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BAR ASSOCIATION**

**1998
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LAW SECTION
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**January 29, 1998
New York Marriott Marquis**

NEW YORK STATE BAR ASSOCIATION
ANTITRUST LAW SECTION

ANNUAL MEETING

Thursday, January 29, 1998
New York Marriott Marquis
New York City

New York City

Section Chair

BARRY J. BRETT, ESQ.
Parker Chapin Flattau & Klimpl, LLP

Program Chair

MICHAEL MALINA, ESQ.

Kaye Scholer Fierman Hayes & Handler, LLP
New York City

Dinner Speaker

HONORABLE JOEL I. KLEIN
Assistant Attorney General in Charge of the Antitrust Division
United States Department of Justice
Washington, D.C.

TABLE OF CONTENTS

**ANNUAL REVIEW OF
ANTITRUST DEVELOPMENTS1**
William T. Lifland, Esq.

**RECENT DEVELOPMENTS IN MERGER ENFORCEMENT
AT THE FEDERAL TRADE COMMISSION6**

Moderator: Michael Malina, Esq.
Kaye Scholer Fierman Hays & Handler, LLP
New York City

Panelists: Honorable William J. Baer
Director, Bureau of Competition
Federal Trade Commission
Washington, D.C.

Kenneth R. Logan, Esq.

Simpson Thacher & Bartlett
New York City

Dr. Richard T. Rapp

President, National Economic Research Associates
White Plains

**HEALTH CARE, COMPETITION AND NEW YORK'S
HEALTH CARE REFORM ACT18**

Moderator: Martha E. Gifford, Esq.

Proskauer Rose LLP
New York City

Panelists: Michael J. Bloom, Esq.

Director, New York Regional Office
Federal Trade Commission
New York City

Barry J. Brett, Esq.

Parker Chapin Flattau & Klimpl, LLP
New York City

John E. Franzen, Esq.

Associate Attorney
New York State Department of Health
Albany

Linda J. Nenni, Esq.

Vice President and General Counsel
CGF Health System
Buffalo

Dr. Monica Noether

Vice President
Charles River Associates Incorporated
Boston, Massachusetts

Francis J. Serbaroli, Esq.

Cadwalader Wickersham & Taft
New York City

PRESENTATION OF THE ANNUAL AWARD

SECTION BUSINESS MEETING, ELECTION OF OFFICERS AND MEMBERS OF THE EXECUTIVE COMMITTEE

SECTION CHAIR BARRY J. BRETT, ESQ.: Ladies and gentlemen, if I can ask you to take your seats. We have a brief bit of business to attend to, and then we can get to the more substantive parts of the meeting. The first order of business, and indeed the only order of business today, is to present to you the report of our Nominating Committee for the officers and members of Executive Committee for the coming year. I will tell you that they do not begin to take office until after tonight's dinner. The Nominating Committee's report is as follows: The nominee for chair is Michael Malina; vice chair, Robert L. Hubbard; for secretary, Martha E. Gifford; for members of the Executive Committee, the officers and the following attorneys: Kevin Arquit, Barry Brett, Ned Cavanagh, Bruce Colbath, Dale Collins, Lloyd Constantine, Steven Edwards, Larry Fox, Peter Greene, Pamela Jones Harbor, Steve Houck, Norma Levy, Ken Logan, Bill Lifland, Steve Madsen, Ira Sachs, Alan Weinschel and Vernon Vig. That is the report as presented by Alan Weinschel, the chair, and I would ask for a motion to accept the committee report in its entirety.

MALE SPEAKER: So moved.

MR. BRETT: Second, Michael?

MR. MALINA: Sure.

MR. BRETT: All in favor.

(Audience said aye.)

The nominating report is accepted, and the officers will take office tonight. Thank you, and with that I will turn the program over to our program chair, Michael Malina.

PROGRAM CHAIR MICHAEL MALINA, ESQ.: Thanks for coming. Every year, for as long as the mind of man goes back, this association has had the privilege of hearing a review of the year's antitrust developments from Bill Lifland. Anyone who has heard them or read them—and the published remarks usually come out a few months after this meeting—knows not only of the pertinence, but of the high quality of the discussion, and it's my pleasure this year to introduce Bill for the 1997 antitrust review.

ANNUAL REVIEW OF ANTITRUST DEVELOPMENTS

WILLIAM T. LIFLAND, ESQ.: Thank you, Mike. My wife made me promise not to tell any Monica jokes, but I can't resist.

One of the female commentators on National Public Radio said this morning that we should all be careful about casting the first stone, that when she was 21 she might have been quite willing to make love to the President of the United States, but it was Richard Nixon.

Well, I put in the back of the room a list of cases which seem to me to be some of the most significant cases. If those lists are all gone, there are some more up here at the end of the table. If I have left out any of your favorite cases, such as cases you've won, I apologize in advance. It's very hard to say that some of the cases are more significant than others. So, I'd better get started.

The 1997 antitrust developments were upstaged by the Supreme Court's decision overruling the 1968 *Albrecht* case. *Albrecht* had held that resale price maintenance agreements were *per se* unlawful. The private antitrust bar has long viewed *Albrecht* as an aberration. Applying the *per se* rule to conduct which seems likely to be pro-consumer and pro-competitive is, of course, contrary to the principle relegating *per se* treatment only to practices which are always or nearly always anti-competitive.

Now, in rejecting the *per se* rule for maximum resale price maintenance, the court left open the possibility that these agreements could be held unlawful under the Rule of Reason. However, since the tendency of price ceilings is to make products cheaper and thus more competitive, it seems unlikely that this will happen. Much more likely it is that the court's apparent willingness to analyze resale price practices in light of economic effects will spur new challenges to the rule that minimum price fixing agreements are *per se* unlawful. There will be some who say that all vertical price agreements, not just agreements on maximum prices, should be governed by the Rule of Reason. They will point out that the law's distinction between minimum price restrictions and other restrictions on dealers is not uniformly recognized as a sound one. They will argue that if some are governed by the Rule of Reason, all should be. But they are sure to run into vigorous opposition from the state attorneys general, most of whom vigorously expressed their opposition when the Department of Justice made a suggestion like that to the Supreme Court when the 1984 *Monsanto* case was pending. And the FTC's *American Cyanamid* decision, which came in 1997 and which came down shortly before *Albrecht*, suggests that the FTC would stand with the states on this issue. The FTC struck down a program that provided rebates only to dealers who sold at or above

stipulated minimums, noting that the dealers would have incurred losses in the absence of rebates, so that the program assured that the minimum prices would be observed.

In the area of horizontal restraints, 1997's major development, in my view, is the trend toward much larger fines, making participation in price fixing and other cartels many times more expensive than in previous years. This emphasizes the importance to firms, which may become entangled in such difficulties, the importance of having a well-run compliance program, both to avoid such entanglements and, if unsuccessful at doing so, to provide basis for mitigating penalties.

On a more technical level, there were some interesting cases dealing with requirements of proof. In holding a trade association of interpreters had violated the law, the FTC stated that the association's rules with respect to fees and travel expenses were *per se* illegal without regard to any possible benefits, but that the rule of reason applied to its non-price-related policies such as length of workday and size of interpreter teams. To find the so-called non-price related policies illegal, the FTC said there must be proof of either market power, or in the absence of market power, clear anti-competitive effects, neither of which had been shown.

A more conventional statement as to requirements of proof was made by the Ninth Circuit in an earlier case. There was less emphasis on market power. The court stated that the plaintiff must come first to prove significant anti-competitive effects. The defendant can then show offsetting pro-competitive effects, and if it does, the burden returns to plaintiff to show that the pro-competitive objectives could have been achieved in a substantially less restrictive manner.

There was also an interesting decision on the type of proof required to establish a conspiracy. The Tenth Circuit, sitting in *en banc*, reversed a circuit precedent according to which a contract imposed on a reluctant buyer was held not to satisfy the requirement of concerted action. The Tenth Circuit's new ruling—that requiring agreement from another goes beyond unilateral action—was stated to be in harmony with the law of the Seventh and Ninth Circuits.

Market definition issues arise throughout the antitrust spectrum, influencing the outcome of all sorts of cases. In a pizza franchising case, the franchisor was charged with violating the law by requiring franchisees to purchase ingredients and supplies only from the franchisor or approved suppliers. The plaintiffs alleged that the relevant market consisted of supplies and ingredients used in the franchise stores.

In affirming the dismissal of the franchisees' claim, the Third Circuit stated that the relevant market could not be restricted solely to the products used by the franchisees, but they must include other reasonably interchangeable products sold outside the franchise system. The court rejected the argument that the Supreme Court's 1992 *Kodak* decision meant that the relevant market could be limited to products the franchisees were contractually "locked in" to buying. A Georgia federal court took the opposite view in an ice cream, franchise case, reading *Kodak* to distinguish between the range of choices faced by customers with no prior commitments and the narrower range of choices open to them once they had committed themselves, in *Kodak's* case to a particular brand of copier, and in the franchising context, to a particular franchise. According to the Georgia court, *Kodak* allowed approval of a narrower market where information and switching costs might allow the seller to exercise market power within that market, that is, to charge supracompetitive prices for the products concerned.

In *dictum* the Sixth Circuit seemed to support the Georgia court's view, commenting that if there were evidence that a supplier had taken advantage of its customers' imperfect information to extract more than competitive profits, it would not hesitate to allow a claim based on power in that market. Plaintiffs, of course, generally seek narrower markets, which may appear artificial. The Seventh Circuit was very critical of one such attempt. A suit was brought by a peanut vendor against a sports stadium which did not allow patrons to bring food into the stadium. The peanut vendor charged the stadium with an attempt to monopolize, claiming the relevant market was one for food consumed at the stadium. The court commented that the price and output of peanuts in any geographic area that could be meaningful under the antitrust laws was totally unaffected by the stadium's policies. As a *reductio ad absurdum*, it stated that if plaintiff's theory was right, fine restaurants could not require patrons to buy their wine from the restaurant rather than from others.

Acquisitions. Market definition is also a key issue in acquisition cases. This was the situation in the year's most publicized acquisition case, which involved a proposed merger of two office supply superstores, Staples and Office Depot. The court accepted the FTC's position that there was a submarket consisting of such superstores, relying mostly on three kinds of evidence: that the superstores charged lower prices in areas where other superstores existed, that they were different in appearance and format from other sellers of office supplies (with larger sales areas and wider ranges of items stocked) and that the parties' internal documents focused on other superstores as their primary competition. Although they held only a 5 percent share of the broader market encompassing the sale of consumable office supplies by all sellers, the merging parties had a dominant share of the "superstore" market, and this led

to the issuance of a preliminary injunction. The view that a particular channel of distribution may constitute a relevant market is, of course, not new. This view underlies many government challenges to acquisitions of pharmacy chains, for example. However, the case for defining pharmacies as a relevant market is stronger because a pharmacy is often a consumer's only practical source of emergency drugs (as distinguished from maintenance drugs, which are readily available through mail order plans). It does not necessarily follow that each channel of distribution should constitute an antitrust market. The year's most interesting acquisition cases, although not the most widely publicized, were two hospital rulings. One involved Long Island institutions: Long Island Jewish Medical Center and North Shore Health Systems. In that case the government claimed that the merging hospitals were two of the few major acute care hospitals in the area capable of serving as anchors, or flagships, for managed care networks. It sought to restrict the relevant market to potential anchor hospitals. The court found that the evidence did not establish that the primary and secondary care services available from these hospitals were unique. More significant, perhaps, was the court's determination that the plaintiff's expert testimony as to the likelihood of a post-merger price increase was unsupported evidence. Among other reasons for discounting any such likelihood, the court cited the non-profit status of the hospitals and the competition generated by the tendency for Manhattan hospitals to expand on Long Island. The court also found that operating savings of \$25 to \$30 million a year were likely from the transaction, and that given an agreement between the hospitals and the state Attorney General, it was reasonably certain that these efficiencies would benefit consumers.

A pledge to benefit consumers with cost savings was also instrumental in a case involving a merger of two Michigan hospitals. The FTC had made a *prima facie* showing of illegality based on statistical evidence. The district court found that this showing was rebutted by other evidence tending to show an absence of harm to consumers. The evidence fell mainly into three categories. First, the court cited studies which purported to show that, in the case of non-profit hospitals, increased market shares were associated with lower prices rather than higher prices. Second, the court concluded that the merged entity would not have economic incentives to raise prices, since its board would be comprised of executives of local employers paying health care costs of local employees, and thus were incentivized to keep costs down. Third, the hospitals had committed to a price freeze, made possible by projected cost savings of more than \$100 million, and consumers should therefore benefit. The Sixth Circuit rejected the FTC's argument that evidence of consumer savings should not overcome a *prima facie* case of illegality. The court said it agreed

with other courts that a direct examination of consumer welfare was appropriate under section 7 of the Clayton Act.

The definition of relevant market also frequently determines the outcome of monopoly cases. In 1997 the most interesting monopoly cases appeared to turn more on the nature of exclusionary conduct that was alleged. One such case was the Ninth Circuit case affirming in part a \$72 million damage award that was obtained by the plaintiffs after remand of the 1992 *Kodak* decision mentioned earlier. Among the most significant points in the court's decision was that the jury was properly instructed that it was illegal for equipment suppliers to maintain a monopoly by engaging in conduct (such as refusing to supply parts to independent repairmen) that unnecessarily handicapped competitors in servicing the equipment. Qualifying this ruling, the Ninth Circuit also stated that such exclusionary conduct by a monopolist would not be actionable if supported by legitimate business justifications. A desire to assert intellectual property rights was stated to be one such justification, but unavailing to the defendant because the jury would probably have rejected it as pretextual in the circumstances. But a Kansas federal court, in a similar case, found no such pretext and ruled that an equipment supplier's refusal to sell parts to independent repairmen was indeed permitted under the antitrust law because the parts were patented and the refusal to sell was therefore privileged.

Other examples of allegedly exclusionary conduct the courts found insufficient to constitute the maintenance of monopoly power were efforts to have purchase specifications written so as to exclude a rival, distribution of disparaging flyers about a competitor and hiring a key employee away from it and charging prices attacked as being unduly low. In finding the prices not predatory, the court relied on an affidavit of the defendant, which stated that the bid was not below-cost because capital expenditures would not be required to perform it. Alternatively, the court thought it implausible that the defendant could recoup any investment in below-cost prices since the bid contracts were short-term and subject to further public bidding on expiration.

In the case of defendants with less market power than that required to make out a case of monopolization or attempted monopolization, exclusive dealing requirements may still be attacked under section 3 of the Clayton Act or section 1 of the Sherman Act. Logic would suggest that a higher level of anti-competitive potential should be present to find this conduct unlawful where the defendant has little or no market power. Some 1997 decisions seem to be generally consistent with this view.

The Seventh Circuit affirmed dismissal of a newspaper's charge that licensors of news services and features unlawfully entered exclusive arrangements with other newspapers. The

court downplayed the anti-competitive potential of the arrangements, pointing out that there were at least three major supplemental news services and hundreds of features available to newspapers. It also observed that the traditional forms of exclusive licenses did not restrict entry at either the licensor or licensee level.

The Seventh Circuit also rejected a shoe retailer's antitrust challenge to its agreement to sell only shoes obtained from a particular supplier in order to continue using that supplier's trademark. The court ruled that the antitrust claim could not succeed under federal law in the absence of evidence that the affected retailers were the only outlets for shoes of other suppliers.

The Ninth Circuit reached a similar result in a case where distributors, accounting for 38 percent of sales, were bound by exclusive arrangements not to serve other suppliers. The court, finding this percentage significant but inadequate, pointed out that other suppliers had alternative channels of distribution available. These alternatives included both direct sales to end users and sales to servicing firms who were potential new distributors.

We now turn to cases involving the frequently asserted state action defense. As generally understood, the state action defense applies only where a state law has clearly articulated and affirmatively expressed a policy of displacing competition with regulation. Unfortunately, many regulatory statutes do not use precisely these words in authorizing state agencies to take specific action. In these circumstances it is natural to inquire whether the conduct challenged as anti-competitive was foreseeable when the state law was enacted.

In 1996 the Ninth Circuit withdrew an earlier opinion and ruled that the state action doctrine did not shield an agreement between two utilities recognizing exclusive service territories for each other. The court ruled that the state public utility commission, which had statutory authority to immunize such agreements, had not spoken with sufficient clarity when the agreements were made. The commission's later statement that it intended to confer immunity was ruled ineffective because retroactive clarification was not deemed sufficient. At the same time, the court retroactively corrected a lack of clarity in its own earlier decision, admitting that it had wrongly suggested that state action immunity was present mainly because anti-competitive impact was a foreseeable result of authorizing a state commissioner to review agreements. The court stated that it had since been persuaded by an *amicus curiae* brief filed by the Antitrust Division that it was error to appear to substitute a "foreseeability" test for the "clear articulation" rule. However, the lesson apparently did not take in sister circuits. Shortly thereafter, the Tenth Circuit ruled that a city ordinance was valid state action because it was foresee-

able that the city would enact anti-competitive legislation when it was granted authority to issue bonds to construct an airport. The Eighth Circuit added a further wrinkle when it held that an airport commission could validly impose a discriminatory fee structure. This was viewed as a reasonable and foreseeable consequence of authorizing the commission to impose fees, which in turn reflected a clearly articulated policy to regulate.

Well, now that we have clarified that subject, we turn to questions of enforcement. As to public enforcement, a significant decision came from the First Circuit. Deciding a “hitherto unanswered question,” the court held that a criminal antitrust case could be based on an agreement made in Japan to fix the price of fax paper sold in North America. The court said that the law conclusively established that *civil* antitrust action could be predicated only on wholly foreign conduct with an intended and substantial effect in the United States. Although it was unaware of any direct authority with respect to a *criminal* prosecution based solely on extraterritorial conduct, the court found that common sense as well as accepted statutory construction directed giving the same meaning to identical wording in a statute establishing both a criminal and civil offense.

