself needing to deal with the question of: What is this new economic learning?

And I must say that there is a total lack of concern among economists on what this actual new learning is all about. And when I was asked in a deposition in the case of a private case brought against the AT&T and McCaw about the notorious paper I wrote with Salop and Salouer on vertical foreclosure, I said, "Well, you know"—I said it on the record, so I can repeat

"FUTURE AND INNOVATION MARKETS": OLD IDEAS IN NEW CLOTHES OR NEW IDEAS IN NEW CLOTHES?

MR. GREENE: Next we are going to cover, as if we hadn't had enough to think about already in mergers with the two panels we already had, the way the program was set up, I thought we would start with the more traditional areas, horizontal and vertical mergers, and I thought that would be kind of straightforward. Obviously, I guessed wrong there. And then to move onto what I thought it would be the difficult, intellectually challenging areas, the new concepts in future innovation markets. Given what we have already seen, I have no idea where this panel is going to go, but we'll give it a try.

The speaker is Jon Jacobson, who is a partner at Akin, Gump. Actually, rarely when you are a program chairman you get the opportunity to pick a speaker that you happen to know, having worked with, who has really thought seriously about the particular area that is the topic. I know from a case that Jon had a long time ago that he's given this particular topic a lot of thought. From the conversations that we had recently I know he hasn't stopped thinking about that topic ever since that case a long time ago.

The commentators are Mark Meyer, who is with LECG, and Sumanth Addanki, who is with NERA. I know both of them and I think their insights into this area will be very interesting. And I suspect, although I'll have to wait to see what they say, that their views on innovations markets and the markets for ideas might be somewhat similar.

I don't know how they plan to divide this up. I'm going to let them keep track of their time. If they run way over, or take one takes the other's time, it is their fault, not mine.

MR. JACOBSON: Thanks, Peter. Let me start with the good news. Which is when you're dealing with future and innovation markets, there are no sales; there are no market shares; there are no elasticities; there are no cross-elasticities, so there's no math. All right, that's the most important part.

The second important point, and I'll get to this in a moment, you can learn everything you need to know about innovation markets by watching an old movie. And the old movie is a 1951 British film called *The Man in the White Suit*. I don't know if any of you have seen it, but it is an Alec Guinness movie. He plays Sidney Stratton, who is a laboratory dishwasher in a textile mill. He invents a fake fabric which is white that never gets dirty and can't be harmed. It is a tremendous invention. The problem is that his reward is an enormous group boycott by the entire country of England. The textile manufacturers hate him; the suit manufacturers hate him; the tailors hate him; the dry cleaners hate him; the soap companies hate him; the labor unions hate him; the landlord hates him; and even his wife won't speak to him. So in the end—that's a happy ending—the fabric in fact disintegrates over time, and of course all the representatives of the status quo are just thrilled about that.

And I always thought the Guinness character had a pretty good refusal to deal antitrust case, but of course this was 1951. Today of course, since it is a private action it would be dismissed for lack of antitrust injury, and any sequel would have to go direct to video.

Now, *The Man in the White Suit* teaches us that although innovations unambiguously benefit consumers, they seriously injure or at least may potentially injure incumbent firms. So incumbents have strong incentives in certain cases to take steps to retard or prevent innovation. And at the very least that thinking has informed the view of the Justice Department and the Federal Trade Commission in the 1990s and various of the merger cases that they brought. These agencies have brought at least a dozen cases involving at least in part the concept of innovation markets. In other words, markets where the existing competition consists primarily of research and development rather than the production or sale of commercialized product. In my few minutes today I would like to talk about a couple of these cases and then analyze the policy questions that are raised.

In a number of recent cases in the drug industry, the Federal Trade Commission has challenged mergers involving products in relatively early stages of development and well prior to commercial market. One of them is *American Home Products Cyanamid*, where one of the markets involved was research and development of vaccines for rhoda virus, which is a children's diarrheal disease, and a potentially serious disease. And the relief there was that AHP is required to license the Cyanamid research.

A much more recent case is the *Upjohn Pharmacia* matter which involved two competing potential chemotherapy treatments for colon cancer. And that consent requires that divestiture of the R&D assets relating to the Pharmacia drug. And the market again is several years away before that product will actually be sold.

Another recent FTC case is called *Sensormatic No-Go*. It is not a drug case. It involves competing technologies for antitheft labels that can be attached by the manufacturer or the

distributor rather than the retailer. And it is another product that does not yet exist but is in development. The relief there is that the Commission's decree effectively converts Sensormatic's proposed acquisition of the North American patent rights from No-Go into a nonexclusive license. We can talk about the efficacy of that kind of relief in a few minutes.

A few of the new cases have focused more on development and design competition in existing markets than on potential competition in future markets. And maybe the best example of this kind of case is the Justice Department suit against the GM-ZF deal in 1993. In that case GM and ZF, ZF is a German firm, dominated the global market for the development and design of automatic transmissions for medium and heavy duty commercial vehicles. After Justice sued to block that deal, the transaction was abandoned.

The last case I want to mention, we'll talk about the policy implications involved in all of them later; this matter has not resulted in a case, and that's the one that you've all heard of, Justice's investigation—which I believe is still not closed—into Microsoft's bundling of the new Microsoft Network into Windows 95.

Firms like America Online were arguing that Microsoft was using its operating system's dominance to attempt to monopolize the market for online services. And the twist there was the concept of attempted monopolization by Microsoft of a market in which it did not yet have a product, online services. The market existed, but Microsoft had not yet entered it. In opposing a Microsoft motion to quash one of its subpoenaes, the Justice Department at least endorsed the proposition that that could be a viable antitrust theory in principle in papers it filed in the Southern District last summer.

Now, do these cases represent a new policy from the enforcement agencies? Or is it really just old potential competition theory with a new set of buzz words? I think much of the policy truly is new. Certainly it's new to think about research, development and design rather than production and sale as relevant markets. We usually think of markets as involving at least some production and at least some sales. The agencies are now looking at R&D as a type of nonprice competition, and that research and development devoted to a particular type of product is a current existing market for antitrust purposes. The drug cases and the GM-ZF matter in particular demonstrate that these concepts go beyond pure theory and they are being applied in actual cases. And that's unquestionably different, I think, from the perspective taken prior to 1988.

Some of the innovation market cases have been based less on current R&D than on future effects in markets that do not yet exist. That concept, unlike the R&D market concept, is not new. And you can go back as far as 1975 to a Business Review Letter issued to the Salk Institute in connection with a patenting licensing program to see that the Justice Department has long been sensitive to potential effects in future markets.

The one time it wasn't was the case that Peter mentioned I worked on a long time ago, which is *SCM v. Xerox* where the Justice Department, on our petition for certiorari to the Supreme Court, expressed the view that you couldn't monopolize a market that did not yet exist. The first brief written in the Supreme Court at that time by Professor Baxter, whose views have changed over time I'm happy to say. Unfortunately, it didn't help us back in 1981.

Anyway, the concept of future effects in existing markets, while not new, is being much more heavily emphasized today and represents at least a substantial change in focus.

Now, what's driving this change? We should not kid ourselves and believe that the agencies have developed a new program to encourage full employment for scientists. Despite the new close scrutiny of R&D, and the argument that R&D is an aspect of current market nonprice competition, the real concern underlying the recent cases is not the abstract concept of current competition and R&D. The concern is the protection of competition on price, quality, service and consumer choice for actual products that will be produced and will be sold and will be marketed in the future. And absent some strong reason to believe that sooner or later the merger will impact these traditional competitive variables in traditional product markets, I don't think anyone seriously believes that any of these cases would have been brought.

So the view which has been expressed in a number of quarters, quite eloquently by George Haig in the most recent edition of *Antitrust Law Journal*, that the innovation market approach is really just potential competition theory with a new vocabulary is not a bad argument.

The major change effected by the new innovation markets policy is really a matter of degree. The agencies are now projecting analysis of future product market effects well beyond the one-to-two-year time frame we became used to following the 1982 Guidelines. The FTC's Federal Register filing in the *Upjohn* drug case makes this very clear. The FTC acknowledges there that there's no present market for colon cancer chemotherapy products but says that this market is expected to exceed the $100 million sales level. When? In the year 2002, which is by my count six years away. Six years is a period that we would not have thought of as cognizable operating under the '82 and '84 Guidelines.

Now, a good question is whether the current innovation market's approach is consistent with the case law. And the best answer to that is yes and no. None of the new cases has gotten even near the stage of a judicial or Federal Trade Commission ruling. Most of the cases have resulted in consent decrees, and a few of them have involved transactions which have been

dropped altogether. And I don't think it's reasonable to expect that any time soon merging parties involving deals involving billions of dollars in many cases are going to go to the expense, and more importantly the delay, of litigating with the agencies when they can get some relief in the form of a consent decree involving one of what is usually very many products involved in a deal. So we are not likely to see any definitive judicial decision soon. And in any event, as you all know, the Supreme Court has not taken a substantive section 7 merger case since the 1970s.