Another government enforcement initiative turned out to be one of the most widely discussed antitrust proceedings in years. To resolve issues raised in antitrust investigations over an extended period, a 1995 consent decree between Microsoft and the Antitrust Division imposed a number of limitations on Microsoft’s licenses to computer manufacturers. One such limitation was that Microsoft would not condition operating system licenses on licensing any “other product.” A proviso stated that Microsoft was not barred from developing “integrated products.” In 1997 the Antitrust Division accused Microsoft of violating the decree by including its Internet Explorer program along with its Windows operating system in software packages licensed to manufacturers. The district court treated the dispute as turning on whether Internet Explorer was an “integrated” component of the operating system or, instead, an “other product.” On this issue Microsoft appeared to prevail at the outset. The court stated that the term “integrated” was ambiguous, and no finding of civil contempt was warranted on the record before it. Yet, the court went on to order discovery and hearing on the Antitrust Division’s claim for permanent injunctive relief, observing that the court was preliminarily inclined to agree with the division’s interpretation of the decree. The court went further and entered a preliminary injunction, finding that the division appeared to have a substantial likelihood of success on the merits.

There ensued a period of confusion when Microsoft asserted it was complying with the injunction by offering cus-

tomers the option of buying a version of its operating software which had been partially impaired by removal of all Internet Explorer codes. This provoked a renewed contempt application, which was resolved by a compromise that Microsoft need remove only an agreed part of the Internet Explorer code pending further hearing. It seems likely that the appellate court will determine, perhaps following a hearing scheduled for April 1998, whether the wording of the consent decree allows the Antitrust Division to get the relief it seeks.

Another controversy arose over the Tunney Act’s stipulation that a court, before entering a judgment settling a government antitrust claim, must find the settlement to be in the public interest. At the time the Microsoft decree was proposed, a district judge deemed it insufficient and refused to enter it. This led to an appellate opinion laying down standards for district courts to apply in considering proposed decrees. Applying these standards, another district court refused to enter another decree. The case involved the legality of a merger of legal publishers. One of the publishers had asserted copyright claims against third parties which the complaint treated as a barrier to entry into the publishing markets concerned. The decree would have required the copyright owner to offer licenses to third parties. The court viewed the licensing proposal as not going far enough to eliminate the barrier to entry, as it would have required the third parties to incur litigation or royalty expense to deal with claims the court deemed questionable. The proposal was later amended to the court’s satisfaction, thus avoiding any issue as to whether the court had exceeded the scope of permissible review of proposed government decrees.

With respect to private enforcement, there continued to be a number of decisions which you could broadly characterize as cases involving inadequate proof of necessary effects. The proof may show only effects differing from those the antitrust law was directed against; in this case, the courts often say there is no antitrust injury. The proof may show only harm to the plaintiff rather than harm to competition generally; in this case the courts often say that an element of the violation has not been proven. Or the proof may show that plaintiff’s harm is only indirect, and there may be others more directly impacted. If the causal relationship between violation and harm is weak, the fact of damage as well as the existence of standing may be drawn into question.

Several appellate courts applied those doctrines in 1997. In one case the Third Circuit ruled that a sales representative whose principal terminated his program because of complaints from other channels of distribution had failed to show antitrust injury. The harm was said to be not of a type that the antitrust laws were designed to prevent, inasmuch as the plaintiff was neither a competitor nor a consumer in the relevant market.

The Eleventh Circuit also rejected a distributor's challenge to the merger of two manufacturers of garden products. Acknowledging that mergers often have an adverse effect on distributors made redundant, the court stated that such a loss would not constitute an antitrust injury because it did not flow from that which made a merger unlawful. The court also stated in *dictum* that the distributor would not be an efficient enforcer of the antitrust law; the direct purchasers of the products concerned were said to be the proper parties to challenge the acquisition.

The Second Circuit also seemed to suffer that the possibility that others might step in to preserve competition warranted rejection of a claim to antitrust standing. A party sought to have a trademark settlement agreement modified to remove limits on the markets in which it could use its marks. The court refused, holding that no antitrust violation had been established. One of the grounds of decision was there was no evidence to support the theory that only the plaintiff was capable of competing against the defendant in the markets concerned.

The Eighth Circuit ruled that judgment as a matter of law ought to have been granted to a radiology partnership which a jury found had engaged in anti-competitive behavior against a former partner. The court stated that the former partner had failed to prove that the anti-competitive conduct was a substantial contributing cause of his damages. According to the court, the record showed that the plaintiff's damages were caused by his unjustified refusal to pay other radiologists to cover for him when he unavailable.

Similarly, the Third Circuit affirmed a summary judgment against a law school challenging the American Bar Association's standards for law school accreditation. Among plaintiff's claims of injury was the assertion that ABA accreditation standards increased the cost of faculty salaries. The court observed that this claim of injury was in conflict with plaintiff's assertion that it had refused to comply with the standards.

The Sixth Circuit upheld a judgment in favor of hotel franchisor which decided to reduce the number of manufacturers licensed to apply its trademarks to amenities (such as soap) sold to franchised hotels. The plaintiff supplier, after losing its license, claimed that tying arrangements between the franchisor and the franchised hotels prevented suppliers from selling directly to the hotels without a license. The Sixth Circuit indicated that plaintiff's loss of amenity sales flowed directly from the cancellation of its trademark license. The court stated that this loss would have been suffered whether or not the franchisor made tying arrangements with franchisees. Accordingly, the antitrust violation was viewed as not a "necessary predicate" to the plaintiff's antitrust injury. The court added that the antitrust injury doctrine was a "mainstay in the rather arcane network of doctrines by which the courts have attempted to confine antitrust litigation to economically rational limits."

"Arcane" is an apt word to describe this network of doctrines. The word suggests, and rightly so, that it is timely to undertake a systematic review of the private antitrust remedy, to reconsider what types of antitrust claims should be pur-

RECENT DEVELOPMENTS IN MERGER ENFORCEMENT AT THE FEDERAL TRADE COMMISSION

MR. MALINA: Our second topic this afternoon is Merger Enforcement at the Federal Trade Commission, and we are very fortunate to have an eminent panel of speakers. No one could be more highly qualified to talk about merger enforcement at the Federal Trade Commission than the Federal Trade Commission's chief enforcer, who is the gentleman to my right, the Honorable Bill Baer, who is the director of the Bureau of Competition at the commission. To his right is Dr. Richard Rapp, who is an eminent antitrust economist and President of National Economic Research Associates. And to his right is Ken Logan of Simpson, Thacher & Bartlett in New York, who has probably done as many mergers at the Federal Trade Commission as any lawyer I know.

We are going to be talking about a broad range of topics with a particular focus on the development of ideas as to how to deal with mergers that are perceived to threaten future innovation, the so-called "innovation market" analysis. And while I hope that I'll be nothing more than a mediator here, I do want to put on the public record my absence of impartiality in that I represented Ciba-Geigy and Sandoz in the matter which led to the *Novartis* consent decree, which is probably the most significant, if not the most notorious, application of this doctrine. The first speaker we'll hear from is Bill Baer.

HON. WILLIAM BAER: I'm delighted to be here, Mike, and to have an opportunity to talk a little about merger enforcement at the commission. My thought was to give a little background about where we are generally on mergers, talk about our approach to this notion of innovation markets and then pass it on to my co-panelists, and maybe we can get into a little heavy lifting back and forth after we are all done.

The obvious and most significant aspect of what's going on in Washington on the antitrust side these days is the pace of merger activity. It is off the charts. In 1991 Hart-Scott-Rodino filings were at a pace of about 1,400 per year. In 1997 there were 3,700 plus Hart-Scott filings. The pace for the first quarter of fiscal '98, the quarter that ended December 31, would set a third consecutive record of about 4,800 filings for fiscal '99. So the work load is crushing, and it's more significant than the numbers might show, because we've had peaks in the merger activity in the economy in the past. In the eighties we got close to 3,000 filings in one year, in 1987 or '88, but a lot of those mergers were different. They were driven by the desire to buy conglomerates, get the breakup value of the companies, finance it with junk bonds and get hold of the cash flow. There were fewer, a smaller percentage of, strategic transactions going on.

There was an interesting story in the [*Wall Street Journal*] a few weeks ago that many of you probably saw about this drive on the part of firms to be number one and number two in the market. It's not worth being there unless you're in a leadership position, and that makes a lot of sense as a strategic objective. But if in fact that's what firms are doing in the marketplace, that means the likelihood that an antitrust issue would arise is greater. And so we are coping with a whole lot more filings than ever before and a whole lot more important transactions. You couple that with deregulation in communications and the energy and financial institutions sectors and the result is just a tremendous wave of transactions that require the commitment of time and resources, both by the Antitrust Division and by us.

You saw in the last three, four weeks we had two major matters, one in the energy sector involving Shell-Texaco, which had formed a joint venture, a limited liability company pooling most of their U.S. assets. After a fairly extensive investigation, we worked out a deal with them to address some problems in the western and northwestern United States and in Hawaii involving divestiture of a refinery up in Washington state, some wholesale and retail asset divestitures in California and some comparable divestitures in Hawaii. An aspect of that transaction investigation is the degree of close cooperation that we saw with the states. There were, I believe, four different state attorneys general involved in Washington, Oregon, California and Hawaii. All had an understandable focus on potential competitive effects in their respective jurisdictions, and we worked very hard to try to develop a common understanding of facts and a common position, and entered into coordinated negotiations with the parties. This was an approach the parties very much looked for. And by our ability to agree on what we needed to resolve, the various concerns, we were able to reach a bottom line in which all of the four states involved and the commission achieved relief that was the same. It is a good example, I think, of how as a general rule federal-state cooperation has improved over the last six, seven, eight years. States take a lot of credit for that improvement and our predecessors at the division, Jim Rill and Janet Steiger at the FTC, also deserve to be commended for it.

A second matter of some interest and significance was the commission's resolution of the Guinness-Grand Metropolitan merger, which I believe was one of the largest mergers in history in terms of overall value. We looked very closely at the distilled spirits market, where both Guinness and Grand Met were market leaders and had to work through some tough issues about whether scotch competes with bourbon competes

with gin competes with vodka. We decided that the companies certainly didn't think so, not in terms of how they price. We also made a more refined judgment about whether, particularly with respect to scotch and gin, there were unique market segments within those categories. And as to both, what we found is that the parties systematically priced their premium scotch products and their premium gin products against each other and not against other scotches or gins and not against other brown or white spirits, respectively. And we ended up concluding that a divestiture was required of the Dewers brand on the scotch side and Bombay and Bombay Sapphire in the premium imported gin market. The analysis in this case was difficult. We didn't have, as we often do in a case where we're looking at retail sales, good, particularly reliable econometric evidence. We didn't really have statistically helpful analysis that would inform us as to cross-elasticities of demand. And so instead we looked to information we could get out of the market, information we could get out of the marketing strategy documents of the companies and their pricing behavior and made our decision based on that information.

One interesting aspect of it is there is this sense, for those of you who follow the trend since the '92 merger guidelines, people think that econometric modeling is driving everything the division and commission does. And we're using that tool wherever we can, but getting the data that produces good results is a difficult task. Building a model that we can feel highly confident with and points us in the right direction is not easy. And as a general matter, I think both agencies are using the econometrics as part of a traditional investigation where you look to what the parties do and say in their documents at the time, as well as to third-party evidence, and then attempt the best econometric analysis you can do.

Another significant aspect of that deal was the international cooperation. There has been discussion about how the commission and the U.S. government in the Boeing-McDonnell Douglas transaction got crosswise with the European community. That was understandable, I think, given the different perspectives on each side. But the fact of the matter is, in most transactions, our record of cooperation is terrific. And indeed in this case we had a series of meetings throughout the course of our investigation and said, well, we can't share the confidential information we've obtained from the parties or from third parties in the absence of some sort of waiver; we can talk strategically about where we are headed, where we think our analysis is going or is likely to go and we can talk about what remedies, if the facts bear out, we're likely to need. And we were able to do that very effectively both at Brussels, at DG4 and with the Canadian authorities. In this case the Europeans went first, and the only problem they found was in the scotch market; they obtained a divestiture of the rights to Dewers in Europe. We secured the same relief but on

a world-wide basis as to Dewers. We reached a similar divestiture agreement as to gin.

Two weeks ago, a week after we were done, I received a letter from the Canadian competition authorities indicating that the cooperation had worked as well as anyone could ever expect. And because our relief had been closely coordinated to what their interests and concerns were, they didn't need to go through the process of imposing any kind of decree on the parties. This was a result the parties welcomed, and the Canadian authorities welcomed, because it simply meant freeing up resources more quickly and devoting them elsewhere.

So the bottom line is, there's a lot going on. It's busy. We are strapped for resources like you wouldn't believe. I mentioned that we had 1,400 merger filings back in 1991. We have the same number of workers, the same number of people working on antitrust matters at the agency in '91 as we do today. And so we really had to stretch and make some tough calls; we have tried to become more efficient. But it's a struggle to get it all done. And for those of you who deal with us on a daily basis and know that sometimes we are not as quick on the turn-around as we'd like to be, it's simply because we are stretched a little beyond the breaking point.

I know that my distinguished panelists have a lot of thoughts on innovation markets. In '92 when the merger guidelines were revised, the notion of innovation as an aspect of competition that might warrant antitrust challenge to a merger first surfaced, and the rationale underlying it is something that I think the business community widely recognizes, especially in high-tech markets. Innovation as a form of competition is critically important. You see it in high-tech markets, sometimes as more important than price competition. In computer markets, it's the person with the faster computer, the innovator who gets the price, and the others fall behind; that it is product quality attributes and the new idea, the better idea, that seems to pay off in the marketplace. We have seen over the years an increasing emphasis on innovation competition. In the course of the last four or five years, the antitrust agencies sought to develop a concept, an analytical framework, for dealing with markets that involved innovation, the potential for future goods competition, and that concept is reflected in the '92 guidelines. It's also reflected in the intellectual property guidelines that were adopted in early '95, shortly before I came to the commission. So I get no credit, and more importantly no blame, from these panelists, at least for those ideas. But one thing they can blame me and the agency for is the implementation of those ideas.

We have tried, in looking at mergers that call for the combination of research and development assets, to figure out whether there is a potential impact on current day competition to innovate, to come up with the next best idea, as well as a

potential impact on competition in the future market, the today non-existent markets for the goods. Mike Malina mentioned the Ciba-Geigy-Sandoz matter; that's a classic example of how we have used innovation market analysis to take a look at potential anti-competitive effects from mergers involving firms with R&D. What we found in Ciba-Geigy-Sandoz was that those two firms were the two leading firms in developing new drugs using gene therapy, where a gene is injected into a cell in an effort to basically change the behavior of the cell. These two firms were approaching gene therapy using some legitimately acquired patent rights but using different techniques. One was using an in-the-body form of treatment, the other was using an ex vivo form of treatment. It looked, even though it was five to seven years away from there being actual competition among these products after FDA approval, that these therapies would be very much in competition with one another. The promise for these drugs is tremendous for treating various forms of cancer and for treating the graft versus host disease that people who receive bone marrow transplants have to confront. There was a tremendous market beginning sometime after the turn of the century for these things, and it's growing exponentially. And the question for us was: Was it potentially anti-competitive for these two firms to pool all of those intellectual property rights and go forward as one united company? Well, we did our homework, we went around and talked to scientists; we talked to third parties and we talked to the FDA. And what we found were these two firms were pretty uniquely positioned. They possessed the intellectual property rights, so they each probably could get to market without being blocked by one another, but just about anybody else would have to come to them and seek a license. So, the concern was that as to the future goods, there likely would be a monopoly position. But the concern also was that combining these assets today potentially might diminish the competition to innovate. One of the things that happens, particularly in the high-tech pharmaceutical area, is there is licensing competition that goes on before the goods are created. Firms are trying to exploit their ideas. If they don't have the capital necessary to exploit them all, they'll license others and reap the benefit. If one firm controls all of the patent rights, if one firm controls all of the intellectual property rights, that licensing competition, which is real, present day competition, is eliminated. Based on that analysis, we concluded that there needed to be some sort of remedy that would create, if not the status quo ante, at least take that same pool of intellectual property rights that the merged firm would possess and have somebody else in a comparable position, so that the competition that previously existed between Ciba-Geigy and Sandoz would exist post merger. And that's the relief that we negotiated while basically drawing some blood, I think, from one another over the course of time.

MR. MALINA: We're still breathing.

HON. WILLIAM BAER: Still breathing, right, and the bruises have healed in that case. And I think it was a legitimate and important act to protect both present day and future competition. We'll hear from others on the panel about whether this method of analysis looking at effect on innovation is the right way to go, or whether we ought to just look ahead to the future product market and apply an actual potential competition standard to decide when to act and not to act. And frankly, there's a legitimate debate that goes on about what the right framework for analysis is. But for me the bottom line is in the cases where we've used innovation market analysis: Have we done more good than harm when we've gone after mergers in the pharmaceutical area? For example, Glaxo-Wellcome involved the combination of two firms that were marketing an oral form of migraine drug treatment. Both were in the FDA pipeline—I guess one was actually through the pipeline, one was close to market. Would there be a suppression of competition? Would there be a potential anti-consumer effect? If you look at the cases that we brought, most people would agree that we did the right thing. There is risk, I suppose, that using innovation market analysis is a sloppy concept, basically making some fairly aggressive assumptions about how few firms there are in the market, that there is some risk that one would act too soon and prevent a combination of firms that would produce real efficiencies. But if you look at the sorts of cases we brought—both at the FTC and at the Antitrust Division—they tend to be cases where just two or just three firms have these intellectual property rights, these committed R&D research efforts. In those cases I think the risk that we are doing more harm than good has really been quite low.

In any event, why don't I stop there, turn it back to Mike, and maybe we can get into some of these issues as we go forward.

MR. MALINA: Yes, I'm hopeful that we'll be able to have some time for questions from the floor. But I think the best way to proceed would be to put some more ideas on the table, and we'll turn to Dick.

DR. RICHARD T. RAPP: Given the nature of antitrust economics and its fundamentally unexciting quality, it always struck me that if I could be really contentious about a subject like this, it would make for a more satisfactory discussion. And for those of you who may have had occasion to read an article I wrote about the misapplication of the innovation market in an approach to merger analysis in the *Antitrust Law Journal* or heard me speak about this subject a year-and-a-half or two years ago, you might be looking forward to just that sort of approach. I haven't grown weary, I assure you. But I must say that I have modified my own views, and partly that has to do with just the sort of moderate and discriminating enforcement

that we have seen from Bill Baer, among others at the FTC, which is the chief user of the innovation market concept, primarily because of its responsibility to look to supervise mergers in the pharmaceutical industry. Although, of course, there have been other industries to which this has been applied. So you'll find me rather more mild mannered, and I hope not too boring as a result of that.