The case most closely on point involved in the innovation markets approach is *SCM v. Xerox*, as I mentioned, I unhappily lost 14 years ago. The Second Circuit's decision in 1981 in that case is unquestionably contrary, at least in spirit, to the approach being taken today in Washington. SCM held that Xerox's acquisition of the controlling xerography patents, which occurred in 1956, four years before the Xerox machine was first marketed, could not be challenged under the antitrust laws. The court said that the policies of the patent laws preclude antitrust liability for a patent acquisition occurring before the time that the relevant product market emerges. That case is absolutely inconsistent with the proposed complaint in the *Sensormatic* case, that's the antitheft label case. That case specifically involved an acquisition of patents for a market that did not yet exist. So it is flatly inconsistent.

Now most of the merger cases that have been challenged also involved patents. It is an acquisition of stock, but the anticompetitive effect is the stock carries with it beneficial ownership of the patents involved in the products that have not yet gotten to market. So one could make a distinction that this is a stock acquisition, not a patent acquisition. But I think the *SCM* case is fundamentally inconsistent with virtually all of the R&D and innovation market cases that the agencies have brought over the last five years. But despite *SCM*, I don't think the recent cases are inconsistent with the broader fabric of the case law, and a reasonable case can be made that the new approach is really the *General Dynamics* doctrine viewed from a different perspective.

General Dynamics tells us that current market production and current sales may overstate future potential competitive significance. In that case, as you'll recall, it was coal in the ground but the reserves were depleting, and therefore the current market share was not a good picture of the competitive significance of the merging parties in the future. The present theory being advanced in Washington is really just the converse of that, which is that while current market shares may overstate future competitive significance, they may also understate current market significance. And when you're dealing with technologies and rapidly changing markets, that's certainly the case. And *General Dynamics*, I think, is one of the few cases that everyone agrees at least is sound in theory. So while I say that I don't think the present policy being advanced in Washington is inconsistent with the broader case law, it is inconsistent with *SCM* but has a sound basis in *General Dynamics* and the reasoning that underlies that decision.

Now, the new policy on the new cases, are they good? Is this a good thing? The answer in general, I think, is yes. But there are very serious dangers with the innovation market approach. And the agencies have to be particularly cautious.

The key point is the protection of competition in future markets. No one seriously disputes the importance of that objective. The disagreements, rather, are really matters of degree as to how aggressively the new approach should be pursued and how far out in the future we should go to predict competitive consequences.

One of the main arguments for a cautious approach is that in the economics literature there's a lack of any empirical evidence supporting a correlation between high research and development concentration and decreased output of innovations. And many forceful arguments have been made that monopoly is more conducive to innovation than is competition. Certainly the work of Joseph Shumpheter, which you're all generally familiar with, stands primarily for that proposition. But I think there are reasonable arguments that can be made for an empirical perspective on this point both ways.

Again, if we take a look at the most recent issue of *Antitrust Law Journal*, there is a spirited debate between Dick Rampet and NERA and Gilbert about what the literature says. And I think it shows at least that the matter can be argued both ways. But whatever the outcome of that debate, we are talking here about an antitrust enforcement policy. And the argument that less competition for innovation is a better social policy is really an inadmissible argument. If the agencies are saying we want more people innovating rather than fewer, we may as litigants contest that in a particular case. But you can't say that that's bad enforcement policy for the agencies to take the position that a monopoly in a particular innovation market is okay, is not an antitrust enforcement policy, and is not a responsible position for the antitrust enforcers of our government to take.

Now, another argument is identifying an R&D market is extraordinarily difficult, and this is a very serious objection. Defining the area of research involved and identifying the participants and potential entrants are all extremely difficult tasks. And the closer we get to pure research, the harder that job becomes. Ideas are simply one type of commodity that can never be monopolized. Where the R&D is closer to the D, to the development, it makes a lot more sense to attempt to define a market, to identify the participating firms and potential entrants and to assess probable competitive impact. And any

resulting case that comes out of that process will be a lot more sensible. Where the case is more at the R stage than at the D stage, aggressive antitrust intervention is very difficult to justify. That seems to be the approach that the agencies are taking. *Sensormatic* and the drug cases that we spoke about earlier are examples of cases where the products in issue were in the fairly advanced stages of development and not at the pure research stage. The *GM-ZF* matter involved actual and measurable current competition and design, and again was not a pure research case. And I haven't seen any case yet—there may be some involved in investigation—where the issue is pure research rather than developed. And I think we'd all be very surprised if any case like that were brought, certainly by the current officials in Washington.

Another criticism of the innovation market cases goes to the relief that's frequently obtained. And some, not all, but some of these cases the relief is licensing rather than divestiture. And that relief can be counterproductive. It can diminish the licensor's incentives to continue the products development. It creates a built-in free-rider problem. And it is a fair comment that many of the cases that have been brought would have been better off if they hadn't been brought at all rather than settle with a licensing decree. To me the Agency's frequent imposition of licensing relief is the one aspect of present policy that most requires further thought and probable change.

The comment most frequently advanced and criticism in the innovation market approach is that future effects are speculative. Predicting competitive impacts in existing markets is tough enough, and it becomes really hard when the market is changing rapidly or has not yet come into existence. The Windows 95 investigation provides an excellent example of that. When the investigation began, it was not unreasonable to fear that automatic access to the Microsoft Network in Windows 95 would enable Microsoft to monopolize or at least gain a commanding share of the market for online services. And a number of commentators in the trade press at the time were predicting exactly that result. Less than a year later the world has changed completely. Not only has MSN pretty much turned out to be a dud, at least so far, but it is now doubtful that online services even represent a relevant product market. That entire industry is rapidly being merged with and even overtaken by the Internet generally and the World Wide Web in particular.

But despite these problems, it would be unsound for the agencies to ignore or down play reasonably foreseeable future competitive effects. Merger analysis is always based on predictions of the future. And when we move into perspective relevant markets or evolving market, the changing policy is really only a matter of nuance and emphasis.

One way to reduce the potential for error in the cases involving these types of future effects is for the agencies to concentrate on cases where the future market is going from two competitors to one or three to two. And the further you get to research rather than development, the harder a line you have to take on making sure it is really only a two to one case. If it is in development, a three to two case may make sense, but the closer you get to research it really has to be a merger to effect a monopoly. If the case involves a six to five or even a four to three, except in extreme cases, the Agency should really just forget about it. The speculative impact is too great, and the consequences of wrong intervention by the agencies are too severe at that point.

But again, if we look at the actual cases that have been brought, the agencies have been basically on target. The Windows 95 investigation involved matters of real speculation, but Justice never brought a case. The cases that actually have been brought have involved markets largely going from two to one. And the products were fairly well along in development. These were really pretty good cases, even if the relief obtained in some is open to doubt. Cases like *Upjohn* in particular are likely to provide important economic benefits. Instead of one drug to treat colon cancer, we may have two; that should lead to more cures and lower prices. And even the textile workers and the man in the white suit would probably go along with that.

MR. GREENE: Thanks very much, John.

DR. MEYER: I'm going to take the next shot. Peter, I don't know whether you knew when you asked me to be on this panel that you were putting me in a little bit of a political problem here. Rich Gilbert is one of the principals of our firm, and he was one of the prime architects of this approach when he was Deputy Assistant Attorney General in the Antitrust Division. There are other principals in our firm, notably David Teese and Tom Jordy, who are also very well-known for their positions and interests on public activities. And if you take a look at these two positions, they don't always match up. I nevertheless accepted this assignment knowing full well that I run a substantial risk of offending one or more of my bosses. The only thing you have to know about this is that any and all of them can and probably will disclaim any responsibility for or agreement with anything I say here today.

As much as anything is universally acknowledged in economics, it is that innovation in all of its many facets is responsible for much of the improvement of living standards throughout the world. It is much more difficult, however, to understand how the process of innovation works, what promotes it and what impedes it.

I want to use my few minutes of time here to address three topics. First, I would like to discuss at a very basic and brief level why the link between market structure and the rate of innovation is not as strong as that between market structure and quantity or price. Second, I want to discuss a few observations I have concerning the use of innovation markets in practice, whether one believes they exist or not. And finally, I want to pick up on a couple of remarks of Jonathan Jacobson and consider whether the innovation market approach adds anything of value to antitrust policy.

Basically, the innovation market approach assumes that there is a relationship between market structure and innovative effort. More specifically it assumes over some range of market concentration that market structure conducive to competition is also conducive to innovation. About 60 years ago the economist Joseph Shumpheter suggested that some degree of market power is actually needed to support the process of creative destruction that innovation implies. You can skip over the work of a whole lot of other economists and come to the key question: Is there any uniformly recognized empirical relation between market structure and innovative activity? The short answer is "no." While some published studies have suggested that such a link does exist, there are a substantial number of respected economists who dispute that there is any empirically validated relationship between market structure and innovative activity that can be used to inform antitrust policy.

There are a number of possible reasons for this lack of a link. I want to highlight just one of them: appropriability. Appropriability is the ability of the innovating firm to reap the benefits of its innovation. This is important in understanding the incentives to engage in the innovative activity. There is both theoretical and empirical support for the notion that more concentrated market structures promote a higher level of appropriability which in turn promotes innovation.