MR. MALINA: It's not too late to withdraw your invitation you know.

DR. RAPP: But to compensate, I will be quick, or try to. What I'll do is give you a very quick overview of the critique, and then spend a couple of minutes on the pharmaceutical industry itself, talk about what it is that is causing these mergers to happen, including the up-to-the-minute ones, and see where the innovation market approach fits into what's going on in the industry. And finally, I will answer the question that is perhaps most intriguing to nobody but me, and that is: Why does the pharmaceutical industry—the primary target of this and an industry that is highly sensitive to public policy issues—why does that industry not care a whit about this? Why haven't we heard from them on this subject? And maybe there's something to be learned from that.

I hope you did see it, but I'll say it anyway, this is my basic objection to the innovation market approach. And it is basically a theoretical objection. Bill referred to an analytical framework, and my fundamental problem is that I do not believe that there is one. If you know the pattern of the innovation market approach to merger analysis, you know that it imitates and parallels very closely the conventional market definition procedure that is used in product markets: identifying overlapping products, finding out who is available, applying a thought experiment that involves a reduction in R&D expenditure instead of an increase in prices. So that they look very much the same. And my basic objection is that while the merger guidelines' product market definition analysis is well-grounded in theory, much of the innovation market analysis approach is not. And the specifics of that are most fundamentally that there is no predictable connection between the number of R&D competitors and the level of funding associated with R&D and no predictable connection between the level of funding of R&D and the rate of innovation in an industry. The research and theory simply do not bear out those relationships.

The next problem that I have is the problem of the false positive; that is that the agency using this approach might interdict—well, not interdict a merger because it never comes to that. There's always a caving in, always, and perhaps somebody else will speak to that. I will not. What happens as a result of that is either compulsory licensing or divestiture of a project. My problem with that is, in many innovation market cases, there are no actual product markets to look at. And judg-

ments about the future course of innovation are sufficiently uncertain so that it really is not possible to know beforehand whether or not you can say that what's going on when you identify an innovation market problem really is one down the road or will materialize into one in the goods markets eventually, which is where consumers' interests come into play. And finally, this analogy between product markets and innovation markets or R&D markets is a poor one, and the most important of these points is simple. If you observe a product market that is in danger of a substantial lessening of competition, the danger is that prices will go up, output will be restricted, and that is an unequivocally bad thing for consumers at any rate. There's no good that comes out of those two outcomes. It is simply not so in research and development. As you can imagine, there are perfectly good reasons that we'll go into in a minute for cutting back R&D, and one cannot simply say that *ex ante*, looking at it beforehand, whether those are good or bad. So that's the critique in a nutshell.

Now, let's take a look, if I may, at the place where these things come into play most and take a little bit of a look at the industry itself and the forces that are driving mergers in the pharmaceutical industry. This would make a good subject for discussion in its own right. And if anybody is interested in this subject, my source is a yet unpublished paper by Dave Ravenscraft and his colleague whose name is Long, who I think have a long association with the FTC. Ravenscraft used to work there and probably still does consult. It is a good paper.

Here is what Ravenscraft and Long said. The merger mania that we see in the pharmaceutical industry, while it may be regarded as part of the general trend, has to do with several very definable sources. The pressure on drug prices from U.S. managed care, from pharmaceutical benefit managers, from an increased intensity of drug price regulation around the world has become intensive. Generic competition both because of Waxman-Hatch in the United States and other things has become more intensive. It so happens that for many companies like the Glaxo-Wellcome merger, for example, we have blockbuster patents that are expiring, and the pipelines behind it are not so strong R&D; costs are increasing and product life cycles are getting shorter. Inevitably what this means, and particularly the pricing pressure is that for any given list of possible R&D projects viewed in the old regime and compared with the new regime, in the new regime some of those heretofore profitable projects no longer will be. So you have automatically an incentive to want to cut back R&D for perfectly pro-competitive reasons.

Why do you have to have merger to deal with these things? There is buyer power to confront; there is R&D productivity to try and enhance, and if you can't do anything else at the top line, at the revenue line, then in order to keep your

profits sustained, cost cutting in a harsher competitive environment is a managerial solution to the kind of environment that the drug companies are facing. And there is a set of mergers that goes with each of these motives. If the primary objective is to answer the question, "How do we deal with managed care?," then a possible answer is buy a pharmacy benefit manager; get control of your own; learn from the information that these things generate. And that is Merck-Medco, for example. To improve R&D productivity, that implies learning more than the typical research based pharmaceutical company does about the newer aspects, biotechnology, combinatorial chemistry and so forth. But if cutting costs is the necessity, that is what these large horizontal mergers are principally about. And you will find that there are other reasons associated with them: having a full product line, having better multi-national coverage and so forth. But where the real value creation comes from, and this is Ravenscraft and Long's point, is it comes from cost cutting.

Now let's take a look, given what we know about the industry, let's consider how the innovation market approach gets played out in a variety of different mergers. And here I am going to draw a distinction between Novarta, Ciba-Geigy and most of the other drug industry mergers that the FTC has seen. I don't know that I'm not exaggerating there, but you can straighten me out on that. Basically, when I talk about innovation markets and when I did a year ago in my very cranky mode, I was talking about them all as if we were talking about merger analysis on projects that are really no more than a gleam in a researcher's eye. And I've said then and I say now that the closer you come to real products in markets that are easy to define, the more this starts to resemble the analysis of actual potential competition, conventional merger analysis, and the weaker my objections become, frankly. So the contrast that I want to draw is between gleam-in-the-eye projects and projects that are near approval, because I think the differences are quite stark. And they have implications not only for merger enforcement, but they also have implications for this odd question that's on my mind, and that is: Why does the industry—not individual companies that are in negotiation with the FTC—but why isn't the industry up in arms about this? And by the way, should we be up in arms about this? Shall I continue to rant about this subject or turn to other things? Here is my analysis of that subject.

Look at the right-hand side first. Look at the projects with products that are at the end of the development pipeline that either have approval or are about to. The concern that I am dealing with is the risk of a false positive, hurting innovation, not helping it, by causing divestiture or compulsory licensing. And as I have said, where you have a project where products are near approval, the risk of a false positive is really quite low. You can define what the market is in conventional product

market terms and say, well, we're almost there, but we can see what's going to happen when the products are approved; we can see what the structure of the market is going to be like and whether there is substantial lessening in competition in conventional product market terms. For the target firm, it is true that the cost to that firm of a false positive, of having to consent out of one of these cases is high, because a project that is near approval has all of the costs behind it basically. The pill making is by assumption, and almost invariably quite minor. It is the research costs that matter most. They are already sunk. If it's gotten this far, it is likely to make some money and the cost is high. But frankly, it is conventional garden variety. You might as well just complain about antitrust every day instead of the innovation market approach. And this is the FTC incentive; the social cost of a false positive is low here. Their need for scale is diminished; the product is almost out there. Getting it wrong is going to mean that there are two players rather than one, three players rather than two. Although mostly it is two-into-one that Bill and his colleagues think about. No worries there. So I've got not much to yell about on this side of the story.

Here is the interesting side of the story, and this arguably is the Ciba side. The risk of a false positive is considerable. And this simply embodies all of my objections to the approach itself. The market is not identifiable. The other competitors are not identifiable. The therapeutic competition possibility from other products is not identifiable. And moreover, it's not possible to know whether a monopolist will move faster than a duopolist. Part of the concern that Bill voiced was not about the product market, but whether research is going to get slowed down, whether the research market is going to be more sluggish as a result of diminished competition. And my answer to that is this is not much of a worry, really. All of the incentives, given the fact that at some point there is a patent clock ticking, all of the incentives, even if it is a one-person race, however odd that sounds, is to move as quickly as possible through the development process to approval. And all you have to do, if you want verification of that, is to read the very vociferous public policy statements of the pharmaceutical industry about reducing approval times at the FDA. It is the most potent source of profit improvement for a product, to be able to get it to market faster.

On the other hand, here is the answer to my question about why they don't care, and this in a certain sense is the sad part. The private cost of a false positive is quite low if you are in the gleam-in-the-eye stage. You may think of research projects of pharmaceutical companies rightly as their crown jewels. But the fact of the matter is that if you have a research project that is remote from approval, it's got hundreds of millions of dollars of cost in front of it; it's got a low probability of success, although obviously the company will have a better idea for any

specific drug what its probability of success is. But remember the number is something like one in 10,000 that gets all the way through, and very few of them are big money makers. What you have to do then, is contrast the expected value at that moment of this project, which I am arguing is likely to be low, with what the cost is of not being able to go through with this merger, and that raises the subject of the holdup problem, which I'll leave for others.

Here is my worry, and this is what's keeping me talking. The social cost of a false positive for the gleam-in-the-eye project is simply unknown. And there I have to say we do differ. These are all the objections that I voiced before. We don't know about the effect on innovation of regulating research and development. There are dangers associated with increasing the number of competitors. The reasons for cutting back R&D may be perfectly pro-competitive and sensible. So this is the unknown that, as far as I'm concerned, is where the danger lies, even if privately the industry isn't terribly concerned about it. And that is really the end of my story.

So I thought I would say to you, look, here is the whole story in three numbers, okay. It takes a half-year to complete a merger for a typical research project; it takes eight or nine years to get it all the way through, and given the average age of a pharmaceutical company CEO, what that means is if he wants the merger, and if the research project is a big winner, it is going to be somebody else's big win. What she said to me is don't do it, Dick, don't say it. Because the truth of the matter is that for these gleam-in-the-eye projects, even if this were 25 years old, it still wouldn't make sense. It still wouldn't make sense. But, again, a more subtle message than the one I hope I gave a year ago. Thanks very much.

MR. MALINA: Ken, I think you've got a tough act to follow.

KENNETH R. LOGAN, ESQ.: I do. I want to start by saying I think Dick's analysis absolutely reflects my own experience in dealing with pharmaceutical companies going through the merger process, including the negotiation of the consent decree which leads to the result. There is an astonishment at the outset that there even is an issue. There is then a gradual understanding of what the theory is at least; there's not agreement with the theory. And in the end, it's a combination of two things. One, life is too short to fight this problem, and we have enough risks attached to R&D that we are not going to fight it out on this one. We will let somebody else take that risk and lose, as well as we will take that risk and lose.

But the other much more practical issue, and I think a bothersome issue, is that we in fact are making law and policy by consent decrees negotiated as part of mammoth transactions where the innovation market problem is a tiny issue. So,

there's no way that the Ciba-Geigy-Sandoz merger or Glaxo-Wellcome or certainly American Home Products-American Cyanamid, which was the first one I was involved in, that we were going to stop that transaction and litigate the question of whether there is an innovation market. It's a very easy decision to say we'll give up one of those projects for all the reasons that Dick said.

My problem with that is I think it is an intellectually dishonest way for all of us to make policy. I don't point the finger at the FTC any more than I point the finger at pharmaceutical companies for rolling over in those situations, although I understand absolutely why they do it, and it's the sensible thing to do in that setting. My suggestion—I don't really have more to add to the economic debate about the worthiness of the theory of where you can identify an innovation market. I think we probably all agree with what Dick was saying, that as the idea moves through the development pipeline and becomes closer to being a real product, we can understand what the competitive consequences are in that setting much more easily than when it's a gleam in the eye. And I doubt there is much serious debate where mergers raise innovation market questions at that stage. If it's a migraine drug where the acquiring party has a drug on the market and where the acquired party is almost through the regulatory process, I don't think there is a serious debate about whether that's an issue. But I can tell you the situation I went through on American Home Products-American Cyanamid was quite different. I think the commission saw it as a merger of three-into-two, and we saw it as a merger of one-into-one because the American Home Products had a Rhoda virus vaccine. Rhoda virus is an intestinal disease; it is primarily a third-world problem, though there is some need for it in the United States. The medical problem is that, in and of itself, it's not that serious of a problem if it's recognized early, and it can be treated in a variety of ways. But if you don't recognize it quickly, it leaves you vulnerable to other diseases. So, in places with reasonably good access to health care—that is, in the United States—overall it's not a serious problem. In the third world, where you can't get quick attention, the dehydration that comes from the disease can be quite serious, leaving you vulnerable to a more serious problem.

American Home Products had a product that was at the FDA in the final approval stage; probably two years away from coming to the market, and a serious question arose as to whether there ever would be a commercial market for the vaccine that they were developing. If there was a market, it was in the third world, and commercially you're not going to make any money out of that. But American Home had already invested \$30 million. They had a modern facility to produce it, and they were committed to doing it. The acquired company, American Cyanamid, did not have a product that was in phase

one clinical tests. It had not been tested on any human being in the world. It was truly an idea. And it had probably no better than a one-in-10,000 chance of getting through the next ten years, at least, that would be required before that product came to market, if it was ever a product. And in between them was Merck, who had a vaccine that was in phase two clinical trials. So, it was probably perhaps four years away from being commercially marketed.

What should have happened—and we would argue there were more than three—there were others who were in various biotech firms or in university research or hospital research that were in pre-clinical stages with ideas that could develop. There was no essential intellectual property right that was held by either American Home or by American Cyanamid. There was no critical facility or asset that you had to have to be able to do this. They were different approaches to solving this medical problem.

What should happen in those situations, and without trying here to resolve the debate on the merits, what should happen is we need to find a way to litigate—if that's our way of resolving disputes—but to litigate that issue and take it out of the context of being held hostage in a merger. And it would seem to me that it is at least plausible, and I would say for all of us the intellectually honest thing to do in that kind of a situation is let the merger close, bring a proceeding, develop a factual record in an administrative proceeding, do it promptly. And we need a more rigorous process to examine the economics and to dig out the facts. But that would be my one suggestion that I would make.

Because as I say, we are developing law by a series of consent decrees—and there are a considerable number, and it's growing, and it is very difficult, I think, going into a transaction to know what you're going to have to give up in that area, other than to know you're going to have to give something up.

MR. MALINA: Let me put the question directly to Bill. Assume a multi-market megamerger, involving billions of dollars in assets, Ciba-Geigy-Sandoz was one. Whatever other competitive problems there are in the merger have been resolved by agreement, and there's some difficulty over an innovation market that Dick would call a gleam in the eye. Would it not be better public policy—rather than insisting on a decree which resolves that problem, which is years away in the future anyway—to let the deal close, use the commission's highly commendable new proceeding for getting these things done on a fast track, file a complaint, bring the case and get the issue resolved so that a court can review the very interesting legal and economic issues here?

HON. WILLIAM BAER: Does this question call for just a yes or no?

MR. MALINA: No, but you have to put your response in the form of a question.

HON. WILLIAM BAER: Look, it's a fair question. I think Ken and Mike have raised a legitimate issue. But I will put it in the form of a question. Does it make sense if, after six months, nine months of study, we're convinced that we've identified a real life problem, not a gleam-in-the-eye problem. I wasn't around for the American Home Products case, and this is really the first critical analysis I've heard of it. And if there really was a one-in-10,000 shot that the competing product, potentially competing product, was going to get to market, if I were persuaded of that, I might have some trouble with the case. In the Ciba-Geigy-Sandoz matter we felt that these were the only two firms, and I should indicate, and Dick—

MR. MALINA: There was one more, Bill.

HON. WILLIAM BAER: That's right, if you looked at the bundle of patent rights, you looked at the FDA pipeline, and one of the reasons why one can do innovation analysis in the pharmaceutical area with less risk of false positives is there is an FDA approval pipeline. We can find out things that the parties don't know about: who else is in the pipeline, how far along they are and how FDA handicaps their prospects for success and the timing of an eventual success in the marketplace. The question for me is, if we think the case is solid, that we have a basis to litigate today, should I let the deal go through and take eight or ten people to litigate against some really terrific opposition in hopes that three to four years down the road, after the Court of Appeals is done with reviewing the commission's record, we will have advanced merger law in a theoretical sense. On the other hand, I've got to get those people on to the next matter. The costs for the administration of justice, not just the internal costs of stretching some people, but of not getting the next deal done is such that I don't think it's a wise expenditure of resources.

One of the most interesting things—well, I've heard a lot of interesting things this afternoon, I don't want to start handicapping them. But Dick's sense that there is a degree to which at least the recent decisions we've made using this method of analysis have been ones where you can see enough of a future goods market competition and a potential monopoly position that in fact there doesn't seem to be a lot of serious mistakes being made. Ciba-Geigy had clearly had a much longer lead time. It was much tougher judgment. But basically, these were the two that had the best shot at getting there at any time in the near future, and the combination of them basically would potentially create a very dominant firm, arguably a monopolist in that future goods market. So we thought we were doing the right thing.

MR. MALINA: You said something that I've often been concerned about, and it's a problem that we had on the other side of the table in the Ciba-Sandoz deal. I'm not surprised to hear that the commission staff makes its decisions on the basis of information it receives from sources that are not available to the being-investigated parties. In our case that was apparently not only the Food and Drug Administration, but certain competitors of Ciba and Sandoz who had axes to grind. Anybody who has practiced before your agency—and I don't intend this to be a criticism because I have great respect for you and your staff—but you do get tired of hearing in response to positions that you take: "That is not our understanding." And when you ask them, "Well, where did you get this idea from?," you get the face of a clam. It is troublesome. And when you are making very significant decisions as to what the future course of competition is going to be in the year 2000, or more likely as I recall it the year 2005, on the basis of what you hear from companies that have a very substantial axe to grind or from the FDA, which can't tell us what they are telling you, isn't there a problem of fairness involved?

HON. WILLIAM BAER: Well, this really gets back to Ken's question about litigation. There is in the investigational stage of things, by statute, a requirement that we maintain confidentiality. We try, and I think we do in most cases a reasonably good job, trying to give our counsel for the parties, our adversary a sense of the factual bases on which we are moving forward, so there's ability to contest as best as possible. But we can't disclose our sources of our details. We can go in and handicap the credibility of the information we're getting and field test it, go out and talk to folks, hire experts, as we routinely do, to make sure that the judgment we're reaching is not simply a competitor's gripe.

I mean we have all been through experiences where antitrust enforcement was based on concern about injury to a competitor. And if anything, the agency is quite cautious and careful about how much to credit that sort of information. But when everything but what the parties are saying to us points in a certain direction, I think we're doing the right thing by going forward.