One example of the importance of appropriability to the innovation process can be found in computer operating systems. On a very simple level compare and contrast the face of Microsoft Windows and Unix. Windows is the property of one firm which can and does appropriate the revenue associated with any innovation, real or imagined, in the product. Unix, which many technical types find superior to Windows, comes in several different flavors from a number of different firms. The existence of these different flavors of Unix means not only are there coordination problems when presenting the product to a marketplace where there are network effects, but that the returns to innovative activity on the part of one firm may have to be shared in some sense with other firms, or at least that extra costs are going to be incurred.

The question I find interesting here is whether Microsoft would have its current position on the desktop if different appropriability conditions had existed for Unix. Even this example doesn't really do full justice to the issue and the complexities of appropriability. Apple Computer appropriates the revenue associated with its innovation in its computer operating system, as does IBM with OS-2. But because of a complex interaction of affects, many view these programs becoming more and more niche products. Even if you appropriate all the revenue associated with an innovation, it is not clear that the scale of operations or the size of the market will be sufficient to support the innovative activity.

In addition to appropriability, the organizational capabilities of the firm and the stage in the product life cycle the industry finds itself can also confound any relation between market structure and innovative activity.

There's been a lot of talk about innovation and the innovation market approach in conjunction with a number of recent antitrust actions or investigations. I have some concerns about how the innovation market approach is being implemented. I want to present three of them.

My first concern is there's no commonly accepted operational definition of the concept of innovation. Some discussions seem to equate innovation with research and development, or research, or development. Other discussions seem to be concerned more with future markets, while some are concerned with the market for know-how or intellectual property. So far I haven't even noticed a distinction in most of what has been talked about in terms of a product and a process innovation, although all the cases that I'm aware of all involve product innovation.

Second, there appears to be a tendency in current practice to restrict the list of potential innovators in a matter to the list of participants in a product market. With narrowly defined product markets based on these small but significant and nontransitory increase in price tests, this could be a real problem. One attempted application of the innovation market approach I know about is to protect consumers that are not embracing innovation. More specifically, in this acquisition a small group of customers have expressed concerns that improvements in a product will cease because of the transaction. These customers are concerned that their Legacy operations—they operate old style software and old style hardware. A friend of mine and former colleague once put it like this: These people, what they are trying to do is protect innovation in the market for 386 chips. Somewhat more charitably, what they want is a breakthrough in innovation in the Legacy product that will give them contemporary performance with no transition or switching costs. That is a very tall order.

The point here is the important competition for innovation is not necessarily restricted to competition within a product market that is defined solely by demand side considerations.

The important competition here is often going to be between competing technologies and paradigms that will fall into different product markets on the basis of the Merger Guidelines paradigm.

Thirdly, I have real concerns that any antitrust investigation of innovation markets will be able to catalog the participants in this market. In a hypothetical 1980 investigation of the computer software business using innovation market approach, how likely would a firm called Microsoft have been identified as an important force in innovation? More recently, let's say 1990 or 1994 even, if this same hypothetical investigation had taken place would Netscape have made it onto the list?

My final point, does the notion of innovation market add anything good, new or useful to the tool kit of antitrust analysis? First, what's good about the innovation market approach? In my view, it focuses our attention of the role on nonprice competition in the role of antitrust analysis. It clarifies this. As a matter of economics, however, this is not new. I don't even think it is new as a matter of law. The increase in emphasis is welcome however. Second, the innovation market approach explicitly recognizes the role that industry history has played and what might play out again in the future. Again, however, this isn't necessarily new.

So what are the dangers of the innovation market approach? It is more complicated, and it is certainly unfamiliar for many practitioners. As a consequence, just on that basis alone, we are likely to have mistakes or incur extra costs getting down the learning curve. I am also concerned that there is going to be a search for bright lines, unambiguous cookie-cutter implementations of innovation markets when what it really calls for is careful and thorough analysis. If we could always assume that somebody as knowledgeable as a Rich Gilbert or Professor Willig or Professor Ordover would be conducting the investigation, my comfort level would go way up.

Finally, do we really need the innovation market approach as an independent means to reach anticompetitive mergers? Are there a significant number of realistic situations where mergers with real anticompetitive effects can only be attacked through the innovation market approach? In other words, won't all anticompetitive mergers be stopped on more traditional product market definitions?

One can engage in thought experiments or dream up hypotheticals where merger or joint venture can only be stopped through the use of the innovation market approach. I am skeptical that such situations exist in the real world, although I can be convinced. Perhaps the most favorable situation for the innovation market approach will be the case where divestiture of some sort would solve the immediate product market problem, but longer term competition would still be harmed by allowing the merger to proceed. Right now I tend to view the innovation market approach as a useful adjunct to understanding competitive effects and possibly entry barriers, more than as an independent basis on which to challenge mergers or joint ventures.

Thank you.

MR. GREENE: Thanks, Mark, very much. Sumanth.

DR. ADDANKI: I was on a panel about three months ago at the FTC. They were holding hearings on merger policy in an age of high tech and global industries. And the panel consisted of Rich Gilbert, Dick Rapp, who Jon mentioned, who are probably on two polar sides of this innovation market issue, as well as Doug Scarlton, who is probably about the same place as Dick Rapp and Dennis Yaro and myself. So a broad spectrum of opinions was represented on that panel. We had a great time, but at the end of the day we realized that we really didn't disagree very much at all on almost anything important. Today, too, I think the disagreements among these panel members are likely to be quite limited.

Let me pick up where Mark just left off, which is that, while innovation is important, and if you really think a merger is going to retard innovation, by all means block it or modify it in some way. At the same time, I should tell you that I think the innovation market as such is at best superfluous and at worst a distraction from the real business at hand. By that I mean that you are more likely to understand whether a merger is going to retard innovation by looking at what that merger is going to do to product markets and looking at how those firms are innovating or engaging in R&D efforts and how those R&D efforts relate to product markets than you're going to be scrambling around trying to define an innovation market.

Innovation isn't something that firms do for its own sake; innovation is what firms do because they want to improve their products to compete better. In other words, innovation is a form of nonprice competition, a very important form. From a policy standpoint as well we really don't care about innovation because we want to have full employment for scientists. We only care about innovation, about R&D and such activities to the extent that they result in better products, reduced prices and so on. In other words, we care about upward markets; the firms care about upwards markets. Logic would suggest that the analysis would probably be most usefully felt on upstream markets as well. And I'm going to show you how that works very quickly.

When will a merger retard innovation? I think the answer is simple: When the merged firm has the ability as well as the incentive to retard innovation. As far as the ability is concerned I think both the prior speakers have spoken eloquently about it.

You really need to have a highly specialized set of circumstances; you need to have R&D as assets that are specialized that cannot be replicated easily and that are really controlled largely by the merging firms. In other words, the merging firms dominate the entire process of R&D in some definable sphere of innovative activity.

This is very unlikely to happen, I would hypothesize, except where those merging firms also have substantially dominant positions in some output market. Now admittedly that output market does not have to be a physical product. The output could be technology in the form of a licensing market or some other technology transfer market. And I believe that the *GM-ZF* case fits pretty squarely into that if you're willing to accept that outward markets can be technology markets as well as physical product markets, because certainly GM and ZF between them really were truly dominant in the supply of the technology used while licensing and so on to manufacture transmissions for heavy duty vehicles.

So straight off, I think you're going to have a lot of clues about whether there is going to be ability to retard innovation by appeal to what kind of positions these firms occupy in product markets. But let's put ability aside, because presumably you could count up dollars of R&D assets and perhaps identify everyone who is and isn't engaged in R&D in every field. I think we all have reason to be skeptical about that, but put that aside for a moment. And let's talk about the incentives to retard innovation.

Given the uncertainty inherent in the R&D process, when can you say that the merged firm is going to have some plausible reason to retard the pace of innovation? And I think it goes back to the man in the white suit. It is really only going to happen when something immediately is at risk, if that innovation should come to pass. Now, that is most likely to happen when the innovation products that are going to be developed by this innovative activity are going to supplant, replace in some existing marketplace existing products that the merged firm is selling. Not only selling, but making substantial rents on, substantial profits on. And why is that? Because if you're only making normal profits on—let's start with the hypothesis that innovation is going to lead to better products, which at least in the first go around is going to give the firm that develops them a little bit of extra profit. These are the rents to the new product, the rents to the innovation. If the firm today, the merged firm today, was selling products and only earning purely competitive profits on them, it is difficult to see why it would want to delay introducing a new blockbuster product. So you've really got to have a situation where the merged firm today has substantial market power, a position to protect in existing product markets, which is threatened, which position is threatened by the innovations at issue that you're concerned about.

The *Sensormatic* case actually is pretty close to exactly that situation. The merging firms were firms that not only had the technology but also are in the production of the existing technology of security labels. And the innovations at issue were innovations having to do with a new technology for security labels, which would certainly be of sufficiently vast improvement that presumably as soon as those products became commercialized, they would supplant the existing bulky, unwieldy type labels in many applications. So there again you have reason to believe that a merger of technology, which is what this case was about, would result, could result in retard of innovation, because the innovations in the pipeline would go to cannibalized sales to existing products which arguably had rents associated with them.

So both the ability and the incentives to retard innovation, according to this commentator at any rate, are going to be found more readily and more easily by examining what the product markets are within which these firms operate and then by analyzing whether if the innovation pipeline you're concerned about involves products which are going to threaten products over which these merging firms have market power today.

There is an exception to all of this, and the exception is what really comes under what Jon was referring to as the future market situation. Because I should say that the fact that a product hasn't been developed yet may mean that it is a future product, not an existing product. But that doesn't mean that it is not going to compete in an existing market. And as a matter of fact, I think the incentives to retard innovation are most plausible when in fact the product that is going to be the result of this innovation is going to fit right into a market in which these firms currently compete. This exception to what I've just said happens when you've got something as institutionalized as the FDA drug review processes. Where it is actually possible to say with some degree—with a straight face, let me put it that way—it is possible to say with a straight face that X years hence you're going to have or you could have a market for a certain vaccine or a certain drug because you're at stage one or stage six of this 24-stage process that the FDA puts you through. And so under those circumstances, to say that you've got two firms, both of whom are roughly at comparable stages in the development of a drug in a particular therapeutic class, which is currently empty, and that if those firms were allowed to merge seven years hence, when all the tests are done and the products are assumed to be successful, you're going to have a problem in that future market. That I suppose is the one situa-

EEC MERGER ISSUES:
MARKET POWER IN THE MULTINATIONAL BUT UNIFIED SETTING

MR. GREENE: I think most of you know Barry. Barry was formerly a professor at Fordham and is now one of my partners, I'm happy to say, and has been involved in EEC antitrust matters for years and years. A long time, Barry. I don't know when you started . . . but at least the last year. Go ahead, Barry.

MR. HAWK: Thank you, Peter. For those of you that are disappointed David Cantor is not here, we did a switch. He's in Brussels, and I'm here.

The EEC merger regulation. Let me try to put the reg in a broader context. There is now more antitrust merger control in Europe than there has ever been, including pre-merger notification, and that's true despite all the hoopla in 1990 about the EEC merger regulation and one-stop shopping. That's turned out to be a farce in that sense. There are far more shops than there were in 1990.

Merger, just to give you an example, merger control now exists in 12 of the 15 Member States, and there's pre-merger notification with waiting periods in more than half the Member States. Most mergers and acquisitions involving U.S. firms with European sales fail to reach the very high EC cumulative thresholds of 5 billion world sales combined, plus each of at least two parties have to be 250 million ECU. Most transactions don't reach those thresholds. You hear about the ones that do, but there are dozens that don't reach those thresholds.

The thresholds probably won't come down in 1996, which is the next intergovernmental conference that's going to discuss all kinds of things. Antitrust is not at the top of the agenda; in fact, it is not an agenda number one. You've got to have funds, they will throw it out. Unless the Commission gives up its powers to grant individual exemptions to the Member States, and notably the Member States' competition authorities, the Member States, like the Germans, simply aren't going to agree to the merger reg thresholds coming down. So the debate on the thresholds is not limited to mergers. It is part of a broader political antitrust fight. So I don't think the thresholds are coming down. That means you have got to look to national filings, which have mushroomed in the last half dozen years. And again it is now common to have to make or seriously consider making half a dozen antitrust filings in Europe—notably Germany, Sweden, Italy, and some of these didn't exist. Austria and Ireland. Four of those six didn't have merger controls in 1990. And if you've got more than 25 percent market share in some product market in some Member State, well, in one of four Member States you have to think about notifying there, which are France, UK, Spain and Belgium. So the majority of Member States you've got to at least seriously consider filing. I'm saying that because there are—particularly a jurisdiction that has its thresholds in terms of world sales, it is difficult to see where the effect and the jurisdiction—there comes a practical point where you just seriously consider not notifying, let's put it that way. And a lot of times you just don't notify. And you know that in your back pocket, if it ever comes about, aside from, you know, irrational legal requirements should not be complied with, they are the sort of vague international law theories, arguments floating around that you could use to justify not filing in a situation where it is just absurd to file. I don't think that's overly aggressive, because in some situations it is absurd. I mean it is not even a transfer of income from shareholders to lawyers, with zero public interest being furthered by antitrust filing.

Now one thing or the main thing is proliferation of merger controls makes, and everything I said about Europe is true in the rest of the world now. So you're getting merger files elsewhere. You really do need tight central coordination of the filings and the merits. That will reduce costs for the client, and it will facilitate the approval process. We can go into that; there are a number of reasons why that's true. It is really worth it to tightly coordinate that. For one, you won't have 15 separate memoranda of local counsel describing their local merger control statutes for the one hundredth time if you've got one law firm that's dealt with all those local counsel, and say, "I don't want your four memorandum on the Irish notification system, know enough about it, just file or don't file."

There's also increasingly tougher—that's national in Europe—there's increasingly tougher EC merger regulation enforcement. In brief, more deals are being blocked or seriously modified today than even 18 months ago. There are longer delays in getting approval, because more transactions are being forced into phase 2 investigations, so you don't get through—well, basically the halcyon days of a cursory one-month review and a one-month approval, even where you had market shares of 40, 50, 60 percent, those halcyon days are over. At least where competitors or customers have "complained," have really voiced objections, structural fix-its are being increasingly demanded. The Commission is now less accepting of conduct remedies. Vertical mergers are being more closely examined, although I don't know how more closely. There is confusion about vertical mergers not only here but certainly in Europe. So yes, they pay more attention, but I'm not sure what's happening. And they also talk of innovation market.

Now, you have a couple of cases now where they are beginning to think about innovation markets. I wouldn't put it any more specifically than that. I mean they are thinking about innovation or they talk about it; it's in decisions. I'm not sure how defined it is. But the conclusion is things are tougher there. Harder to get things through. You have to pay a higher price to get a transaction through, and there are more delays.

Now, why? One reason for that is the influence of competitors and customers. There are no standing limitations, all right. The Merger Task Force is overworked; they don't have the people. They traditionally rely tremendously on the case, the fact and legal case being made by outsiders, all right. So if a company is willing to spend the money to go in and whatever, provide input, whatever, you go in and talk to the Merger Task Force. If there are interesting market shares, there is a very good chance that you will put that merger at least into phase 2. And you've got two phases, one month followed by four months. Under the present procedures, once you get put into phase 2—you do not get approval at the end of the first month—it's not impossible, but it is now extremely difficult to accelerate that four months procedurally, all right. It's not impossible, but you have to settle with the Commission very quickly in the beginning of that four-month period, or you're probably going to get dragged out the full four months, or there's a high risk of that. So this may violate the Sherman Act, that's another whole question, it certainly raises public policy questions. But if a competitor—well, I'll take the baldest example. If a competitor goes in, that delays the transaction. As I say, if it is an interesting case on the merits from an objective point of view, there is a decent chance that you'll get your competitor's merger into delay for four or five months. And I'm not talking motives, but certainly in the last year and a half you've got dramatic examples of competitor intervention, which has not so much led to total prohibitions, because they tend not to do that—extremely rare, still only have three total prohibition—but you're getting more serious forced modifications, okay, divestitures, licensing, what have you.

The Member States are also playing a stronger role than they were several years ago. On Thursday afternoon some people feel that the internal Commission rule is if a well-respected agency comes in that first month and says we really don't like this, you'd better take a hard look at this strong presumption in favor of going into phase 2. In other words, as a practical matter, you have another whole set of series players. Not all the Member State authorities—some are more important than others, sort of the major, not so much the major countries, the major antitrust countries, like Germany and U.K. are always players if they are interested. And a Member State, if you've got a problem in a particular jurisdiction or you have particular political influence in your favor, you may go to them. But my point is they are stronger players than they were several years ago.

I'm doing this very generally. There is some law to this. Why do they go into phase 2 more easily? The test for the opening of a phase 2 investigation is the Commission must have "serious doubt" about the lawfulness of the transaction. Well, what they have done is they have tremendously relaxed that standard, and maybe they are moving toward sort of a Washington agency standard of, well, we just need more time, so you just keep complying, or we'll send out a second request, because we need more time. They are moving sort of that way. Certainly it is more of: We'll open up a phase 2 investigation because we need more time, and we think we need more time because a competitor is coming in here raising questions, et cetera, et cetera, without really sort of focusing, as they were three or four years ago. Can we conclude that there is a "serious doubt" that serious doubt standard? I don't think it is the legal standard anymore.

Now they are getting tougher in Brussels, the Merger Task Force. The big question: Is there still a stronger preference to have your merger in Brussels rather than in a Member State? Certainly the preference is not as strong today as it was 18 months ago, because Brussels is getting tougher. But probably overall you'd still rather be in Brussels, particularly where a merger raises substantive issues in Germany and the UK, because they are still the two toughest national authorities. Or the other extreme where there's no problem on the merits, but you're going to have to file in ten countries in Europe, even though there is absolutely no question whatsoever on the merits, well, then you might rather be under the merger regulations, despite the high costs of the form CO, it might be cheaper to fill out the form CO if you don't get carried away, and if you control yourself and the lawyers and say there's no problem on the merits, we are not going to run amuck in filling out the form, all right. We will negotiate a more limited filing and just say to them that there's no problem on the merits, say that yourself every night, and we are not going to make this a huge case, please, all right. And they are so busy that if you persuade them there's no problem on the merits, the Merger Task Force Commission are very forthcoming in saying, all right, you don't have to provide all this information.