MR. LOGAN: Mike, can I comment on two things. One is, everybody ought to be clear: I think the health staff that you have is terrific.

MR. MALINA: Amen.

MR. LOGAN: They have been through enough of these drills that they really do understand it. They are as straight with us as they all can be, understanding a need to in the next deal, have third parties who are willing to talk to you as openly as these people have. And we all understand that. But what you tend to get is simply we see it as three-into-two, you know.

And it's not—you say, "Are you sure it is not a false positive?" or you say, "Are you sure that the public health benefit at the end of the day will be better with a divestiture or not?," the answer you get is, "This is three-into-two and more is better than—you know, three is better than two." So, it's a real classic IO theory, and it just says three competitors are better than two, thank you very much.

MR. MALINA: I want to agree with Ken, that the effort at transparency—is that still the buzzword?

HON. WILLIAM BAER: Yes.

MR. MALINA: The people on your staff who deal with pharmaceutical mergers are as open within the limits of what their obligations are as one could expect. But what I was suggesting is there is nonetheless an element of unfairness that perhaps can't be helped. We had a question over here.

MALE SPEAKER: I would like to address this to you, Bill. And picking up what Ken said, and I'm troubled jurisprudentially about the way merger law is developed. We have this vast case law, all this case law out there, and then when the guidelines came in, the new set of guidelines under Baxter came in, we pretty much had stopped litigating, but you've got all these cases out there. What do you do when you have a problem; you got a merger issue, you're going to advise a client about a problem? Do you go look at the cases? Now you've got to look to see what the division is doing, and everything seems to get resolved—almost everything gets resolved by consent decree. Then you take a case like *Staples*, which goes to court, and what's the judge citing in *Staples*? *Brown Shoe*. That makes us shudder. And I know, Bill, one way of looking at that decision is this was a real sophisticated analysis that the court is engaging in, you know, unilateral effects. Another way of looking at this is the judge went and looked up a bunch of old cases and didn't know that nobody was doing that anymore. How do we resolve this? This is troublesome to me just from a counseling aspect. A client comes to you with a problem, where do you look for the law?

MR. MALINA: Do you need three hours, Bill?

HON. WILLIAM BAER: Well, this one could go on forever. It is clear that a cost to the current scheme of merger enforcement, merger regulation—a term I hate, but a term that's in vogue—is that we have fewer controversies that get resolved in courts, and that is a cost. It means there is less judicial guidance. We don't know whether the *Proctor & Gamble* case is good law. We probably all assume *Vons Grocery* really doesn't control. And I'll come back to *Brown Shoe* in a minute. But there is a cost. But you've got to take a look at the benefits side.

What Bill Baxter did was basically set the terms of debate for how we look at mergers. And if you look at the revisions in the reform and again in '92, we have an analytical framework for discussing mergers that creates more opportunity for dialogue between parties and the government than ever existed before. I think Tom Cooper is the fellow who used the expression that the latest iteration of the guidelines, the '92 guidelines is the year of the storyteller. And what he meant by that, the '92 guidelines forced us to go beyond simple structural presumptions and to work through how it is the evidence suggests it is a predictive judgment in all cases, that a particular transaction will hurt competition. That forces my staff and John Baker's staff, the economist at the agency, really to work things through a lot more thoroughly than we did.

The guidelines have an internal application; that is, we are forced to go through a checklist, but they also have a benefit in terms of facilitating dialogue. I think we're challenging fewer mergers than we used to. We are basically at a somewhat higher level of confidence. The ones we go after are ones more likely to result in problems. We are creating opportunities for the parties to come in and make very effective presentations on the market issues in the anti-competitive effect issues. So there are such—and we are getting done sooner and less expensively than we otherwise would. Those are all extraordinary benefits to the way the current system works.

There is a problem. We fight less, and therefore we have less judicial guidance on where we are going. The *Staples* case, if I can take a point of personal privilege on that, obviously it was a great opportunity for a bunch of talented lawyers outside the government, inside the government to go to war over tough issues of market definition and competitive effects. And it was a great opportunity. It was a privilege to have been involved in that case. We had a judge who was a very right judge. I said before the decision came down and what he did, as I read it, he didn't do anything particularly heavy lifting or sophisticated. He appeared to understand the merger guidelines and how you define a market. He did look to the case law, and say basically that part of market definition is trying to measure cross-elasticities of demand, and that's really what I was up here a couple months ago talking about.

Brown Shoe, you know I think it was the Supreme Court's effort, without a lot of help from the industrial organization and economists, to say that really the bottom line here are the products in the same market, and is the combination of the products going to basically give them a unique ability to raise price? Are they such close substitutes, and are the other substitutes far enough away that there's some unilateral market power?. Well, that's what unilateral effects analysis in the '92 guidelines is all about. *Brown Shoe* was a somewhat more crude way of getting at it. There's so much noise in that deci-

sion it has been cited for so many different things. But I think the judge understood that focusing on the notion that you're trying to measure cross-elasticities in figuring out demand side and competitive effects is what he was doing. So I think there's a little more to it than simply rote application of the Supreme Court precedent that's flexible enough to get you the result you wanted in the first place.

MR. MALINA: Dick, you've been uncharacteristically silent.

DR. RAPP: I was just remarking to myself that I bet he hasn't lunched with economists. All that I was going to add to the discussion of *Staples*, as it is coming out you should know there's an old history to this debate. A very great economist in the 1930s named Joan Robinson wrote about the economics of imperfect competition, and somewhere in there—I have to paraphrase what she said—is you won't often find discrete gaps in the chain of substitution. Which means for economists that often it is the case that even though the merger guidelines make perfect sense to us in many contexts, we will skip over the relevant market issue, get to the answer as we see it, and then double back because of the necessity to put it—for legal reasons. So there is, from our standpoint analytically, there's no harm in that. It's part of what we live with. *Brown Shoe* is another story, and I will pass on that.

MR. MALINA: Ken.

MR. LOGAN: Yes, I think the *Staples* decision sort of delivers a different message. I mean I think you do feel like you're turning up the sixties music in the background while you're reading, but I think the message is somewhat different. What my takeaway is, actually, number one, is that the FTC knows how to try a case and will do it and do it in a first-class way. Number two is, for all the niceties that we go through in trying to either understand unilateral effects or define markets, you'd better read your own documents first, because that was a whole lot better than theory, and it was used much more effectively than theory. But the other is, I walk away saying the attention that we have all given to unilateral effects over the last two years, since Carl Shapiro really put it back on the table at the Antitrust Division, is that it has added—it is supposed to be a tool to help us. I think it's actually added confusion and uncertainty in a way in which we advise clients. And it is mildly bothersome, actually, to hear Bill earlier talking about the Guinness-Grand Met merger and saying that the econometrics wasn't robust enough, that it didn't give us guidance. We were representing Seagram in that transaction, a third party that provided econometrics to the commission, and they did their own. But where it fell down is that the black box of the econometrics is difficult for the economists and almost impenetrable for the lawyers. And it was an effort, I think, that informed us, but to say at the end of the process we sort of have to put it aside

because it isn't robust enough to get you to a conclusion. I think that's the problem that we as practitioners are having in trying to figure out how we use that new tool to be able to advise clients. And what we end up, at least I do, and I think—I mean we espouse the markets that were ultimately used by the commission in Guinness-Grand Met. But narrow markets are in, and unilateral effects will confirm that and will give you an intellectually honest way to support it. And without looking back to whether you're revitalizing *Brown Shoe*, I just think you've got a solid basis upon which you can define a narrow market and predict with some degree of certainty whether there will be a price increase that's sufficiently behind competitive effect. But I'll stop here. There is this black box problem that nobody quite knows what to do with. And that's both, my sense is, within the bureau of economics as well as within the outside world.

One of Dick Rapp's colleagues was the economist working with us, who is as good as anybody I suspect in the world doing this stuff, and you know, he too is tough to get a dialogue going with the econometrics to figure out where it is really at and what you can show.

MR. MALINA: This is very interesting to me, since I was brought up on antitrust back in the early sixties under the tutelage of Milton Handler, who was railing year after year after year that these cases have to be viewed as fact-intensive and that you cannot solve them by simple mathematics. I have said for many years that Professor Baxter's great contribution is those guidelines, because it gives you a way to talk to the government, as Bill said before. I think we, all of us, face a significant risk of looking at the methodology as if it were an end rather than a means. After all, what we're trying to do is determine whether or not a particular combination is going to have a significant anti-competitive effect. So, you learn the methodology is: First you define a market; then you see what the shares are; then you compute a Herfindahl index; then you see whether other factors apply; and then if none of that helps, you look to see if there are unilateral effects. These are useful tools, but they are not the end result. But I think that Bill and his staff are beginning to move toward stating the reality which all of us have confronted for years. You really often start at the end, and you say look, this is likely to have a significant effect because it's going to enhance the power of this combined firm to do thus and so, and then work back to rationalize it in a way that can fit within the grid. We are not sophisticated enough yet, I think, to come out with any other methodology. But I do agree that when you have to try to follow the guidelines page-by-page in order to follow the methodology that we've been told is what's being done, you sometimes create more theoretical problems for yourself.

We have got little more than a half an hour before this has to close. I do want to open it to questions from the floor. Barry.

SPEAKER IN AUDIENCE: I would like to follow up on Ned's question, building on the *Staples* decision and the effect that it has on counseling, and how you deal with mergers. Clearly, *Staples* reflected an approach and a result that were surprising certainly to the judge, who begins the opinion by saying that intuitively he thought the result was going to be wrong. Many of us are often in situations where we are confronted with a corporate partner who will come in and say this deal is out there, should we talk about it? Should we abandon it right now? Does it look silly? Should we put a few million bucks in doing it? Should we let the company be in play and go down this road? Does *Staples* and the use of econometrics, and the kind of proof that was used there, and the approach and the result suggest that in order to answer that question right at the beginning, we've got to call Dick very quickly and do our economic analysis and maybe begin the analysis to tell our clients very early on we've got to look at the 4C documents right at the beginning before we can even tell you whether to go ahead and look at it? Must we do all of that first, before we take the substantial risks and incur the costs of going down the road? Have you seen that kind of shift and that the parties are doing their research early? Maybe they are going to have better 4C documents if they start their analysis earlier. Does that seem to have happened as a result of *Staples*, and do you think it should? I guess Dick would certainly have a point of view that we ought to be calling him earlier?

HON. WILLIAM BAER: I don't think we've seen much of a shift since *Staples*, but what I learned as a practitioner at a firm for some 15 years doing a fair amount of merger and acquisition work was what we all know, which is they want an assessment. If you simply do a market share calculation, have some businessmen tell you entry is easy and come back and tell people that, you know, with entry easy, even though the shares are pretty high, you know, we ought to have a fighting chance of getting this one through, you may be in trouble. You've got to do what lawyers have always done, go to the documents, the contemporaneous business records and find out what's there. As Ken said, in *Staples*, Office Depot, in order to justify a bigger market, they were forced to tell a story in court that was wildly different than their documents. Indeed, one of the great moments of that case was my colleague George Cary cross-examining the CEO of Staples, and all he did was simply go to the pricing manual that Staples had put out a year earlier, say, "Read the statement and say that's correct, isn't it, and it's correct because . . . , isn't it?" And the guy could only fight him so much. They were committed to an analysis or a view of the marketplace that they couldn't really walk away from.

Obviously, getting an economist in early is better than not. The situations where good sophisticated econometrics can be done aren't all that many, and they take some time, and you may not be able to wait for that. But I'd start, as good lawyers always have done, with understanding the company's documents, get the company's own view of the marketplace, and the investment analysts, too. Because that always gives you a real insight into how everyday business decisions are made. It may turn out the market is behaving differently than the businessmen have always thought. But that isn't always the case.

DR. RAPP: Can I just add my two cents, if I promise not to endorse the view that economists should be brought in at the creation?

MR. MALINA: Just be sure to give us your phone number.

DR. RAPP: The two points that I want to make about this subject are first, I was not involved in *Staples*, but my understanding is that the complex econometrics lost there. And that, viewed from an economist's standpoint, while the documents are interesting, it was the war between a relatively technical multivariate analysis and a simple set of price comparisons that the FTC put forward, which was the way the battle was framed for us. And the fact that those price comparisons were powerful and difficult to overcome was an important consideration, at least viewed from my perspective.

The fact that these are fact-intensive is undeniable. But if you ask me whether they are more fact-intensive than other sorts of merger analysis, I would say, no, frankly. What they are is often model-intensive, in that the way that you look at the sources of the power to increase price and the way you model the market in order to portray that can importantly determine the outcomes. What you believe and what you portray about the relationships between the demand elasticities, the margins and things like that are often very important. And the practical advice that I would offer, and I'll put it in the form of a—see if you agree with me on this—is that these cases to a greater degree than others really do require a high level of communication between the economists working for the merging parties and the staff, if the idea is really to achieve an understanding.

I worked on one of these about a year ago, the Vail ski merger. You wouldn't think that a merger of ski slopes would be a complicated econometric exercise in unilateral effects analysis, but indeed it was. And it was edifying—I can't use any other word to say, because there was a very, very high level of interaction that was permitted between the economists on both sides of the issue, the Justice Department economists and ourselves, so that we could figure out what the assumptions were that we were making. And that is what led to under-

standing it. So, it happens the merger was approved; it was a close call, but it wouldn't have been on the basis of a mistake for that reason. And my point is that that is more true in these unilateral effects differentiated products mergers than they are where the model is a model of threat from collusion. It's a simpler issue there.

HON. WILLIAM BAER: The question really is: Are we willing to share? And the fact is we're prepared to do it to the extent we can, consistent with confidentiality obligations and consistent with timing in getting from here to there.

One of the things that outside parties don't fully appreciate is when firms come into compliance with a second request, that often is the first time we have got the data with which actually to work with the model. We may have developed something, but we're scrambling very hard to see if we got something that tells us something. And at that point we can probably talk about assumptions and general approaches, but we don't have anything to share. We had a huge fight with Staples and Office Depot. They came in with a very talented economist, Jerry Hausmann, who had some strongly held views about what his econometrics showed and demanded to see ours. Our problem was we basically had never found a way to ask for the data in the right fashion, and it was really only after we had his analysis, got his underlying data and scrambled to work with that to come up with something that we began to get to the point. This happened right at the time we went to court, and we found that his analysis was pretty seriously flawed. Our analysis tended to show a price effect that supported the simple comparative pricing data that the parties had gathered and on which they based their business decision.

So we are prepared to do it and have done it, at least on the level of conceptually getting the economists talking. You talk about how fairly do you model this market? What variable do you use? What adjustments do you make? And I think that's a dialogue we need to continue to have.

MR. MALINA: Anybody else? Yes, sir.

SPEAKER IN AUDIENCE: Could you focus on joint ventures just for a few minutes? I wonder, for example, if anybody knows how many of the 2,400 filings might have been joint ventures instead of mergers, or where do the guidelines stand, and are there any differences in evaluating joint ventures as compared to mergers?

HON. WILLIAM BAER: Well, it is a great question. And you may or may not be aware, for the last five months we've had a project ongoing down at the commission, a fascinating series of informal roundtables and presentations to talk about how joint ventures differ from mergers and if there is a way to write more guidance to the business community on where we have more problems and where we don't. It has

proven to be one of the most challenging and analytically difficult projects the commission has ever undertaken. And right now we have completed the information-gathering part of it, and Susan DeSanti and her folks are working with others of us to figure out whether there's enough there that we can offer some meaningful guidance to lawyers in the business community about how they differ. Obviously, one way we tend to do the traditional analysis of a joint venture by basically saying if it were a complete integration, would there be a section 7 problem? If there is, then given that this is less than that, what are the implications, both positive and potentially negative, from having a limited degree of overlap in competition? So, we do try and distinguish. I don't know percentages. For those of you who are more familiar with Hart-Scott-Rodino form terminol-

ogy, I don't think there is a joint venture box for us to check off.

MR. MALINA: If it's a partnership, it doesn't get filed at all.

HON. WILLIAM BAER: No, so we aren't able to track the collaborations. But there clearly is a lot going on. Indeed, as states have increasingly adopted laws on limited liability companies, we are seeing big transactions, particularly in the energy field, but elsewhere as well, where people are using that form or structure to combine some or all of their assets.

MR. LOGAN: I think the same debate, intellectual debate, about how do you analyze this thing and what part of it is section 7 and what part of it is section 1—I think that is also going on in Europe, because they are revising their merger guidelines currently and with different terminology, but they are exactly at the same point of trying to figure out the inter-

HEALTH CARE, COMPETITION AND NEW YORK'S HEALTH CARE REFORM ACT

MR. MALINA: Even though we have to follow a tough act, I'm confident that we will succeed because we have a really first rate group to discuss a package of problems involved in health care. And to lead us through that, I will turn you over to Meg Gifford, our newly elected section secretary, who will chair this program.

MS. GIFFORD: Thanks, Mike. Let me introduce our panel of speakers, because we are going to have a different format, so I would like to just let you all know in advance who is sitting up here and what their backgrounds are.

Starting at the far right is Michael Joel Bloom. Michael is the director of the New York Regional Office of the Federal Trade Commission, and actually Michael should appear on the next panel we do on career paths in the antitrust field. Because after graduating from law school, he joined the staff of the commission's Bureau of Competition, then moved to the corporate sector, where he worked as antitrust and trade regulation counsel for Westinghouse Electric Corporation, and then went to Xerox Corporation. Following that Michael came back to the Federal Trade Commission and became assistant director of the New York Regional Office and then director. He has received the commission's awards for consumer advocacy and for supervisory excellence.

Next to Michael is Barry Brett. Barry, as some of you may have heard, is chair of this section until the conclusion of dinner tonight. Barry has been a partner at Parker Chapin Flattau & Klimpl for over 20 years, where he is currently the head of the trade regulation and antitrust practice. He served as a law clerk to Judge Charles Metzner of the Southern District after graduation from law school. Barry has been involved in some rather notable antitrust cases, which even some of us who have been practicing antitrust law for fewer years than Barry will remember or at least know about, including *Berkey Photo v. Eastman Kodak*, and the termination of the 1954 decree governing the theatrical industry. He's been involved in the New York State Attorney General's actions against Visa, and was also involved in the Walter Reade-Columbia Pictures merger injunction case and cases against the Shubert Organization involving New York theater tickets. And I think that is only a small fraction of Barry's breadth of practice.

Seated next to Barry is John Franzen. John is an associate attorney in the Bureau of House Counsel, Division of Legal Affairs with the New York State Department of Health, and we hope that John will bring a unique perspective to this panel on antitrust and health care matters. John has been with the

department for 21 years and has primary responsibilities in the fields of managed care and hospital establishment matters.

Next to John is Linda Nenni. Linda is vice president for Legal Affairs and general counsel of Millard Fillmore Health System in Buffalo and has been named vice president and general counsel of CGF Health System. CGF will be the successor entity in the merger and consolidation of three major health systems in western New York: Millard Fillmore Health System, Buffalo General Health System and Children's Hospital of Buffalo, a merged entity which will consist of 12,000 employees and 1,800 physicians, providing services at 46 locations throughout western New York. Linda will obviously bring to this discussion a perspective on the practical aspects of the issues we're discussing.

Next to Linda is Monica Noether. Dr. Noether is a vice president of Charles River Associates, where she specializes in developing and evaluating strategies to deal with the changing health care environment and in antitrust analysis for various clients. She has provided expert testimony in a variety of litigated matters, as well as consulted in many others. And among others, she has been an expert witness in the health plan merger hearing involving Harvard-Pilgrim Health care and the Matthew Thornton Health Plan in Massachusetts, and the subsequent acquisition of Matthew Thornton by Blue Cross and Blue Shield of New Hampshire. She's been an expert witness in an attempted monopolization case involving claims by a radiologist against his former employer and in a variety of hospital merger lawsuits, and has consulted extensively and provided economic analysis in non-litigated hospital mergers and other health care related matters.

And finally, but not least, because this is a health care and antitrust law panel, is Frank Serbaroli. Frank is currently a partner at Cadwalader, Wickersham & Taft in New York. He served for three years as an Assistant Attorney General of New York and he served as general counsel to two hospitals, Our Lady of Mercy Medical Center and Westchester County Medical Center. His practice is health care law. Frank also brings us the benefit of having a knowledge of antitrust law to go along with that. That should provide us with an interesting perspective. And I would like to mention that Frank served on the New York State Public Health Council and served as a member of the Governor's NYPHRM task force. That's the task force whose report resulted ultimately in the Health Care Reform Act, which deregulated hospital reimbursement rates. He also writes a regular health law column for the *New York Law Journal*.

I am going to start off, as Frank knows, because he's getting up, by directing a question to Frank, a sort of open-ended question: Would you address the issue of what antitrust issues have arisen in New York State because of market developments in the health care field? And in particular, Frank, to the extent you can comment on antitrust issues that you believe have arisen as a result of or in connection with the Health Care Reform Act, we'd be interested in hearing that.

MR. SERBAROLI: Thank you, Meg, and it's a pleasure to be here with everyone today. Trying to distill antitrust in the health care field down to a short program is virtually impossible. There is actually a four-volume treatise dealing just with antitrust in the health care field, written by a fellow named Jeff Miles from Ober Kahler in Washington, D.C. It is a really excellent treatise that covers virtually everything you ever wanted to know (or didn't want to know) about how antitrust is affecting the health care field.

Health care represents 15 percent of our gross national product in this country or over a trillion dollars a year. So, no matter how you look at it, this is big business. It's one of the country's largest business sectors, and certainly one of its largest marketplaces. As we all know, until 1975 the learned professions such as medicine and law were regarded by the courts as exempt from antitrust scrutiny. In the 1975 *Goldfarb* decision and in its 1982 *Maricopa County* decisions, the Supreme Court lifted that exemption, and in 1976 in the *Trustees of Rex Hospital* case, the Supreme Court declared that even local hospitals affect interstate commerce and are subject to antitrust scrutiny. I don't think that the Supreme Court at the time realized that these decisions would open up the floodgates to a whole new subspecialty within antitrust at this time because very few cases had been brought up to that point. Someone counted them a while back, and from the time of the enactment of the Sherman Act in 1890 until 1975 there were perhaps two Supreme Court cases involving health care; since then there have been at least twelve or thirteen.

I can also remember as a young assistant attorney general in New York—and I'm pleased to point out that my bureau chief at the time, John Desiderio, is here in the audience—that our Antitrust Bureau really pioneered a number of applications of New York's Donnelly Antitrust Act in the late 1970s. We were involved in breaking up group boycotts of the Medicaid program. A number of Medicaid providers, such as pharmacists and ambulette owners, were unhappy with the Medicaid reimbursement fees set up by the state and how late the state was in paying that reimbursement, and they decided to organize boycotts which we then went to court to break up under the Donnelly Act. There was also a case involving some physicians who attempted to boycott the Workers' Compensation

program, but the physician case wasn't as successful as some of the other health care provider cases.

In those, you have to remember that there wasn't much talk about a health care "marketplace." What I mean is that, historically, doctors mostly practiced by themselves and hospitals for the most part were really islands unto themselves. They didn't actually compete with each other. They took care of their own patients from their own communities. The hospital's board of directors consisted primarily of prominent citizens who got involved in local fund raising, and perhaps in some limited strategic planning. The word competition was never a word heard in discussions in the boardroom, and it was almost in bad taste to consider the hospital as being engaged in anything other than a charitable mission. Times have certainly changed. Now antitrust is everywhere. Most recently here in New York, we've seen cases where antitrust was brought to bear in the mergers of hospitals and the creation of multi-hospital systems. I believe there's going to be some discussion later on about the LIJ-North Shore case that was recently decided in federal court against the government.

Antitrust problems frequently arise nowadays as a result of the reconfiguration of the entire health care system, which is experiencing a lot of new dynamics and a lot of evolution. We have a tremendous number of surplus inpatient hospital beds in New York State and not enough patients to fill them. There's a trend more towards ambulatory surgery and outpatient treatment. Home health care is getting patients out of the hospital faster, getting them back home and having their care provided at home. And this is basically forcing a lot of consolidation in the health care field. More and more hospitals are talking about how they are competing against each other, how they are offering duplicative services and how to eliminate unneeded services. For example, if two local hospitals have two different applications pending for a major piece of equipment they may come together to discuss the possibility of a joint application. They may agree to locate the equipment at one site and have both hospitals use it. These discussions may expand to include whether they should start consolidating their back-office operations. Perhaps they will consider a merger, maybe a so-called "virtual merger," which is a relatively new term in the health care lexicon referring to the situation where a parent corporation is set up over two voluntary hospital corporations, and the parent corporation is given the authority to appoint the directors of the two hospitals. The parent corporation may also be given broader powers, such as entering into a management contract to operate the facilities or to set financial policy and so on. There are as many different variations on these mergers and virtual mergers as there are hospitals talking about them. But what I think we're going to see in the natural progression of the developing economics in the health care industry is a contraction. There will be fewer hospitals. There

will be larger hospital systems, the same way we saw consolidation taking place in telecommunications and cable.

Antitrust is also of concern in any type of joint ventures that are entered into, for example, between hospitals and physicians to offer a particular type of service if the result is that another group of physicians is going to be excluded from providing service, or if exclusive contracts are entered into. Another area of interest is the formation of independent practice associations, or IPAs. These are organizations of physicians or other providers that are formed specifically for the purpose of gaining bargaining power with HMOs and other payors. And the antitrust implications there are very clear. If an IPA is not correctly set up, it could turn out to be a plain, simple run-of-the-mill horizontal price-fixing arrangement. Certain antitrust criteria must be met in the creation of an IPA, including an ownership interest on the part of the physicians, possibly putting some equity at risk and so on. It can't just be a vehicle or a veil for horizontal price fixing.

We have seen antitrust have a role in the formation of physician-hospital organizations, with issues like monopoly and vertical price fixing. For example, recently the Justice Department broke up two physician-hospital organizations, one at Danbury Hospital in Connecticut and the other at St. Joseph's Hospital in Missouri; those were thought to be arrangements that resulted in a virtual monopoly being created between the hospital and the physicians in the community to the exclusion and to the detriment of other physicians who didn't or couldn't join. Exclusive dealing arrangements have always presented potential antitrust problems in health care. For example, if a hospital wants to franchise out one of its ancillary services, such as radiology, anesthesiology or laboratory pathology, very often it will do so in an exclusive contract with a small group of physicians. That generally results in some other physicians being excluded from participating in that service. But, as long as the hospital can show that it was done to further the aims of the institution such as furthering quality and efficiency of care, the exclusive dealing arrangements will generally be upheld. On the other hand, if it is in an area like medicine or surgery—and a department is closed out to new applicants just for the benefit of the existing physicians, such as the surgeons so that they can maintain a monopoly on the surgeries that come into the hospital—that obviously is going to trigger some antitrust concerns.

The innovations that are being driven by the economics of managed care are really quite remarkable. Right now, we are seeing large hospitals that are actually considering getting into the insurance business because they believe there's an opportunity to eliminate the middleman by creating their own insurance companies and having the patients who come to the hospital buy even lower cost insurance so that they can be taken

care of in the hospital. Only large systems with many facilities and a great deal of financial clout are able to do this. But the irony of this innovation is that this is actually how the Blue Cross plans came about 60 years ago. They were a response to the fact that health insurance was scarce and hospitalization was very expensive.

Many hospitals are also in the process of buying up physician practices in what perhaps could be considered a form of vertical integration. The hospitals are doing this because they want to continue to assure themselves of a flow of referrals to the hospital for inpatient services as well as for outpatient services, laboratory services and so on. As an example, if you've got a physician ready to retire who has a very large practice, and another doctor affiliated with another hospital is ready to come in and buy the practice—and the referrals of patients from that practice suddenly may start going through another hospital—the hospital where the retiring physician used to admit all of his patients may make a bid to buy that practice, situate some of its salaried physicians there, make it an off-site clinic and thereby assure it is going to retain the referrals. If this arrangement is not properly structured, it may trigger not only antitrust but also fraud and abuse and anti-referral liabilities.

I mentioned before the situation where a hospital closes out a department to new physicians, thereby subjecting itself to a possible antitrust suit by physicians who are being prevented from practicing. That generally is not a problem in a place like the city of New York, where you've got many competing hospitals; if a doctor can't join the staff at one hospital, there's always another hospital available. It is of very serious concern in rural areas, where there may be only one hospital with one surgery department or one department of internal medicine, and the doctor who relocates there and wants to bring his patients to the hospital is shut out. If the hospital is shutting down the department of surgery to new applicants because its operating rooms are overloaded and it can't possibly take care of additional patients, that's a legitimate reason, and may withstand antitrust scrutiny. On the other hand, if it is being done, as I said before, primarily to benefit the interests of the existing surgeons in the surgery department in maintaining a monopoly over service, that is likely going to cause antitrust problems.

Quality assurance and the peer review functions of hospitals are another area where antitrust claims frequently arise. For generations, hospitals have been involved in self-assessing their quality of care, doing peer reviews of their doctors, e.g., surgeons reviewing the cases done by other surgeons, internists reviewing cases done by other internists to be sure that everybody is practicing up to a level that the hospital has set as far as acceptable quality. Abuse of these processes has

brought about antitrust ramifications as in the Supreme Court's *Patrick v. Burget* case, where it was alleged that the quality assurance functions were being used as a veil for anti-competitive behavior in forcing a physician off a hospital's staff and thereby preventing him from practicing in that particular facility. Prior to the enactment in New York of the Health Care Reform Act, all hospital non-Medicare rates were set by the New York State Department of Health. As a result, there were no horizontal price fixing issues involving hospitals. With the recent deregulation of these rates and the growing economic power of HMOs and the other managed care organizations, we sometimes encounter the situation where two hospitals will form some type of a loose affiliation, short of a merger, and then present an HMO with an agreed-upon set of fees for taking care of that HMO's subscribers. It would seem to be easy to make a case that if the integration of the two facilities was not very thorough, that this affiliation is simply a case of horizontal price fixing.

In the past 20 years, there has been a variety of historical precedents involving antitrust. I remember when I was in the Attorney General's Office, our bureau participated in the famous chiropractors case in which various medical societies, such as the AMA, American College of Radiologists, American College of Surgeons, and so on, had ethical precepts against their members having anything to do with the chiropractors, because the science of chiropractic was regarded by the medical establishment as quackery. In point of fact, chiropractic medicine was recognized and licensed by various states as a form of medical treatment. That case went on for 16 years before it was finally resolved and the various medical societies eventually gave up their objections to dealing with the chiropractors.

I'll stop there because I think we've got quite a few other issues to cover. But if anybody has any questions about any of the areas that I've covered, I'd be glad to answer that them.

MS. GIFFORD: Thank you, Frank. I would like to follow up with a question related to the effect of the Health Care Reform Act in New York State, and ask this of any of our panelists. In addition to the obvious change that HCRA has effected, which is to deregulate hospital rates and therefore possibly to subject hospitals to heretofore unfamiliar areas, such as horizontal collusion charges in dealing with managed care organizations and other insurers, does anyone have a view as to whether there are other antitrust issues that have been triggered by the adoption of HCRA within the last year or so? John?

MR. FRANZEN: Sure. One of the issues that in fact the Attorney General is dealing with right now involves a combination of hospitals in the creation of what we call an "active parent." And the issue at hand is the issue of joint negotiating on behalf of the two constituent hospitals by the active parent,

and the issue of when and for what purposes the parent was established as a joint operator of the constituent hospitals. The questions addressed were: Did the Public Health Council approval of that combination encompass joint negotiating with managed care plans? And the other issue which the Attorney General, I believe, is focusing on is the issue of whether state action immunity was accomplished by virtue of that approval. And the basis for that question is the change I think from regulated rate setting to negotiated rate setting.

MS. GIFFORD: Anyone else who would like to follow up on John's comments or add any thoughts about areas that have been triggered as a result of HCRA?

MR. BLOOM: Equally, deregulation in New York has stimulated tremendous consolidation throughout the health care industry, so the application of section 7 of the Clayton Act becomes important in ensuring that these consolidations don't eliminate the very competition that HCRA looks to—to squeeze out excess capacity, spur innovation and drive prices down.

MS. GIFFORD: Well, I think that's a very good segue into my next question, which was actually also to you, Michael. Which is, given particularly the changes in the health care regulatory system here in New York recently, what role will the antitrust agencies be playing now with respect to health care markets in New York State, and are there particular issues, maybe in addition to what you've just mentioned, that you see likely to be of concern to the antitrust agencies?

MR. BLOOM: Well, I should start by observing that the health care program is one of the larger programs within the "maintaining competition" mission of the FTC, and it has occupied a significant part of the resources of the New York Regional Office, particularly in the period immediately preceding deregulation to date. Traditionally, our concerns on the conduct side have related to efforts to thwart the encroachment of managed care into what some physicians and other health care providers regarded as their fiefdoms. In some instances we'll see more subtle efforts to frustrate the full development of managed care rather than efforts to stop it outright, and we will be on the alert for that. At the same time, gross efforts to thwart managed care have not stopped.

Just recently the New York Regional Office brought an investigation, together with our colleagues in Washington and Puerto Rico, where there was an alleged naked effort on the part of a large segment of the medical community to stop the adoption and thwart the success of the government's managed care program. And what's particularly interesting is that our relief included not only the traditional remedy of prohibitory injunctions against the physician organizations and the physician leadership; but the commission sought and obtained \$300,000 in restitution in this case. And I think we can look to

restitutionary remedies as something that the government increasingly will seek, to make restitution to the victims of antitrust law violations, to ensure that violators do not profit by their misconduct and to ensure that the deterrence message that we send is fully adequate.

Among the issues emerging are efforts to unionize health care professionals—physicians, dentists, pharmacists and others. And indeed, already in New Jersey there's a case that's arisen involving AmeriHealth Corp. in which physicians providing some of their services through AmeriHealth HMOs sought to unionize. The National Labor Relations Board has, within the last couple of weeks, made a determination that physicians were independent contractors not properly organizable under the labor laws. But I don't think we've heard the last of health care professionals seeking to bargain collectively under color of the labor laws.

On the structure side, among the issues that have recently been joined is: What product markets can be carved out of the notion of payors? Are all payors, taken together, the relevant product market, or may, for example, HMOs alone, in some instances, constitute a product market? In particular, it has been suggested that Medicare HMOs may be marketed differently and have low-costs elasticity with other payors.

Finally, where there are partial integrations amongst providers or investors in facilities, I believe that we're going to need to carefully assess the extent to which those integrations really do or don't justify concerted conduct. I think we are going to see small integrations as purported justification for fairly significant collaborative activities in terms of competitive import, and it remains to be seen what will stand.

MS. GIFFORD: Thank you, Michael. If I can just ask you to follow up. With respect to the vast array of areas that you've just outlined, is there a practice or a protocol, if you will, by which your office of the Federal Trade Commission and the New York State Attorney General's Office might take the lead or primary responsibility in one area versus another?

MR. BLOOM: I don't know that there's an explicit protocol, but we cooperate and collaborate regularly. We have, by and large, common interests and lean organizations with which to pursue them. Therefore, we often try to stretch our enforcement capacity by working together and drawing on the comparative advantages, and relative availability, of our staffs. At times this has meant that one organization has taken the lead; more often, and particularly in instances involving hospital mergers, it has meant that we have conducted investigations jointly. This has, I believe, both reduced the burden on the parties and increased the benefit to the public of our enforcement efforts.

MS. GIFFORD: John Franzen, if I can ask you a similar question. Given the array of antitrust issues that are now at the forefront in New York State's health care markets, what role with respect to antitrust issues is the New York State Department of Health, as opposed to the Attorney General's Office, likely to play?

MR. FRANZEN: Well, we have for some time with respect to the hospital industry—and I use the term hospital in the broad sense—been aware of, started to learn about antitrust issues, kept an eye out for them, and in particular mergers and “active parent” establishments, raised the issues with applicants during their reviews. In some cases where Hart-Scott-Rodino was invoked—well, in all cases where Hart-Scott was invoked—we asked for the timing of the waiting period, asked for the results. If a waiting period was still pending at the time the decision maker acted, we placed a contingency on any approval issued.

We have recently—this week as a matter of fact—formalized an early warning referral process to the Attorney General's Office, whereby as soon as the department becomes aware of a proposed transaction, CON transaction or otherwise, when we become aware at the very early stages that such an application is coming along, we are asking that the initial reviewers of those applications make a referral of the project narrative directly to the Attorney General's Office. We will probably employ a similar approach, perhaps less formal, perhaps just directly from counsel's office with respect to managed care issues that are going to arise more and more.