All right, so if it is a no-brainer case you probably want to be under the Merger Regulations because you're going to avoid the national clause. The other extreme, if you got a really hard case on the merits in Germany and UK particularly, you may want to be in Brussels. You can't totally preempt the national; technically you can preempt the national authorities, they will still have influence, but you're still fighting in Brussels, and they have got influence on the process.

Let me turn to joint ventures. I'm not going to start the metaphysical—oh, we have to talk a little bit about the concentrated cooperative joint venture distinction—but this is certainly not law, well, it is law, but I mean it is metaphysics. I'll tell you in terms of surprises, I mean this thing about joint ventures under the merger reg are surprises, particularly surprises to corporate lawyers. Because the merger regulation has been interpreted to cover a broad variety of arrangements, some of which are called joint ventures, some of which corporate lawyers wouldn't even dream of as a joint venture, but these arrangements will end up being a concentrated joint venture, therefore under the merger regulation, triggering, mandatory preclosing notification, filling out this at first glance a full form, all right.

Now, many of these surprises derive from the regulation's extremely broad definition of joint control. In order to have a joint venture, you first must have joint control. It is very easy to have joint control; you can have joint control with a minority share holding of 5 percent. It woke up I forget which investment bank it was, but they ended up in a 5 percent interest, decided to take an equity interest, and all of a sudden they were in joint control, and once you're in the joint control group, then you're counted for purposes of calculating the thresholds. So the more people in the joint control group, the more likely it is that the numbers will add up to meet the thresholds.

Now, you can have joint control where either in the corporate governance rules and/or a shareholder's agreement, let's say there's 5 percent minority shareholder has effectively a veto—to cut through this—a veto over decisions like the budget, a business plan, appointment of top officers, okay. And there's some combination; there's no—probably the budget is the most important. But there's a list, a little laundry list to look at. As I say, corporate lawyers are very surprised they are participating in a merger. And you've got decisions with minority shareholdings as low as 5 percent where that shareholder has ended up jointly controlling something, turning it into a joint venture. Formation of one-shot bidding consortia can suddenly be notifiable, because you got joint control over the consortium that says 35 percent interest in some privatized company. But you look at the consortium, or you look at the consortium ends up even though it takes a 20 percent interest but they are saying, well, yes, we are going to be effectively running the company, we want a veto over certain things like certainly the financial plan, officers. You end up counting a lot of companies, in which case it is easy to meet the thresholds.

So I started with the surprises of how can this transaction fall under the merger regulation. I mean, what we are doing here is we are just taking a 5 percent interest in something. It is a combination of two things. You add parties or concerned undertakings who must be counted for purposes of calculating the thresholds, and then in the second sort of calculation rule, it kicks in only with joint ventures is where there is joint—if you have joint control, you have a joint venture by definition. And you count everybody in the joint control group to meet these two thresholds of 5 billion ECU combined world sales and each of at least two parties has 250 million ECU of European sales so it is 5 billion plus two have 250 million ECU. Now, you have joint control very easily. All right, now you have four people in the joint control group, okay, plus the target.

The ordinary calculation rule, when a business is acquired, is on the seller's side you count only the sales of the business being sold. So if Exxon sells a restaurant you only count the sales of the restaurant, you don't count all of Exxon. In a joint venture situation you count the sales of the parents, not simply the joint venture or the assets being contributed to the joint venture. So if Exxon and General Motors open up a restaurant in Rio de Janeiro it is notifiable under the EEC regulation if you work out the rules. They each have $6 billion of world sales; they each have $300 billion of world sales; the amount of sales of the joint venture is irrelevant at that point; it is zero. But that doesn't matter at that point.

So the combination of joint control puts in a lot of parties, and the joint venture rules you count all the sales, sort of the sales related to the transaction, so you end up with a lot of notifiable transactions. So then you get funny surprises. It is a clear acquisition of control. A is buying B, or buying a business of B; you only count the sales of that business. But the seller decides, for whatever reason, to retain 10 percent of the business, all right. And soon as I get 10 percent, okay, ordinarily that's all right, but what does that 10 percent give the old seller? Again under a shareholder's agreement or corporate governance rules, usually the corporate governance rules in that situation, this joint seller hasn't disappeared; it has joint control, and it is not now acquisition of a business. It becomes a joint venture, in which case you count all the sales of the selling company, all right, which can then kick you over the thresholds. So you have a lot of joint ventures are notified. As I say, in a lot of them they have arguably not even effects in the community let alone raising a question of the merits.

Now, to make it a little worse, more joint ventures get covered under the merger regulation. You have this distinction between concentrated joint ventures, which are viewed or treated as mergers, they fall under the merger regulation, and cooperative joint ventures, which are not. Okay, if you have a concentration, a concentrated joint venture, to work backwards, articles 85 and 86, which are the counterparts of section 1 and 2. They do not apply to a concentrated joint venture. They don't apply to mergers so you disapply 85 and 86. Then you say, fine I may or may not be under the merger regulation,

depending on whether I meet the thresholds. So if you have a concentrated joint venture that does not meet the thresholds, it escapes EC competition law. You escape the merger reg and you escape 85 and 86, because it is a concentrated joint venture, okay.

I'll go back to that. Trust me here. It is like section 1, section 2, section 7. You get 85 and 86 which is like 1 and 2; the merger effect is like section 7 of the Clayton Act, and you have this thing called a concentrated joint venture that is—well, if it doesn't meet the thresholds. If you have a concentrated joint venture, you do not apply article 85 and 86. It is like eliminating the Sherman Act jurisdiction. But then you have to meet the thresholds to fall under the merger regs, and if you don't, you've escaped everything. People try to restructure, okay, let's try to avoid everything. Well, avoid EC law, you may not have avoided national law in that situation, all right. There's more opportunity to do that, because the Commission has expanded the definition of what is a concentrated joint venture. I will just give you two examples. They now say that you have a concentrated joint venture even where there is a strong—I'm talking this way vertical—even where the parents are buying from or selling to the joint venture. It used to be you could have a short-term transitional agreement between the parent and a joint venture, fine, you could have a supply agreement for years, fine. They are getting a little looser about that. Okay, fine if this is nothing but an input joint venture, we will look at, after the joint venture is formed, we will look at how much the joint venture is buying from the parents or selling to the parents. And if they are buying from or selling to, there's more of a vertical supply buy/sell relationship, we will say that's not concentrative. Okay, just trust me on that. There's no logic to this, all right. It gets worse because of the autonomy on it. You sort of memorize the rules and forget about the logic. The point is now the Commission is willing to say this is concentrative even though more and more widgets are being supplied to the joint venture or bought from the joint venture. Similarly, another rule was both parents had to exit the market of the joint venture. The idea was you set up a new business, and the parents exited from this business. Well, they have moved away from that to the point now you can have a concentrated joint venture where even one of the parents—you can have two—where even one of the parents remains in the joint venture and competes with it. It used to be where you have industrial leadership and all kinds of strange things, and you would try to explain this. Well, no, now you have parent A and parent B; parent B has got to exit or must not get into the market, but parent A can continue to compete with the joint venture. That joint venture remains concentrative, all right.

So just again, the scope of what is a concentrative joint venture keeps expanding. It's not so much despite trying to rationalize this and spillover effects, that's not it; it is turf fight, too. This increases Commission jurisdiction by making it concentrative. It also increases the Merger Task Forces' turf or jurisdiction within the Commission against the operating parts of the Commission that enforce article 85 and 86 because if your joint venture is concentrative, the Merger Task Force reviews it. If it is a cooperative joint venture, Jon Temple Lang or someone else in the operating divisions, all right. So part of the decisions go off really on a turf fight or a turf fight within the Commission. And then depending on who you know or what industry it is, you might decide that you'd rather be with an operating division. And that can affect—if the antitrust lawyers have the opportunity, you may not, all right—if you've got the opportunity or it is important enough to suggest changes in the structure of the transaction. Because you can start playing around—there's far more fun being an EC antitrust lawyer with the corporate people because you've got more room to go to the corporate people and say gee, it is silly, but don't think about that—but there's a strong antitrust reason to do it this way. It is irrelevant in the U.S., okay.

The question, is it still preferable to have your joint venture under the merger regulation or maybe have it under articles 85 and 86? I think today, and we can spend more time on questions if you want, today it is still, generally speaking, it is not as clear, it is like do you always want your mergers in Brussels? It is probably true, but it is not as clear as it was 18 months ago. You would probably also prefer to have most joint ventures under the merger regulation—well, you certainly do if you don't meet the threshold; you escape the EC law entirely. But even if you meet the threshold, you probably still want them under the merger regulation rather than have them

ADDRESS TO THE SECTION

MR. CAVANAGH: Good evening. I'm Ned Cavanagh, Chair of the Section for 1996, and I want to welcome all of you to our annual dinner. I want to take care of a few items of business now, and then we are going to have our dinner, and then afterwards we are going to have our speakers.