MS. GIFFORD: Thank you. I'm going to turn now to the issue of mergers somewhat more specifically. Frank mentioned earlier an issue or a case that obviously has been on everyone's mind recently, and that is the case of *United States v. Long Island Jewish Medical Center*. I think it is worth pointing out, though probably most in this room are aware of this, that at the same time, during the same time period that the LIJ-North Shore deal was being put together and investigated and ultimately challenged and litigated, a number of hospital mergers or other significant strategic—it sounds like significant others, that phrase we used to use—significant strategic alliances have been planned and have gone forward without challenge. In some cases we hear this has happened without really much in the way of questions from the antitrust agencies. The activity has been extraordinary.

I would like to start by asking Linda Nenni, who has been going through a merger process over an extended period of time, to give us some background and some insight into what that process has involved, with particular attention to issues of dealing with the antitrust agencies and counseling clients involved on the coordination issues that arise during the course of the pre-clearance process.

MS. NENNI: Well, I think that sort of is a two-part question. At least I'll try and answer it in two parts. Michael may be able to comment on this, but I'm told by our own antitrust counsel that Buffalo is a good case study. And we were I think quite fortunate, but for good reason, in having relatively quick resolution of our Hart-Scott-Rodino filing. But I think as in-house counsel advising my client and even as an outside attorney advising your clients on these issues, I think that having done some work up front made a huge difference. In our case—and this was really business driven, it wasn't legal machinations—but in our particular case, these boards got together in May of 1996, the discussion ensued among various directors of these institutions. And they involved antitrust counsel early on in the process. And I think that that's very much advisable. Counsel was involved through the planning and evaluation phase. And I think that held us in good stead in terms of providing guidance, having all of the parties understand the process. And we in fact had an efficiency study commenced early on; Coopers & Lybrand were brought in the fall, I think in September of 1996. The efficiency study was really demanded by the boards of the institutions, some more than others, who really wanted to be convinced that there would be community benefit to this transaction. Obviously, it was driven by the issues that we are talking about, and I think New York is somewhat unique if this were looked at nationally, again I'm advised, because of the issue of deregulation.

But in our community, and I don't know if this is true downstate, but excess bed capacity is a huge issue. Coopers' studies showed that in western New York, within five years excess bed capacity would be double and triple within the CGF system to what it is today. And those were pretty compelling reasons for the merger. But I think involving counsel up front and also involving constituencies, we had work groups and task forces involved from the get-go. I mean we had—the discussions ensued in, as I said, in May of '96. Coopers was brought in to do an efficiency study that was completed in February of '97, and a letter of intent was signed in March. And I understand that often in these cases the parties will get together, they'll sign a letter of intent, and then they'll begin a serious study of efficiencies and the like. So we had done that up front. We again, had a lot of work already initiated with respect to the Hart-Scott-Rodino filing, and that was filed very soon after the letter of intent was signed. I think within days. And we received our approval in July from the FTC.

Also, I might mention we experienced the kind of joint effort that Michael was talking about in our particular case. We didn't know initially when we first started to talk to the Health Department what the involvement, what kind of active involvement the AG's office would take. And they did come in and review the merger, but we had the benefit of some joint meetings with the federal and state agencies. And, in fact, the

state AG's office pretty much accepted the documents that we had submitted for federal review for purposes of their review. And we have their signoff, at least on the antitrust side, already. Really, the only approvals that we're waiting for are on some HUD financing and then from the state—I shouldn't say only. The major approval that we are waiting for at this point is the Public Health Council, and that kind of leads to the second part of your question.

Because we had hoped, given the time frame that I've told you about, we had hoped to be on the agenda for state review to be initiated in November and completed by the end of the year, but that was delayed. So we're now on a time frame of, hopefully, the end of March for CON approval from the Public Health Council. And that, of course, leads to the challenge from general counsel's point of view of just keeping these parties on a separate course. Until we are approved and finally merged, we have to perform as individual entities; and yet; at the same time, obviously there are lots of planning efforts going on, looking ahead to hopefully being merged by April 1.

MS. GIFFORD: Linda, to the extent you can, consistent with confidentiality and privilege issues, can you comment on strategies or methods that you've adopted to monitor and run that process of keeping the institutions on a separate basis?

MS. NENNI: Well, I will say that we provide guidance on a regular basis, and that's on advice of counsel. Counsel is still involved in advising us, and then I try to communicate and do communicate with all the various leadership, both at a board level and a management level, so that folks have an understanding of the need to step back and keep these issues in mind.

MS. GIFFORD: I'm going to ask you one more follow-up question, because it will then lead to a question that I have for Barry. And that is, do you have a view of whether the involvement of both the state and federal antitrust regulators is useful, helpful or necessary in evaluating a hospital merger, which some have certainly considered to be a local matter?

MS. NENNI: Well, I wasn't directly involved. I don't know that I can say—and we had the benefit of being able to deal with both on a joint basis. So I think the perspective is slightly different, obviously, and the issues were slightly different. But not having had it be a huge hassle, very frankly, for us, I'm not sure that I can really say that I would prefer one or the other or prefer that it be local.

MS. GIFFORD: Well, Barry, that does lead into a question to you. As we all know, and as Frank made clear, the markets for health care, including hospital markets, are markedly different around the state. You've got New York City, but you've got the opposite end of the spectrum in what are truly rural areas that have one hospital, and it's probably a very

small community hospital serving an extraordinarily large geographic area upstate. And while these are market definition issues that the federal merger guidelines ought to be able to take into account, at least that is the theory, there has been some criticism of how the guidelines have attempted to take different types of hospital markets into account.

Barry, I would like to ask you what your views are on the issue of local versus federal regulation and investigation of hospital mergers?

MR. BRETT: Well, if that's a cue, Meg.

MS. GIFFORD: That's a cue.

MR. BRETT: So let me pick up, and if I may let me stand to address that for a few minutes.

MS. GIFFORD: Barry has been thinking about this issue for a while.

MR. BRETT: When you try cases you become more comfortable thinking on your feet where you can walk around a little bit.

If we go back to about 30 years ago, we saw that in merger cases a disgruntled Supreme Court Justice Stewart observed in dissent in one case that the common theme that emerged was that, in merger cases, the only thing that was clear was that the government always won. That was the *Von's Grocery* case, in which the government prevented a merger between two retail grocery chains with less than ten percent of the market. That was a grand time for the Department of Justice and the FTC to review mergers. They pretty much had a sense of power and confidence about their ability to stop any transaction that they wanted to challenge

We now have a new mantra which applies to government merger cases in the hospital area. The common theme is the government always loses. In the most recent series of cases challenging hospital mergers in various parts of the country, the federal enforcement agencies have sustained an unbroken string of humbling and unexpected losses before a variety of district courts and circuit courts. Now if you were here earlier today you heard some of the well-deserved praise which the FTC got for its ability to litigate in the *Staples* and *Toys 'R' Us* cases. We know that the folks down at the FTC know how to try a case; they know how to assert aggressive positions and they know how to do that very successfully. But they have been losing. And the results have not been limited to just the FTC. The Department of Justice has also brought several cases recently, and they have lost. And, again, that shift between agencies is kind of unusual. In most subjects either one agency or the other will have jurisdiction over a particular subject area and the agency will generally cede it to the other, and you'll see a continuity between the two agencies. So here we see both

the DOJ and the FTC taking a shot at hospital mergers and both losing.

So if we know it's not the agency, we know it's not the lawyers that account for the string of losses. I think we ought to look to see what we can discern from this string of recent cases that can impact on future analysis of hospital mergers and address the question that Meg put, and I think it is a very appropriate one.

What I propose to do is review four cases in some fairly sophisticated jurisdictions around the country, which represent the latest jurisprudence in hospital merger litigation. The opinions raise important questions about the litigation and analysis of hospital merger cases. The four cases we'll talk about are the LIJ-North Shore merger up here, the Butterworth-Blodgett merger down in Grand Rapids, Michigan, the *Freeman Hospital* case in Joplin, Missouri, and the *Mercy Hospital Service* case out in Dubuque, Iowa.

Now, of these four cases, the FTC's effort to enjoin the Butterworth-Blodgett merger is most striking. The case involved two of the four general acute care hospitals in Grand Rapids, Michigan. The FTC lawyers did their typical great job touching all the bases, and they went through everything that you're supposed to do in analyzing a merger and proving that it is unlawful under the horizontal guidelines. They proved the relevant market and the geographic market and undue concentration based on standards that were satisfactory to the judge. He was convinced. By all of the numbers and ratios in the horizontal merger guidelines, it was a gimme. The injunction could not be lost. The numbers were striking. The Herfindahl numbers used to test mergers showed that the concentration levels would be between 2,700 and 4,500, depending on the market definition, an increase of over a thousand points and almost as much as 2,000 points in the Herfindahl index. Now, for those of you who are more involved in the health care industry and don't deal with these Herfindahl numbers, typically if the numbers get up to 1,800 in concentration after a merger, with a few hundred points increase, in what we call the delta in the merger before and after, you apply those numbers. I'd be happy to spend a little time talking about the Herfindahl index, anyone who is interested, but I can't imagine any sane person wanting to hear. These numbers are off the charts. Again, this is a gimme. And it was done in two markets.

But District Judge McKay who heard the case had an advantage over those folks in Washington who had brought it on; he knew the chairmen of the two hospitals that were involved. And the opinion describes it. He says one was the CEO of one of the largest and most successful bank holding companies in the Midwest, and the other was cofounder of Amway, outstanding public-spirited citizens who are really concerned about the community. They served without fee; this

was a public service on their part. He reviewed that and other factors about how they function. The judge concluded that the merged hospitals would have community interests at heart, and they sort of promised that they wouldn't raise prices to consumers. And they even issued a community commitment statement promising not to abuse their market power. Therefore, he denied the injunction, based on a lot of very, very empirical, local, touchy-feely kind of factors not mentioned anywhere in the merger guidelines and not the kind of thing you would expect to see in a litigation of the Boeing-McDonnell Douglas kind of merger or some other merger that dealt with national or international transactions. Bear in mind, it affected only the local area, and he knew it. The injunction was denied. The FTC appealed, and the Sixth Circuit found no abuse of discretion and affirmed.

Well, a little more recently, when Long Island Jewish and North Shore decided to merge, the Department of Justice decided to take a turn and show the FTC how it was done. Again, that's not unheard of, but kind of unusual. There's usually a continuity and development of expertise in one agency or the other.

Another gimme for the guys in Washington. They looked at the proposed consolidation of the two dominant hospital facilities in a densely populated area of New York. It is close enough to us that we know how important those two hospitals are in the Nassau and Queens area. Once again, all of the criteria, the checklist of the horizontal merger guidelines were met. DOJ showed they were the only two anchor teaching hospitals in Queens and Nassau, and those who dealt with those hospitals in the area of managed care plans in particular—and I think that's very, very important to bear in mind—had no alternative. That's going to be a theme that we'll talk more about, and I think that's an important part of this analysis. The injunction action was tried before Judge Spatt in Uniondale, before whom I've tried a few cases. He's a veteran trial lawyer, knows his way around the courtroom, been a state court, federal court judge for a long time, and he's an important part of the local community. He reviewed all of the facts about the hospitals and local population. He went through a careful analysis, he found the markets, he found the market share. And then after going through that analysis, he said, well, I really don't believe or wasn't persuaded by the testimony of this expert from somewhere that DOJ brought in who said there would be a 20 percent price increase resulting from the merger. He cited the *Butterworth* opinion, and then he pointed out something which was kind of interesting. That the hospitals involved gave millions of dollars of free medical care every year to individuals in need, and that any profit they got, even if they increased it, is funneled back to the communities in the form of new programs and facilities. He therefore concluded that there would be no likelihood of adverse effects on compe-

tion and denied the injunction. His opinion also refers to—and this is a quote: “The proven past intentions of the members of the boards of both hospitals, who are successful business and religious leaders and are not compensated for their services.” Again, that was important to him in evaluating a merger that affected only a local area. He did not decide it based on a lack of interstate commerce, and it seemed to be resolved in terms of jurisdictional issues.

In Dubuque, Iowa, the only two general acute care hospitals tried to merge, and DOJ tried to enjoin them. Again, a traditional analysis, the district judge criticized the government for basing its case on what the hospitals had done in the past and not by assessing what these institutions and their public-spirited citizens were likely to do.

Now, again, speaking from the point of view of a trial lawyer, one would think that proof of what people had done in the past and a course of conduct as to how they behaved would be more probative than someone coming in and saying, “Look, I know what they are likely to do in the future or I can surmise what they are likely to do.” But the court criticized them for basing it on history and looking to conduct in the past. He wanted them to say what they would do in the future. Similar to what we heard Judge Spatt saying and what was in the *Blodgett* case.

Again, out in Missouri the district court refused the FTC's request for an injunction against the merger of the second and third largest acute care hospitals in Joplin, Missouri. As in Dubuque, the judge concluded that the proof of where patients had historically been going was not probative of what the local population would be likely to do in the future.

Now, what do we learn from these results and opinions, and what does that indicate that we ought to be thinking in and talking about? We see that enforcement officials in Washington with great expertise in merger analysis and litigation skills are making decisions about very local matters and losing. The lawyers and the economists at the agencies, in all of these cases, agree the cases are supported by the empirical proof and by economic theory. On the other hand, in each of the cases the local enforcement officials had not challenged the transactions, and often approved them. In each case powerful community interests, including those likely or allegedly the ones to be adversely affected by the transaction, opposed the lawsuits. Community leaders were represented on the boards of both hospitals involved, and they were the ones whose conduct was at issue, and they objected to the cases being brought. Local district judges with greater knowledge of local conditions and strong ties to the community affected by the transaction rejected the application of traditional proof and criteria and approaches based on the horizontal merger guidelines. Almost intuitively, they seemed to conclude and reflect in their opin-

ions that the guys in Washington didn't understand what was going on in the local community.

Now, the feds have not given up. Are the folks in Washington, the Department of Justice and the FTC, just stubborn? And why are they continuing to fight the good fight and putting all these resources that Bill Baer talked about being so precious earlier today in other areas? Why are they putting them to work for local consumers who don't want their help and don't want them in there? And local communities don't want their help. Are these discussions just aberrations; are the opinions aberrational? Or do they reflect the fact that the government is doing something wrong? I suggest to you that we can learn a lot more from this pattern and from some greater analysis that might be coming forward from the government than we've already had. Perhaps something else is going on. And I think maybe we heard a little bit about it earlier when Michael Bloom talked about what the concerns were, the concerns about making the world safe for managed care. Perhaps the government isn't just concerned about the local consumers and the guidelines involved.

We got a hint that maybe there are some other concerns out there in 1996, when the FTC announced it was going to challenge a merger between Rite-Aid and Revco, which it had already indicated it was likely to approve. After the transaction fell apart, and the parties abandoned it in light of the FTC objection, the government folks were fairly candid that their concern was not the effect on consumers, the people the guidelines say they are supposed to be protecting, because consumers could buy the health and beauty aid products and prescriptions in a whole bunch of places. Entry was easy. You buy things from mail order. Everybody is selling prescriptions all over the place. They were concerned about the HMOs, who absolutely had to go to these large chains in order to advertise to their customers that they were supplying them with the right place to get their prescriptions filled. They were concerned that the combination would affect their ability to bargain and get lower prices. Not the public. The effect on the consumers was apparently irrelevant. The FTC candidly admitted that they were more concerned about third-party payors than they were about the consumers.

We also know that the government is the largest third-party payor for health care in the country. And I think they made it pretty clear that they have an active policy of supporting HMOs in order to keep down the costs to Medicare and Social Security systems. Perhaps some of these factors make the government an interested party and not playing its traditional role of protecting the public, and maybe some of those factors are influencing the government to bring cases they ought not to be involved in.

I think it is also appropriate for us to question the relevance of the merger guidelines in traditional antitrust analysis to hospital mergers. Guidelines are based upon the concept of promoting competition and letting market factors sort everything out. The person who makes a better product can charge more if he wants to, let the public make their choices. But normal market forces are not at work in the hospital area, and standard analysis doesn't work. There is a virtual total separation of physician and hospital selection, on the one hand, from the payment obligation, on the other hand. It seems to me it makes it fairly silly to think in terms of the 10 percent price increase analysis that the guidelines talk about for market definition and being important when you're talking about health care. The people who are making the choice, generally, or who want to be making the choice, aren't the ones that are making the payment. And even if they were making the payment, you're not going to see too many people concerned about the cost or the 10 percent difference in price when you're selecting the surgeon to do your coronary bypass. Local people raising money are not prepared to accept ruinous competition in which one player may fail. Clearly the courts have found local conditions a lot more overwhelming and a lot more important than the HHI numbers. Is there some inappropriate hubris reflected in the smug folks in Washington shaking their heads about the local judges and the fellows in the *Blodgett* case who just didn't understand merger law? Or did the local folks know better? Perhaps it shouldn't be a surprise that they haven't been successful.

Let me close with a couple of questions for the group and for everyone to think about. Isn't it clear that the role of Washington-based enforcement officials in reviewing local hospital mergers has to be re-evaluated with a recognition of the federal government's lack of impartiality and its remoteness from the scene? If local officials and the community want a purely local hospital transaction to go ahead, can it ever be appropriate for big brother in Washington to know better? And don't we need tests other than the horizontal merger guidelines in imperfect market conditions? I held my breath and bit my tongue, because I didn't want to take whatever steam there is out of the paper by intervening earlier, but when we hear Michael talking about the FTC becoming more active in Puerto Rico and the local area or supervising in a local area, it occurs to me that we should be more concerned of looking to Steve Houck and his folks to be dealing with that. That's a local concern. The concern about protecting the HMOs and making the world safe for them is a very questionable one, and I'm not sure that that reflects the views of everyone in this room and everyone in the community. Maybe that's a wrong policy decision, and it's a policy decision that ought to be made locally. And I think that at some point in this program we might shift from the usual form, Meg, and instead of just get-

ting questions from the audience we might throw some questions to the audience. Steve is here, and I would love to hear at some point his point of view on the extent to which these issues should be dealt with by Washington or should it be left clearly to his office. They have got some awfully good lawyers there. With that I will close.