The first item, I want to acknowledge the work of Peter Greene in putting together an excellent, excellent program today. Peter and his committee worked very, very hard, and we had a very, very well-attended series of sessions this morning and this afternoon. It was very substantive, and I think excellent.

We started this morning with Bill Lifland, who gave the Annual Review of Antitrust Law in a way that only Bill Lifland can. Bill has done this ever since I can remember. It was just excellent, a clear presentation. And even though the Supreme Court hasn't done anything in antitrust this year, it was well worth listening to, Bill.

After Bill's presentation we had a panel on Robinson-Patman Act with Irv Scher and Bob Marin. And it was interesting watching those two guys talk about the Robinson-Patman Act the way most of us talk about baseball.

This afternoon was devoted to mergers. Michael Weiner and Bob Willig talked about horizontal effects; Dale Collins and Janusz Ordover about vertical mergers and the new interest that both the FTC and Department of Justice have in vertical mergers. Then we talked about innovation markets: Jonathan Jacobson, Mark Meyer and Sumanth Addanki; and then we closed out with an excellent presentation by Barry Hawk about mergers in the EEC.

It was just a very, very well done program, and we are very, very happy to have had that today.

We also installed our new officers, and if you'll just bear with me for a minute, I want to tell you about that. The new vice chair for 1996 is Barry Brett; the new secretary, Mike Malina; the executive committee, Alan Weinschel, Walter Barthold, Lloyd Constantine, Steve Edwards, Larry Fox, Peter Greene, Pamela Jones Harbour, Steve Houck, Bob Hubbard, Norma Levy, Bill Lifland, Ken Logan and Vernon Vig. We look forward to a very, very active and exciting year.

I would just like briefly to introduce our dais. Starting on my right on the far side, of course, is Bill Lifland, whom I've already acknowledged; Rob Giordano, Department of Justice, head of the New York office of the Antitrust Division; Peter Greene, who was our program chair; Bill Baer, head of the Bureau of Competition in the FTC that we are going to hear from later; Charles Biggio, from the Antitrust Division, who will also be addressing us later.

Starting on my left, Mike Bloom, head of the FTC Regional Office; Steve Houck, who is Chief Anti-Enforcement Officer for the Attorney General's Office in the State of New York; Alan Weinschel, who is chairman emeritus; and Barry Brett who is the new vice chair.

One other thing, my first official duty as 1996 chair is to present our out-going chair with a token of our appreciation. Alan, if you would come up. You worked very hard this year Alan. You provided a lot of inspiration, a lot of ideas, and this gift is for you as a token of our esteem and of our appreciation.

MR. WEINSCHEL: Thank you very much. I considered it a privilege for the last two years, and I enjoyed it as much as it was hard work. Thanks.

MR. CAVANAGH: Let's enjoy our dinner, and then we will have our speakers afterwards. Thank you.

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MR. CAVANAGH: We are very fortunate tonight to have two speakers from Washington to let us know what's going on. Our program has said that Lawrence Fullerton, who is Chief of Mergers for the Department of Justice, Antitrust Division, was going to be here. Unfortunately, Mr. Fullerton told us that he had a dire emergency with some merger work and unfortunately couldn't get up here. But fortunately for us his deputy, Charles Biggio, was able to come. Charles is a graduate of the Fordham Law School, Senior Counsel to the Attorney General for Mergers and Mr. Fullerton's right-hand man. Before joining Justice Department, Charles spent ten years at Sherman Stearling. Charles.

MR. BIGGIO: I just have a few things to say to you tonight. Before I start talking about some of the substantive things I want to say, I'd just like to make a couple points about some of the challenges we face at the division at the FTC in merger enforcement.

There's been a variety of pretty significant changes recently, both in the regulatory landscape as well as in some technological changes that I think have given us some new things to think about in how we apply merger principles to transactions that are going to be occurring in various industries. For example, in the media and telecom there's been some changes in the regulatory landscape of the elimination of some rules and some of the FCC regulations changing that will stimulate mergers in an area where there have heretofore have not been a number of significant mergers. At the same time technologi-

cal changes in these industries are radically changing how information is collected and distributed. Voice data, video communications are all affected. And firms that were once locked into a given technology or industry are now branching out. Telephone companies are offering video dial tones, and cable companies are threatening to enter the telephone business. Various strategic alliances between cable, phone companies, media companies to develop new products are springing up all over the place.

In other areas the Federal Energy Regulatory Commission has changed some of its rules on how power can be distributed between the various local utilities. I think that's opened up dramatically the number of mergers we'll see among the electrical utilities.

As a result of all these changes, I think we will see more mergers in these areas, which will increase our workload dramatically. We have always seen many bank mergers. We get about 2,000 bank mergers a year to look at, many electrical utility mergers, telecom mergers and so forth. So our work will increase.

We will also be faced with a variety of new issues which we haven't had to face today that we haven't had to face in the past. Vertical issues are being squarely presented to us in some of the media mergers that have happened in the last year or two. The impact of mergers on innovation markets in development of new technologies is becoming an increasingly important part of our regulatory agenda.

Also efficiencies are playing a very important role in our analysis of these transactions. As we worry about applying merger principles to new types of transaction, we are always having to balance what efficiency enhancing qualities these mergers have. And so these new transactions in newly unregulated industries are also causing us to continue to evaluate how to apply principles of efficiency to our analysis.

I'll say one point on the application of the Merger Guidelines, which people continually question whether the Guidelines are being followed by the agencies or whether there's requirements that the Guidelines be changed as a result of all this. I think the Guidelines are a very flexible tool for analyzing mergers historically and in the future, and I don't think that the Guidelines as written now require dramatic changes in order to be applied to the changing circumstances we are facing.

I would like now to move onto a couple areas of specific concern, devoting most of my comments to the application of unilateral effects section in Part 2 of the Guidelines to our merger analysis. I understand that was a topic of some discussion this morning with Mike Weiner and Bobby Willig. I'll just summarize a few key principles just to frame my comments.

What we are talking about in a unilateral effects theory is the internalization of the competition between the two merging firms, where the product of one firm is the sort of next best or close substitute to the products of the other firm. The result of which is, if a price is raised for one product, a substantial portion of the shares are diverted to the shares of the other merging firm, and so the lost margin or the lost sale is internalized. There's no lost profit as a result of that. There can be a price increase on either or both of the merged firm's products. It may not be symmetrical, but the theory works whether it is one product or both where the prices are raised.

Now, admittedly, the case law, most of it is old. It has not been sympathetic to finding violations where differentiated products are concerned. On the other hand I note that courts have recently been somewhat sympathetic to the concept in the pens case which I think prompted some of Michael's comments today. The court disagreed that the market boundary was not all pens. The court understood that there was some line beyond which the market had to be drawn. Also, the judge's approach in the cereal cases, the Kraft cereal company, shows that at least she appreciates how mergers might be harmful to consumers in differentiated product markets.

In any event, I think we are becoming better versed in how to understand and identify and prove where a merger might result in unilateral anticompetitive effect. And because of our increasing familiarity with unilateral effects, I think everybody should expect that if we perceive an anticompetitive problem in a differentiated product market, we will seek relief notwithstanding the legal impediments that might be perceived.

The most recent example of the division's efforts in the area of unilateral effects is our bread case, which involved Interstate Baking and Continental Baking. The product involved was white pan bread, which is probably most known to everybody as Continental's Wonder Bread product.

Wonder Bread was the number one and Interstate's brands were the number three white bread products in the country, and we analyzed the effects of this merger in five geographic markets. As I said, Continental's primary white bread brand was Wonder, and Interstate sells under a number of brands, depending on the region. Their major brands were Butternut, Sunbeam, Mrs. Carl's and Webber's.

Now white bread, believe it or not, has special attributes. A large core group of consumers, viewed to be special for some reason, they seem to be distinctly drawn to the distinctly bland flavor and texture. Kids apparently refuse to eat anything else. I don't know that for a fact, but. . . . Surprisingly, Ann's comment in the press release, that she grew up on Wonder Bread and bologna, was actually something she said. It wasn't one of Connie Robinson's typical ghost writing.

In the relevant geographic areas we found that Interstate and Continental's brands were the two or two of only three of the primary premium white bread brands. A private label existed in all the markets, and it was fairly substantial. But there were no other premium brands of significance in these markets. In any event, even including private label, the increase in concentration in these five markets would have been quite significant. In each case the post merger firm would have had a market share of 35 percent, so it at least falls in the Guidelines 35 percent proviso.

Based on the evidence we had, we concluded that a price increase for Wonder would have resulted in Interstate's brand picking up most of the diverted sales, and vice versa. Private label was a factor, but it would not have picked up a sufficient amount of sales, we thought, to defeat a significant price increase. We did in fact allege a market that included the private label; we didn't try to distinguish between premium branded market and an all white bread market.

Interestingly, because of the significance of the brands—and I think that's the crucial thing to keep in mind in these types of cases, the brands were very significant, had quite a bit of equity—entry as a result of this by new bakeries or expansions by existing suppliers would not have, we believe, been an adequate competitive check post merger. There had been, in fact, a number of very substantial companies who were very sophisticated brand managers who had tried and failed to enter white pan bread.