MS. GIFFORD: The thought had occurred to me that we have to direct a question at Steve Houck, but we could let him have a few minutes if he wants to think about this before he answers and commits the resources of his office over the next 20 years to doing nothing but health care work.

But before we do that, is there anyone—this is an open-ended but obvious question—is there anyone else on the panel who would like to comment on Barry’s suggestion here? I’m looking at Michael, but Frank just put his hand up. I’ll give Frank first shot.

MR. SERBAROLI: I think one of the points that Barry made is a particularly important one. I’m fond of paraphrasing the late Tip O’Neill’s quote that “all politics is local,” to the effect that all health care really is local. A merger between two hospitals in a particular area in a particular community is not like the merger of two Staples, it’s not like the merger of two Toys ‘R’ Us. A potential merger between a community hospital and Columbia/HCA, for example, is something that is appropriate for review by the Justice Department. This is particularly true if a merger between two competing hospitals would result in a consolidation into one hospital that had control of all of the inpatient hospital services in a particular community.

But in following these cases, the same cases that Barry talked about, I think the government has demonstrated that in some of these situations it simply doesn’t understand the complexity of health care in general, and hospitals in particular. If the Justice Department and the Federal Trade Commission went over and talked to their colleagues in the Health Care Financing Administration, which administers the Medicare program, I think they’d find out that the Medicare program would be delighted if there were more consolidations, and if the costs to the Medicare trust fund thereby started dropping. Furthermore, hospitals don’t offer a single-market product or service. Hospitals are like small cities with different businesses. They have got inpatient services in which they compete with other hospitals. They offer outpatient services where they are not only competing with other hospitals but also with independent ambulatory surgery centers, diagnostic and treatment centers and private doctors’ offices. They offer laboratory and X-ray services, the so-called “ancillary” services, and there too, they are competing not only with other hospitals, but also with commercial laboratories, commercial imaging centers, sometimes publicly traded hospital companies, other clinics,

and again even private doctors’ offices. If a hospital provides home care services, it may be competing not only with other hospitals but with independent local certified home health agencies, independent licensed home health agencies and national chains that offer home care services. So, there is not a monolithic product here that’s definable; a hospital provides a wide variety of services that are clearly separable. And it’s very difficult, I think, to determine or make a case that a merger of two hospitals is automatically going to result in a monopoly over one or more of those services, particularly in the intensely competitive hospital industry in the greater New York area.

MS. GIFFORD: Okay. I would like to ask Michael to comment on Barry’s provocative suggestions, and then I’m going to ask Dr. Noether to give us some information, some background on the economics of these markets and in the course of that to comment on this particular issue and the analysis of these markets from an economic point of view, and whether it really makes any difference to look at them from a local or federal enforcement vantage point. But, Michael.

MR. BLOOM: Thank you. Well, the first question is where to begin. Let me begin by stating, if I’ve not already done so, that my remarks today are not necessarily those of the Federal Trade Commission nor of any individual commissioner.

That being said, if we are stubborn, as Mr. Brett suggests, it is in that we are stubbornly committed to the notion that competition in health care markets, as in other markets, advances the public interest. Hospitals often operate within relatively local markets, and we know that an appreciation of sentiment within the affected communities—in which I include consumers, employers, physicians, payors and so on—is important to correct definition of relevant markets and to accurate understanding of a merger’s likely competitive effects within those markets. To that end, commission staff often consults closely with the offices of the attorneys general and with representatives of government at the county and municipal level as well. Moreover, the FTC and the attorneys general, in addition to augmenting one another’s attorney resources, often bring different things to the party. Thus, for example, the FTC may be able to provide expert economic assistance that is less readily available to the attorneys general. The attorneys general may be able to provide unparalleled access to information and opinion within the state bureaucracies, especially the departments of health.

We are working hard to understand why the FTC and the Department of Justice did not prevail in the preliminary injunction actions that Mr. Brett and others referred to. In particular, as several before me have observed, the result in *Butterworth-Blodgett* surprised, in that it appeared that the

FTC staff methodically established the elements of a violation, precisely as detailed in the merger guidelines. But I don't think that these defeats can be attributed to hubris, as Mr. Brett suggests. Rather, we may need to look hard at whether we've done a good enough job in telling our story. Barry suggested that the government was bent on making the world safe for managed care. That is not the story we mean to tell. As frequently observed, the users of health care services often are not the purchasers of those services. We may need to do a better job in linking up the interests of users, purchasers and payors of health care services—in relating the impact of a merger on managed care companies to the price/availability of health care services to consumers. Making the world safe for managed care is important not in itself, but, as many would attest, because competition among payors can drive costs out of the health care system, enabling employers and other purchasers of health care to purchase more coverage for more people at lower cost. Enabling more consumers to have more health care at less cost: that is the rest of the story.

With respect to the suggestion that, as a major purchaser of health care services, the federal government has a conflict that should lead the FTC and the Department of Justice, in effect, to recuse themselves from enforcement action in health care markets. . . . It certainly is true that the federal government purchases a lot of health care services, but no one has ever suggested that my judgment is or ought to be swayed on that account. And frankly, it hasn't even occurred to me. I'd raise the further question: If, as I suspect, the state too is a significant purchaser of health care services, just who is qualified to review and challenge these as appropriate mergers in these markets?

I take Barry's points very much to heart. I think that we need to do a good deal of soul searching to understand the optimal level of our involvement here; to further define our relationship with state and local authorities and interests. But I think that there is a constructive and substantial role that we should and will continue to play.

MR. BRETT: May I just raise one question, too. And that is, I wonder if you'd be willing to bet on the outcome of a public poll as to whether or not the interest of managed care companies and the interest of consumers are in fact in harmony? I suspect that there are a few people out there who might think the managed care folks really just want to keep the costs down, are not all that concerned about quality or getting everyone well protected, and the folks making the choices have very different interests.

MR. BLOOM: I might happily take your side of the wager. But I think that only underscores the need for us to refine trial strategies that more clearly relate consumers' interests to the interests of purchasers and payors; that more clear-

ly explain how market power directed against managed care companies, for example, may reduce the output of health care services available to consumers. We may need to do a better job of explaining this, but that doesn't change our fundamental inquiry or objective. And there is a continuing need for us to be involved.

MS. GIFFORD: Thank you. If I can now ask Dr. Noether to address perhaps some of those issues of market power in this context, maybe we'll have a little bit more light shed on this subject.

DR. NOETHER: The advantage of going last is that at least some of the background details have already been filled in, and I can hopefully avoid going over some of that again.

I'm really going to walk through the same four hospital merger cases that Barry did but try to bring out more of the economic theories that underlay the government's challenge and the hospital's defense and some of the kinds of evidence that were brought in at trial.

Before I get into that, just to throw my two cents into the managed care consumer battle, as an economist, I do see that managed care has, in fact, enhanced competition in health care markets; that managed care is in fact, driving a lot of the consolidations; and a lot of the consolidations are, in fact, resulting in more efficient delivery of health care. On the other hand, I also think that managed care requires competitors out there to be able to negotiate discounts that, in fact, get passed onto employers, who, in turn, if they are paying less for health care, can pay higher wages to their employees, who are the ultimate consumers. So, I guess I would come on the side that yes, sure, patients are consumers, but I don't think we want to minimize the role of managed care players.

Turning now back to the four hospital mergers that have already been mentioned, the Joplin, Missouri case, the Dubuque, Iowa case, the Grand Rapids Butterworth-Blodgett, and then finally the case that you probably know more about, since I'm from Boston, the *Long Island Jewish-North Shore* case.

I think that even though the government lost all of those cases, and there were certainly common themes in the issues that were raised in each of those case, the emphasis across the four cases has varied somewhat, and certainly the courts' view on the issues varied. In the first two cases, chronologically—the Joplin, Missouri case and the Dubuque, Iowa case—where there were district court cases opinions issued in 1995 on these cases, really the only significant issue was geographic market definition. In both cases the government attempted to define a fairly narrow market where the merger would have led to a very large firm in that market, very high concentration. And the hospital's alternative market definition was a much wider

geographic market, where there were many competitors and no cause for concern.

Briefly, in Joplin, this was a case in Missouri, where Barry said this was number two and number three merging—by the way who were considerably smaller than number one—the government proposed a market that I think was about 27 miles wide. The hospitals' market was 13 counties, considerably bigger, had lots and lots of hospitals in it. In fact, in this case even the government's market did have some other hospitals in it, but it was the government's opinion that the hospitals outside Joplin were, in fact, substantively different from the hospitals in Joplin, that they were smaller, more rural hospitals, and they did not provide the same range of services. Therefore, even though the market might be bigger, the only relevant competitors were in Joplin. So, this sort of gets into a product market definition issue as well. Is a hospital a hospital a hospital? And clearly, as Frank said, hospitals produce bundles of services and different hospitals are producing different bundles of services.

The district court did not agree with the government. The government, by the way, to support its geographic market analysis, analyzed what is traditionally done in hospital mergers: patient flow data. These are hospital discharge data at the patient level. Usually they have the patient's residence zip code on them, the hospital that the patient is admitted to and usually some kind of measure of what the patient is admitted for, like a DRG. And so they are obviously useful for at least tracking historical patient travel patterns.

The government had done that, presented analysis of patient flow data at the trial. It also presented views of hospital administrators from hospitals outside the Joplin area who said that they didn't believe they competed with the hospitals in Joplin because they felt that they offered different services, and in their view the patients that one observed in the discharge data traveling from these surrounding areas, from outside Joplin into Joplin, were going for services that they couldn't provide at their hospitals. The district court argued that this was fine and dandy that the local hospital administrators said this, but this was an interesting turnaround where the district court didn't listen to the local hospital administrators but that the government didn't really use the patient data the way it should have, and that it could have analyzed with the patient data whether or not it was true that the patients who were coming in from around the area were coming in for different kinds of services and that the government hadn't done that.

The district court also criticized the government for not looking at outflow from Joplin. Joplin, if you have any sense of the geography, is located on the corner of Missouri with Kansas, Oklahoma and Arkansas pretty nearby. To analyze outflow effectively, one would have needed data from all four

states. The government didn't do this. Defendants also didn't do this, but they said in this particular case that they assumed that since there was inflow, there was probably outflow. The district court again sided with the defendants there, and the government lost, and the appeals court upheld that.

In Dubuque, again the issue was geographic market. In this case the two merging hospitals were the only hospitals in Dubuque, and the government was alleging a market that essentially consisted of the county in which the hospitals were located and, since Dubuque was on the corner of three states, a 15-mile radius around Dubuque extending into Illinois and Wisconsin. I should say here I have a slight bias on this case in that I was the government's expert, so I also know a little bit more of the underlying analyses that were done.

The merging hospitals in this particular case alleged really a fairly broad geographic market. They alleged a market that extended essentially about 90 miles around Dubuque, a large enough circle really to include the neighboring cities, if you consider 90 miles neighboring, of Cedar Rapids, Waterloo, Iowa City, Davenport and Madison. Clearly, when you include those cities in the market there are lots and lots of comparable hospitals, and there's no issue. The hospitals also believed that several rural hospitals that were within 30 miles of the Dubuque hospitals were also competitors to the hospitals in Dubuque.

In this particular case, the kinds of evidence that the government presented with respect to geographic market were the patient flow kinds of analyses suggesting that there wasn't much going in and out of Dubuque. And I should say that in this particular case we did look at it service-by-service line, and we were able to show that the people who were leaving—who, by the way, were mainly going to the University of Iowa and Iowa City or to the University of Wisconsin in Madison—were in fact going for things that either were not available in Dubuque or where one could argue that there were sufficiently sophisticated services that going to a teaching hospital might be worthwhile for at least some patients.

The government also presented evidence about where physicians at the Dubuque hospitals had privileges and showed that while the two hospitals cross-privileged many of the doctors in Dubuque, practically none of the doctors had privileges anywhere outside Dubuque. Probably most importantly, the government presented the views of managed care players, as we see in the subsequent cases as well, who felt that they couldn't sell a plan to employers in Dubuque that didn't include one of the Dubuque hospitals. Also, there was some dispute among the physicians in the community, but the government had a number of physicians who said that they would only ship a patient out of Dubuque for a service that that patient couldn't receive in Dubuque, and also that they would

not consider getting privileges at a hospital outside Dubuque. And finally, the government had some evidence from the hospitals' documents that they certainly considered each other their primary competitors.

The district court sided with the hospitals primarily, I think, on the basis of the evidence of one of the witnesses that the hospitals brought on who was from the University of Iowa, and his job essentially was to set up outreach clinics in communities surrounding Iowa City, some of which were fairly far afield from Iowa City. And it was his argument, and an argument that was made by the hospitals generally, that as average daily censuses were going down and hospitals were getting hungrier and hungrier for patients to fill their beds, they were being forced really to look further afield for patients, and that as a result of that they were doing things like setting up outreach clinics in areas outside of their own local service area to draw patients in. And that this was having the effect of bringing maybe what used to be different geographic markets together. The district court found this to be a convincing argument and, as was mentioned earlier, he criticized the government—and I quote here, “[T]he analysis must focus not merely on where patients have gone for acute inpatient services but where they practicably could go.” And he was thinking in the future these outreach clinics would become a bigger factor and would, in fact, get patients to travel further, and to be sensitive to the marketing practices of hospitals in really fairly distant areas.

Before I move on to the other two cases, just let me quickly say there were a couple of other issues that were raised in the Dubuque case where the court sided with the government. One was the issue of whether non-profit hospitals are different, whether they are good guys who aren't going to do anything to harm their community. The judge did not buy this argument in the Dubuque case. He felt that while the boards of the hospitals were, in fact, made of community members, that their primary allegiance as board members would be to the hospitals rather than to their communities. Also, the hospitals had done an efficiency study and had come in arguing that there would be substantial cost savings from the merger. The judge rejected most of their efficiency claims as just being too speculative to really consider.

Moving on to *Blodgett*, things get a little more novel, as Barry said. With respect to product market definition and geographic market definition, the district court acknowledged the FTC's market definition and agreed that these were correct and that the hospitals in this market would have market power after the merger. However, he believed that the nonprofit hospitals in this case were very, very different. The fact that they were nonprofit, and the fact that they had a community-based governing structure made up of business leaders and payors, made the situation very, very different. He also, in addition to this

touchy-feely kind of argument that Barry mentioned, took into account economic studies that were presented by the hospitals and the hospitals' economic expert that showed—using Michigan data and, I think, California data as well—that nonprofits tend to have lower prices than for-profit hospitals in the same market. So that market concentration doesn't have the same effect on nonprofit hospitals as it does on for-profit hospitals. I should say that this decision and, in particular, this study has raised a fair amount of controversy in the economic profession. I know of at least two other studies that are about to be published that come up with different conclusions using, in some cases, the same data. So, I think this is an issue that probably really hasn't been put to bed yet. I think it highlights an issue in hospital mergers—really in all health work, that there obviously are a lot of data out there. Because everything has an insurance claim associated with it, so there are lots of data to play with. Unfortunately, the data aren't always—because health care services are so complicated—the data really don't fully reflect all of the different dimensions of the health care product. And so I think, therefore, it's easy to come up with different conclusions depending just on how you use the data. And that's one of the things that's made drawing conclusions for health care markets more difficult.

In terms of the other justification on the *Butterworth-Blodgett* case, in this case the judge really did acknowledge the efficiencies that would be generated by this merger. I believe this is, in fact, the first time in a hospital merger the court bought onto the efficiency justifications that are almost always raised by the hospitals. The situation here may be a little different than in some of the previous hospital merger cases in that prior to the time that the merger was announced, one of the two merging parties, Blodgett, did a study and realized that because of its location and because of its plant it was not going to remain competitive in the market without undertaking a major new building plan, really an entire new facility, and the estimated cost of that facility was close to \$200 million. At that point a community group undertook a study of hospital services generally in the Grand Rapids area and recommended that some type of consolidation occur. So, I think that's an interesting backdrop to the subsequent view of the judge that the community would serve there to really discipline the interests of the hospital. And, also, why he maybe found the efficiency arguments more convincing.

Finally, turning to the North Shore-LIJ suit brought by the Justice Department recently, here the primary issue took yet another turn, and in this case we turn to a product market definition and we get completely in the hands of the issue of whether managed care is the relevant consumer or are individual patients the relevant consumer. In this case the DOJ put forth a product market definition of anchor hospitals, and it said there's a limited number of hospitals that are candidates to

serve as anchor hospitals so as to provide enrollees, meaning enrollees of managed care plans, with the option to use a reasonably convenient hospital that has a prestigious reputation and has a range of high quality services. So, in this case the government argued that the customers are the managed care plans who are trying to put together networks that will serve the residents and employees of Nassau and Queens.

The government alleges that there are only two candidates to serve as the anchor hospitals for these networks, namely the two merging parties. The geographic market that the government alleged in this case was approximately Nassau and Queens. They didn't really define precisely the boundaries of it. The competitive effects—this was mentioned earlier—were that essentially if the merger went through, LIJ and North Shore would cease to compete for managed plan care business and would no longer give discounts which were estimated on the order of 20 percent. This is where the 20 percent price increase mentioned earlier comes from. The government presented views of managed care players, but in fact did admit that the merging hospitals, on the one hand competed with Manhattan facilities for tertiary and quaternary services—the complex services. On the other hand, the merging hospitals competed with local hospitals for primary and secondary services. From the government's perspective, this really didn't matter because they did not believe their product market could be broken up into the individual services. Rather, it was the cluster of services, good reputation, convenient location that together constituted the relevant product market. The defendants obviously argued against this, felt that they did face competition for every single service that they offered, by hospitals close and farther away. They also noted lots of efficiencies from the merger that would enable them to be more competitive with managed care because it would lower their cost structure and therefore allow them to offer yet greater discounts. They pointed to trends in decline of admissions, especially those spurred by recent deregulation in New York. And they also signed an agreement with the New York State Attorney General that mandated they would pass on the savings that they would get from the merger, estimated at \$100 million or more, on to consumers.