Now, I understand there is a variety of ways to look at and critique an approach to evaluating unilateral competitive effects. I think, for lack of a better word, called words of wisdom for the private bar coming in and trying to present their case to the Division where the products are branded and do have distinct attributes or are perceived to be different by consumers, I think there's a variety of things that you should keep in mind.

The first one, as I said before, is notwithstanding the old case law, we believe that unilateral anticompetitive effects are an important part of our regulatory program, and we won't hesitate to seek relief where we think that a unilateral effect will occur. Again, our job is to evaluate whether consumers will be hurt and try to remedy that harm.

Also, obviously, we have a responsibility of trying to develop the case law so that the courts and the legal rules take into account all dimensions of competitive harm. We should also note that certain types of arguments will be lesser or greater or more persuasive to us in a unilateral effects differentiated product market type of case. For example, geographic markets, a broad geographic markets based on how far product is shipped from a plant will not necessarily be persuasive to us where local competition is determined by the presence of competing brands in the local area. After all, being able to ship a product over long distances won't do you any good if once it gets there consumers don't like the bread, won't prefer it, won't buy it. It will just sit on the shelves and rot. In the bread case it was true that bread can be physically shipped over quite substantial distances. But we looked at the pricing in local markets and where the firms were actually selling, the fact was that bread could be shipped over long distances did not make much of a difference of how the bread was priced in local markets. It was where the brand was recognized that counted.

Similarly production capacity. While capacity or excess capacity may in certain circumstances be a competitive constraint, the ability to produce won't be given as much weight as the ability to sell. Again, in bread there was plenty of capacity; that influenced the remedy we sought, obtained in that case, and I'll come to that at the end. But this fact didn't make much difference in terms of the firm's ability to sell product. Again, it was the brand that mattered that established the firm's market share.

Another avenue of attack you might consider is entry. Even though it may be easy to enter a market from a standpoint of the ability to manufacture or make the product, if brand equity is important, simply building a facility will not translate into sufficient sales to defeat a unilateral price effect. Moreover, since the anticompetitive effect is tied to the significance of the individual brands of the merging firms, unless the share of one of the merged brands can be in effect duplicated or supplanted by a new entrant, that is unless the new product is perceived to be substantially similar to the products of the merged firms, entry, even if physically easy or even if it does occur, is not necessarily likely to be sufficient to defeat a unilateral price effect.

Product market is another area where I think care should be given. I guess there was some discussion this morning about whether or not you needed to define a market from a legal standpoint. I wouldn't necessarily dispute that you have to. At the same time it's not clear that defining a market actually could be that crucial to our analysis of the likely competitive effects of the market. We will be interested in examining the extent to which the product of the merging firms are sufficiently close and isolated substitutes that other products are not providing an effective competitive or constraint on their pricing. And similarly, to the effect that the merging firms are not close substitutes, that will be an important factor in evaluating whether the merger is unlikely to result in a unilateral effect. Also, the existence of efficiencies will also play a very important part in our analysis of the unilateral effects of a transaction. To the extent that it can be demonstrated that the incremental costs of the merging firms will go down, that will lead

us closer along the lines that the merger is unlikely to result in a price effect. So efficiencies will play a very important role in our evaluation of mergers and differentiated products.

I should note in passing that the ’92 Guidelines have a 35 percent threshold under which we will not ordinarily try to establish unilateral effect. I think that’s a good rule of thumb. At the same time, the 35 percent rule isn’t cast in stone, and we will at least examine whether there is a possible significant anticompetitive effect in transactions where a post acquisition market share is not 35 percent or defined within the context of a given market.

Now, moving right along, I want to say a few things about remedies. Generally our policy is to be flexible in seeking remedies, and our goal is to resolve competitive problems while permitting the parties to achieve the efficiencies that the other aspects of the deal may have. In the bread case, for example, we obtained a remedy which was focused primarily on the brands. We didn’t require the parties to divest bread making facilities or other assets if the purchaser did not require them to adequately support its efforts to sell the brands in the affected markets. There was quite a bit of excess capacity in the industry, quite a long history of third-party private labeling, and we didn’t feel that the requirement of having capacity was so crucial to the purchaser of the divested assets as to require the parties to divest bread making equipment or plants. On the other hand, if the party that the divesting parties had lined up for the sale needed the bread making assets, then that would be a requirement of that particular divestiture. But it wasn’t in all events required. Distinguishing that case from our recent enforcement action in the Kimberly-Clark-Scott paper matter, which also involved a differentiated product market in facial tissue as well as in baby wipes, there we believe that the tissue making facilities for the facial tissue were sufficiently important that we did require the parties to divest at least some capacity, although again in that case the brand was the important asset.

So I think the message there is while we are going to be flexible, we do analyze the remedies on a case-by-case basis. And we will seek what we believe to be the appropriate level of divestiture, brands, plant and equipment, and so forth that meets the specific circumstances.

That’s all I have tonight. Thank you very much. If you have any questions, I’d be happy to answer them now or after Bill speaks.

MR. CAVANAGH: Thank you very much, Charles.

Our next speaker is Bill Baer. Bill is head of the Bureau of Competition at the FTC. He is a graduate of the Stanford Law School where he was a member of the Law Review. Bill began his career at the FTC and spent about five years there. He went on in private practice to become a partner in Arnold and Porter. And last April when Bob Pitofsky was named chairman at the FTC, he called Bill back.

Bill, we are looking forward to hearing you.

MR. BAER: Thank you, Ned. It is good to be here. I bring you all regards from Bob Pitofsky, who is right now somewhere between Tokyo and Seoul on a competition mission. He has high regard for this organization and the people that are here tonight, and did ask me to pay my respects, which I am glad to do.

It is a little intimidating to be here as an after dinner speaker. I was actually reminded of a conversation I had with a friend up here with whom I worked on some criminal matters a few years ago, former Assistant U.S. Attorney here in the Southern District, and he was telling war stores about his time as a prosecutor. And I asked him what was really the most threatening, most dangerous position he ever found himself in. And he said he had really seen a lot; he had seen prisoners go out of control in a detention center; he had been in a courtroom and had a prisoner try to escape; he had been involved in arrests where people pulled guns. But really the most dangerous situation he ever found himself in was one time when he was between Alan Dershowitz and a TV camera. And being between you and the exit is a little bit of an intimidating experience for me. But I’ll try and get out of the way quickly enough so that I won’t be stampeded.

As Ned mentioned, I’ve been at the Commission now for about seven or eight months. It’s fun being back.

I have, it turns out, achieved a certain measure of notoriety since returning. For those of you, like me, who don’t have much of a weekend social life, you may have seen that *20/20* in early December did a piece on slotting allowances, the payments that retail grocers often extract from manufacturers to place a new product on the shelves. After the reporter introduced this story as the grocery industry’s dirty little secret and why the government was doing nothing about it, I knew the piece which ran would not be favorable. And I had the dubious pleasure of trying to explain a fairly sophisticated concept of why a slotting allowance might not necessarily be illegal in all instances.

Well, that produced an outpouring of consumer support for the agency, for me personally, for my heritage and even there was one reference to my mother. But I actually got a letter a couple days ago, I just wanted to read a couple sentences of it from a consumer in Decatur, Georgia. It reads:

Dear Mr. Baer:

> Thank you for getting me off the hook. For many years my wife said that I was the most naive man in America because I once believed that the evil Reverend Jim Bakker actually had seduced the innocent church secretary Jessica Hahn. After listening to your child-like innocence about slotting fees, she has put me in second place.

Now, he goes on to lay out in some detail his concerns, and then he concludes by saying:

> The Federal Communications Commis-sion totally abrogated its responsibility to provide for the public interest, convenience and necessity many years ago, the result is the filth that we are exposed to on a daily basis on the airways. Your comments during the recent *20/20* broadcast are concrete proof that the Federal Trade Commission is currently on a course to similarly abrogate its mandate. I'll not address your conclusion that there is no evidence that slotting increases consumer prices, except to say that Rodney King is disappointed that there are people like you in California, but O.J. Simpson and the Menendez brothers are delighted.
>
> Cordially.

Anyway, so I actually got about 300 letters commending my comments on *20/20*. But I wanted to segue from that to talk a little bit about the challenge that we, Charles Biggio in the Division, and Bob Pitofsky and those of us at the FTC are facing. You know the last four months the balanced budget debate has really involved kind of a precedent discussion about the future role the government is going to play in each of our lives. And antitrust enforcement hasn't really been an issue and for obvious reasons. You know the dollars involved, about $135 million for antitrust enforcement if you combine my bureau's budget with Ann Bingaman's. It is quite small when you are talking about a $163 billion deficit. It is less than .1 percent of the annual deficit, much less to say a much smaller percentage of the annual federal budget.

But that sort of insulation from debate isn't really going to last for long. Whether or not there's a final agreement on the details of the seven-year budget, given the apparent consensus on that goal, all federal agencies and all federal programs are going to be in for an unprecedented amount of scrutiny as the budgetiers are forced to try and extract every bit of savings they can from current programs. It is really going to be zero-based budgeting with a vengeance, because a lot of agencies will find themselves zeroed out.

What I wanted to talk about for a few minutes tonight is how antitrust enforcement will and should fare in this debate. It seems to me that in order for us to prove our work, we are going to have to demonstrate to the public and to Congress satisfactory answers to three basic questions. First, does federal antitrust enforcement make a real difference to average consumers and taxpayers? Second, can we do what we do, can we enforce the antitrust laws without imposing undue burdens on the business community? And third, can we enforce the law in such a forward-looking way to be attentive to the dynamics of the marketplace, taking into account issues like the globalzation of the market and, as Charles mentioned, the rapidly changing technology we are seeing in many industries?

Let me address briefly, and I won't rattle on as long as I could be prepared to do, and suggest an answer to each of those questions. Now, those of us who studied and practice antitrust law, we certainly all can agree on the benefits of a competitive free-market economy, and we are also all likely to agree on the importance of effective antitrust enforcement to the competitive marketplace, conceding that we may have differences about what the appropriate level of enforcement is or what's effective. But the people who are not members of the antitrust fraternity, antitrust really must seem like a terribly complex and abstract concept. And they really have little way of knowing in concrete terms what actual benefits are produced by antitrust enforcement. Some may even misapprehend the nature of what we do, and see it as an intrusive and restrictive form of regulation. When if we are doing our job right, the opposite is true; effective and focused antitrust enforcement is deregulatory and procompetitive. It really is the less intrusive alternative to a regulatory scheme.

Part of the challenge we are going to face at the federal enforcement level is trying to demystify a little bit what we do to the average consumer and the average Congressman. We'll need to translate our jargon into simple language that shows that what we do can make a real difference. Let me give you an example. A couple of months ago the Commission brought a case involving First Data Corporation's acquisition of First Financial Management. These two firms competed in a variety of areas, but they owned the only two consumer money wire transfer services in operation in the United States. First Data owned a business called MoneyGram and First Financial had acquired Western Union, you know, the grandfather of all money wire transfers. The merger would have been a mergered monopoly and without any doubt raised prices to millions of consumers who need these services, many of whom are low-income folks with no other means of transferring money quickly and efficiently.

The way the wire transfer works these days is different than the old Western Union concept we used to see. The sending party goes to an agent, such as a check casher, a grocery store or convenience store. And both of these firms have about 20,000 locations all across the country. You complete a form, you pay a transaction fee; the transaction information is fed into a computer network, and the money becomes available almost instantaneously to the recipient at the other end, who could be at any other of the other 20,000 transfer points. It is a little like an ATM, but for people who don't have banking privileges, who don't have ATM cards because they can't afford to is another way of getting $500 to a child at school or to somebody, a sick relative. The service is fast, secure and convenient. And they are mostly used by consumers—or about a third of them are used by consumers—who have no bank accounts. The market is big, it is 13 million transactions a year and about $275/300 million in fees.

Until '89 the market was controlled by Western Union. That year, though, First Data entered with its MoneyGram business, and it forced Western Union to change its pricing strategy. It eliminated the annual 5 percent price increases that had been going on for as long as anyone could remember, and at the present Western Union had not raised price at all. Our consent agreement forced divestiture of the MoneyGram business by First Data, and in the meantime it is operating as a separate business unit. And we have seen just in the last week or two MoneyGram advertising promotional prices that are actually 70 percent lower than Western Union. And even assuming that is a promotional price that won't go on for long, on an annual basis we calculate that this is easily a $20 to 30 million a year savings for consumers for keeping both of these wire transfer services in business.

I could go through other examples. We brought a case involving Boston Scientific, some catheters, where the data we were able to assemble suggested that prices over a two- to three-year period would be lowered to the point where in the out years people would be saving $15 or 20 million annually. We brought a case involving Hoechst/Marion Merrell Dow and four overlapping pharmaceutical products. Where if you look at just one of the market, a big market, we are talking $15, 20 million in savings.

If you total up just two or three or four things we have done this year, two, three or four things that Charles and Larry Fullerton and Ann Bingaman have been involved in, we actually get up to very quickly annual savings of over $130 million, which is roughly the combined budget for our two agencies. And that is six or seven of 10 or 15 matters that we may bring per month. So I think there is a story to be told that there are bottom line savings that antitrust enforcement brings to consumers. And part of our job over the next few years is going to be to bring that message.

Now, the second question I posed related to, Can we do what we do and minimize burden? And I think both agencies have spent a lot of time in the last couple of years trying to focus on trying to get from here to there in a way that minimizes the burden we impose on the business community. We recognize now—it is debatable whether we always recognized it adequately that it's an important part of our job—things like Hart-Scott-Rodino filings. We have moved towards exempting 8 to 10 percent of the transactions that are filed every year, because we have been able to identify a group that are just unlikely to involve any antitrust overlap of significance, saving small businessmen and others $45,000 and the acquiring person's fee.

We recognize that the occasional good natured but intense debate between the Antitrust Division and the FTC over who is going to be cleared to handle a matter had actually gotten out of hand. And we were sometimes taking 20, 22, 24 days of a 30-day waiting period under Hart-Scott forcing us, if we had any remaining questions about a transaction, to issue a second request once the matter was cleared to one agency or another. We've taken that time period and cut it down to under ten days in situations where actually we have a serious disagreement. In 98 percent of the transactions we do it in a matter of a couple of days. So we basically have been able to free up more time for us at the two agencies to deal with you and your clients and try and get a handle on industry in about 25 or up from 20 days, and I found at the Commission, and I'm sure it is true over at the Division, we are getting rid of matters in the first 30-day waiting period that two years ago we would have issued a second request on because we just weren't sure. That extra week or week and a half makes all the difference and allows us to focus in on problems that matter, to apply our scarce resources more effectively and save the business community unnecessary costs and delay in connection with the transaction that we ultimately would have cleared anyway.

We have in the last year adopted a sunset policy designed to get rid of old orders after 20 years. Initially, before I arrived you could come in and petition to have the order removed. We have basically in the last two months made that an automatic process. So there will be literally thousands of old orders that are off the book. Many of you who do merger work will know that a distinction that had grown between the Antitrust Division and the FTC was the FTC's insistence on a prior approval order where we challenged the merger. We demanded that as part of our relief that before you made a transaction in that market again you had to come in, file a petition and get prior approval. That made brilliant sense when we didn't have Hart-Scott-Rodino. But if you're going to have to file on the

transaction anyway, about the only benefit we got out of it was that we got a little more leverage. You know, you couldn't do it until the Commission said okay. But that meant for your clients whose matter, unfortunately, was cleared to the FTC or wound up at the FTC and tried to make a second transaction, you weren't able to be as fast afoot in the marketplace. And given that we had Hart-Scott, Hart-Scott works, and basically is an efficient time-sensitive process, we decided we could rely on that principally, and for the last six months or so have been in the process of taking old prior approval provisions off the books.

Those are just a couple of examples of things we have done and things we need to do. For those of you who have ever had the fortune or misfortune of being involved in an FTC Part 3 administrative adjudication, those things have gotten so bogged down it takes forever to get from here to there. And if that process is going to work, if it is going to be an important part of how we enforce our law, which I think it ought to be, we need to expedite it; we need to find ways to streamline it and to force people to join issue quicker. We are in the process with our general counsel, Steve Caulkins, doing a fundamental re-examination of how we litigate administratively. And we are going to come up with some proposals that will put both respondents and complaint counsel to the test in terms of trying to get a matter done quickly and much more efficiently.

Now, the third issue I raised is whether antitrust enforcement is sufficiently forward looking, and whether it takes into account changing market realities. We have done some things, many of them together with Antitrust Division, that suggest that we are sensitive to those issues. The Guidelines that have been jointly issued by the Division and the Commission, not just the '92 Merger Guideline, but the Intellectual Property Guidelines, the International Guidelines, the Health Care Guidelines, all reflect a sense that better guidance to you provides your clients as a more efficient and effective way for us to go about and do our job.

But perhaps the most important thing that is going on at the Commission right now are the hearings that Bob Pitofsky commissioned this fall. We have taken a hard look at antitrust and where it is and where it's going. There really are about 11 issues that I think we focused on during about two and a half months of hearings on both antitrust and consumer protection issues. We looked at measurement of market power, at entry issues, the ability of firms to enter new markets, the treatment of efficiencies in both the merger and the nonmerger area, the treatment of efficiencies in innovation markets. And we looked at failing firms in distressed industries. We looked at the impact of antitrust and consumer protection laws, small business, the relationship of antitrust, intellectual property. We looked at foreclosure access and efficiency issues relating to networks and standards. We looked at strategic conduct in the context of innovation based competition. And then we looked at cross border issues involving both consumer protection and antitrust. And finally we looked at agency process: What is it that we are doing that works, and what is it that needs some correcting?

We went in without a predetermined sense of where we were going to come out. We were stunned by the level of participation, the level of interest, and the quality of the testimony we received. This was really returned to one of the Commission's historic missions as a forum for people to discuss antitrust competition policy, not in the context of a specific case, but more globally.

What have we learned and what are we going to do with what we learned? You'll have to stay tuned for a complete report. We are in the process of analyzing the testimony and comments. But let me just say we will be issuing a report sometime probably in the May to June time frame. I think the report will say that in many areas antitrust enforcement has it about right. We are certainly not going to take the position that

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