As it has been already said, the judge allowed this merger to go through. He did not think that the product market could be defined as anchor hospitals, but rather he examined two product markets, one for primary and secondary services, and the other for certain, more complicated tertiary and quaternary services, and he noted the point that I just made. That in both of those markets, while there are different competitors, there are competitors, and therefore the merging hospitals really have no market power in either. He also went on to say that even if there were an anchor hospital market that made sense, he didn't believe that the merged entity was going to be able to

exercise market power. He pointed out that there was another player in the market, namely Winthrop Hospital, which had been rated as one of the top 100 best hospitals by *U.S. News and World Report*. And, also similar to the Dubuque outreach theory, that Manhattan hospitals were increasingly forming alliances with other hospitals on Long Island, and that they could also serve as anchor hospitals, essentially disputing that the anchor hospital had to be local. He also thought that the commitment to the state Attorney General to pass along the savings on to the community in the form of community outreach programs was important, along with the support that the Attorney General was giving for the merger. He noted also the nonprofit nature of the hospitals, which I think caused him to give greater weight to the community commitment.

In terms of the efficiencies, the judge went in between what the hospitals were saying, which was the usual \$90 to \$100 million per year once they got to the most efficient point, and what the government was saying, which was about \$6 million of efficiencies, and he postulated there would be somewhere between 25 to 30 million. So he's taking a position somewhere in between what previous judges had done, some efficiencies but not others. And I think he also gave a lot of credence to the notion that there is a lot of excess capacity in the hospital industry; that particularly in New York, with recent deregulation, there was going to be more of a push towards more empty beds. Stewart Altman, who is a fairly well-known health policy analyst who I think was the head of ProPac, the federal government agency that until recently advised Congress about hospital issues, testified on behalf of the hospitals. I think the court found this testimony quite credible about how the industry is undergoing lots of change and that you need to allow a lot of consolidation to enable cost savings to be recognized. Particularly, as I said, in New York this was important, because New York hospitals perhaps have been protected for longer than others in the country.

I think maybe I'll stop there for now.

MS. GIFFORD: Okay. Can I ask you, though, a quick follow-up question, which is: In light of the economic theory that one brings to hospital mergers and the different analyses that you've reviewed from your perspective as an economist, is there likely to be a significant difference depending on whether these mergers are analyzed and handled by the federal agencies versus local agencies?

DR. NOETHER: I guess as an economist I don't have a strong view about that. I certainly agree that hospital markets are local and that hospital mergers have to be analyzed on a very fact- and case-specific basis. Certainly the majority of hospital mergers that are occurring are going on to create really needed efficiencies in cost reductions. So, wherever that sort of understanding of the local market comes from, that I think

is what's critical. Whether it has to be done by a local agency or whether a federal agency can do it, I'm not sure.

MS. GIFFORD: Barry.

MR. BRETT: Meg, may I just ask Monica a follow-up to your question, and it's this: From the point of view of an economist, in talking about how one analyzes mergers and the objective of letting the marketplace make decisions, does the almost total separation of choice and payment obligation, where we have so much insurance and third-party payors, suggest that the traditional methods of analysis need to be approached differently in terms of the objectives and what may be a pure market functioning in these areas?

DR. NOETHER: I think you certainly need to take that into account. I would also say that it does not allow you, however, to throw away the traditional tools. In other words, I think there's sort of an upstream and downstream way of thinking about the consumers of health care. I think you've got the ultimate patients who, you're right, are not going to be very sensitive to price (a) because a lot of what they have to deal with happens on an emergency basis, and (b) because they are not paying most of the bill. On the other hand, I think upstream, the entities that are, in fact, paying the bills on behalf of these consumers are clearly very price-sensitive. The managed care plans on the other hand are selling—have to sell their policies to employers who, in turn, are hiring these ultimate patients and are therefore competing for the ultimate patient, the consumers. So I think there is a link there, and that the plans are essentially competing with each other to sell insurance to employers who, in turn, are competing with each other to hire the ultimate consumers, who are the patients. So, as I say, I don't think you can really divorce the two completely.

MS. GIFFORD: As predicted by this entire panel, there is no way we are going to cover the variety of subjects that we had hoped to cover this afternoon, and I want to give members of the audience a chance to ask some questions. But with the sufferance of the section chair as a panel member, I would like to spend just a few minutes on the issue of integrated delivery systems, which are a form of multi-provider network that happens to be a specific development of the Health Care Reform Act in New York. John, can you tell us what an integrated delivery system is under HCRA?

MR. FRANZEN: An integrated delivery system can be read about in section 4408-A of the Public Health Law; it's essentially a provider-sponsored HMO. It is an element of HCRA that was proposed by some large hospitals and systems, but they are subject to all of the requirements in article 44 of the Public Health Law and regulations under article 44 and all insurance law provisions applicable to HMOs. The significant distinctions between any other HMO and an IDS are really the

fact that they are provider based, and they must be provider owned or sponsored or controlled, and on the basis of that, satisfactorily constructed. They have the potential for receiving a break on the initial startup, solvency and reserve requirements imposed on a traditional HMO by the state Insurance Department. The Insurance Department has indicated, however, they'll start with the existing review guidelines that they use for HMOs. Statutorily, those reserves required of a regular HMO are the highest reserves that can be applied to an IDS. Apparently the theory is, if you integrate sufficiently a large spectrum of providers, a vertical spectrum of providers, that perhaps this plus the bricks and mortar involved justify a break on the solvency requirements.

The statute also makes a very brief first prong "state action" statement that IDSs will be exempt from federal and state antitrust laws. That provision doesn't exist for other HMOs. And the question that's still open, I guess, is whether, assuming the first prong has been addressed, whether active supervision has to be additionally established in regulation or whether the existing statute and regulations pertaining to HMOs are sufficient to secure the apparently intended state action exemption for anti-competitive activities by an IDS or amongst its constituent providers.

MS. GIFFORD: Is there any current plan that you know of, John, to put into effect a system of active supervision, such as is called for by the *Ticor* decision and others?

MR. FRANZEN: There is nothing imminent at the moment. We are certainly looking at the issue. We want to talk some more to some experts, including Mr. Houck and Mr. Bloom. These would be commissioner's regulations if they were deemed to be necessary. As I understand the state of the issue under state action, while *Ticor* is the latest and probably landmark state action decision, it's not clear whether where you have an existing scheme, such as HMOs are provided with in article 44, you have to go beyond that. As I recall from the last time I looked at it, there's a suggestion that where you have anti-competitive agreements that you have to actively supervise the life and health of those agreements. If that's the case, then we'll probably have to do some more in terms of regulation to meet that second prong.

MS. GIFFORD: I think there certainly would be some hesitancy on the part of institutions that are considering putting together an integrated delivery system and submitting it to the state for what is undoubtedly a rigorous review process to go ahead with that in the absence of some greater certainty on this antitrust issue. Linda, I see you agree with that. Would you like to comment on that?

MR. FRANZEN: I think that's valid.

MS. NENNI: No, I think that's true. We had talked earlier about whether or not the system or the parties in Buffalo had considered it. And it is kind of premature at this point. But one might question whether or not it would be advisable, even on my part, to say we should absolutely do this when you've got that question out there, subject yourself to the regulation when you really don't know you've got the protection.

MR. FRANZEN: We have no applications in-house yet. We have met with six or eight groups that indicate they are interested.

MS. GIFFORD: Linda, is this integrated delivery system something that a hospital provider, from your perspective, hospital providers in New York State do see as a potentially valuable new framework within the deregulated system?

MS. NENNI: Yes, I would say so. I think, however, there are a lot of considerations, not all legal, as to whether or not it is advisable—if and when the degree of capitation and the relationships that exist in terms of aligning providers, aligning physicians with hospital providers and risk arrangements, and the variation of receptivity of the payors to working those kinds of contracts out, I think at least in part drive the strategy of if and when to consider an application to become an integrated delivery system under the statute.

MR. FRANZEN: I think another factor is—or you might want to keep it in mind as a question—the current state of the managed care market, whether it is fairly full. It is very competitive. I think it might be a very challenging undertaking to try to come in and create and successfully run a new managed care plan, at least in some areas.

MS. GIFFORD: I would like to open this up for questions. Are there questions from the audience? Michael.

MR. MALINA: Is there any antitrust lawyer in the room who would be comfortable advising a client to do one of these things without much more vigorous regulation by the state? I know for one I would be very, very queasy. You go directly to jail and you don't pass go or collect \$200.

MS. GIFFORD: Well, Michael, this is why from a personal, selfish point of view this question was on the agenda at all, because that's exactly the position that I've been in, and I was really hoping we might get some answers to this and whether there's further regulation coming down the road.

MR. MALINA: I think it would be very risky to counsel someone to go forward with this kind of a program without a great deal more certainty on the antitrust status of these things.

SPEAKER IN AUDIENCE: Under the New York State certificate of need law for a number of years the commission-

er herself has been attempting to get two hospitals in numerous communities to merge by using the approval process to give one this service and the other another service. At the present time I understand that either the Department of Justice or your office, Mr. Bloom, is challenging a couple of mergers of upstate hospitals in towns that really can't support more than one hospital. Have you taken that or do you take that into consideration, that the state officer has used his regulatory powers to try and force hospitals to merge when they eventually come together and are trying to merge?

MR. BLOOM: I'm frankly not aware of the situation that you're describing. We certainly would consider whether action of the Department of Health constituted state action. We certainly would work together with Steve Houck to understand the import and motivation for any action of the Department of Health. But I'm at a loss because I'm not familiar with what you're speaking about.

MR. SERBAROLI: Tell them to go ahead.

MS. GIFFORD: Since we have all been using his name, I'm not going to wait any longer. Steve Houck is the chief of the Antitrust Bureau of the New York State Attorney General's Office. And Steve, have you had adequate time to think about the issue of local versus federal?

MR. HOUCK: Well, you've said so much, it is kind of hard to remember. I have a lot of thoughts about what was said. One thing I do remember, that Barry said, is that we have a brilliant staff. I 100 percent agree with that. A number of them are present here today. And in fact, we tried to augment our staff in the health care area in anticipation of all these various antitrust-related problems that are and will be occurring in light of deregulation here in New York State. And our relationship with the Department of Health is very important to us. We have had an excellent relationship with John Franzen personally, and we have tried to formalize that a little bit, as John pointed out, given the number of mergers and other joint activity that's occurring. Also, our relationships with DOJ and the FTC are very important. They do have at least one advantage I can think of over us, namely Hart-Scott-Rodino. Filings have to be made with the federal government and not with us. So, they often get a little bit of an earlier start than we do with respect to documents. And in fact, a number of the transactions that take place upstate are not even known to us, and that's one reason why we work with the Department of Health to try to get a little bit of an earlier warning on some of these things so we can take a look at them.

We do have a number of active investigations looking at transactions around the state. In New York City and up in Buffalo, there is still a fair number of hospitals up there, you know, that was one of our considerations, both in the LIJ-North

PRESENTATION OF THE ANNUAL AWARD FOR SERVICE TO THE ANTITRUST LAW SECTION

IRVING SCHER, ESQ.

Weil Gotshal & Manges

MR. MALINA: Good evening to everybody. I'm Mike Malina, and Barry Brett tells me when this dinner is over I'm going to become chair of this section. And I'm wondering why I'm here, because the program that I chaired finished about an hour and a half ago. Nonetheless, it does fall to me to welcome you all. And I must say, as an attendee of this dinner over the past number of years, it is a genuine pleasure to see how many people and firms are here represented today.

I was thinking all day of what kind of a joke one could tell to such an august group, and it did occur to me that Georgie Jessel is quoted as having said to his companion when they attended the funeral of Harry Cohen, who was the generally despised president of Columbia Pictures, and they were going toward the funeral parlor and they couldn't get in because the mob was so great. Jessel was quoted as saying to his companion, if you give the people what they want, they'll come out.

I suppose the presence of Mr. Klein brought you out, and if that's so, it's well deserved.

It falls to me to introduce the people sitting here at the dais. And I'll go from my right to my left which I take is your left to your right, if that's right. And while everybody is deserving of applause, we ought to save applause to the end, or we'll be here till God knows when. On the far right is Michael Bloom, who is the director of the New York Regional Office of the Federal Trade Commission. To his left is Ralph Giordano, who is the head of the New York Office of the Antitrust Division of the Department of Justice. We very carefully seated him a few steps away from his boss so he doesn't have to account for what he's been doing. To his left is Meg Gifford, who is our newly elected secretary and chaired a very exceptional program this afternoon on antitrust and health care. To her left is Steve Houck, who is the head of the Antitrust Bureau of the New York State Attorney General's Office. Next to him is our honored speaker this evening, the Assistant Attorney General in charge of the Antitrust Division, Joel Klein. To my immediate right is the gentleman who is still chairman of this section, Barry Brett. Over here is Irv Scher, who will be receiving our award for service to the section, and to his left Amy Katz, his lovely wife. To her left, Alan Weinschel, who was the chairman of our nominating committee this year. And all the way over there is Bill Lifland, who for more years than one can remember has delivered his review of antitrust developments in the past year, and this afternoon was no exception.

We will try, but I cannot promise to get everybody out by 9:00. I am virtually certain we'll get everybody out by 9:30, and that's not bad.

Before we have dinner, I do have one very pleasant job to do. Barry, would you stand up, please? I have here a token of thanks to Barry Brett, who has chaired this section over the past year and is very much responsible for a very substantial increase in our attendance at the dinner and our attendance at the program today. He has really made a mark in the section's history for all of us. This is a Tiffany clock which, when it ultimately gets engraved, which it's not, will say: Presented to Barry Brett in recognition of his services as chair, New York State Bar Association, Antitrust Law Section, 1997-1998. There you are.

With that I'll say bon appetit, and you'll be hearing from us further after dinner.

* * *

MR. MALINA: In an effort to try to move things along while we are enjoying dessert, before we proceed with some of the other business of the evening, I want to express the section's gratitude to Charles River Associates, which was good enough to sponsor the really lovely cocktail hour that we had this evening.

And I also would like to thank those law firms that were gracious enough to share their tables with the substantial number of law students that were invited here this evening. This is part of the section's attempt to expand our influence, such as it is, to the law schools, and we will be having more to say about that as the year goes by, and you'll be hearing about it.

One of the really lovely parts of this job is the ability to be presenter of our award for distinguished service. And we are particularly honored this evening to be able to give to you the first recipient of that award last year, who this afternoon once again graced us with his annual antitrust review, which anyone who was here was privileged to take in. Before I present Bill Lifland, however, Irv Scher's partner, Alan Weinschel, asked for special permission to say a few words. And since he's a former chair of this section, we were not in a position to say no. So here is Alan.

MR. ALAN WEINSCHTEL: Thank you. Michael Malina is always in a position to say no, since he's said no to me a lot of times on things we've worked on.

Before Bill gives his award to Irv, I just thought I'd add some personal notes to my partner and my friend.

First, anyone who has worked with Irv will agree that one of his most endearing traits is his enthusiasm and animation when it comes to antitrust law. Irv is truly a lawyer's lawyer who approaches reading cases with a sense of "what might we discover here."

There was a time some years ago when a memo was circulated through the firm announcing the availability of the Integrated Research Retrieval Vehicle, the IRV. You just dial 8120, state the problem, and case citation would be provided immediately. It worked a lot better and a lot faster and a lot cheaper than Lexis. Irv has also been seen prowling the halls, ducking into various offices to ask the occupant, did you see what the Sixth Circuit just did? Because Irv is almost always the first one who has not only read the case but devoured it and figured out what it really meant.

Now, the second thing that I wanted to say is that it is absolutely fair to say that, between Irv's frequent CLE lectures, the classes he's taught at law schools, his stint as chief of antitrust developments and his stewardship of the *Antitrust Advisor*, that a very large number of people in this room, as well as elsewhere, had been taught something about antitrust law by Irv. Some have listened more carefully than others, of course. But we have gone back and examined the record, and Irv has never been wrong on a single point of antitrust law.

There have been times that judges may have disagreed with Irv, even one who made it to the Supreme Court. But I can assure you that they are the ones with erroneous views, not Irv. I can always assure you that there isn't anybody more deserving of this award than my partner, Irv Scher.

MR. MALINA: Thank you, Alan. And here is Bill Lifland.

MR. WILLIAM LIFLAND: I've known Irv Scher for pretty close to 20 years now, and I thought I was familiar with the amount of time he contributed to the Bar Association as well as the amount of time he devoted to CLE programs, such as PLI, and I also thought I knew a little bit about his writings. But when I got his biography, I was amazed by how much he had done that I did not know about. I didn't know that during the time that he was working his way up in the American Bar Association Antitrust Section from committee chairman to member of the council, and then section officer, section delegate and chairman of the section, he was also a member of the council of another ABA section, the Business Banking and Corporate Law Section, for which his responsibilities must have taken almost as much of his time as the Antitrust Section required. Also, while I thought I knew his work in the CLE area, I did not know that he was also serving as an adjunct pro-

fessor at NYU and teaching a graduate school course on antitrust and trade regulation subjects at Syracuse. Finally, I was familiar with Irv's writings about the Robinson-Patman Act which, incidentally, I can recommend to everyone, but had not realized that Irv has found time to edit and co-author the *Antitrust Advisor* and the ABA's antitrust developments book that so many of us have just behind our desk. And while he was doing all these things, he was also carrying on an active practice at the Weil Gotshal firm and, incidentally, just incidentally, found time to be chairman of this section and a frequent participant in its programs. So, Irv, it gives me great pleasure to express the gratitude of this section and of many of us individually for everything you have done for us all.

MR. IRVING SCHER: Thank you, Bill, Alan and Michael.

I'm extremely pleased and honored to receive this award. The reason I'm pleased is that so many of you missed *Seinfeld* tonight to be here. But all is not lost, because I'm taping it, and if you would like to borrow it, just give me a buzz, and I'll get it over to you.

I'm honored for a number of reasons. First, I certainly can think of many others who deserve this award well before me. Therefore, it means a great deal to know that you have singled me out so soon after its inception. Second, the award is presented by my peers and colleagues in the New York antitrust bar. That's significant recognition, because this bar is a great center of antitrust law. We have distinguished law schools and a heritage of outstanding antitrust professors. It's also the home of many fine antitrust jurists, both in the district courts and in our Court of Appeals. Moreover, the knowledge, experience and antitrust expertise of this section's members are not exceeded anywhere. In all my years of practice, I haven't known a finer bunch of antitrust lawyers, as colleagues or as adversaries.

But even of more importance to me, as I look out at tonight's attendees, I see much more than just professional associates. I see many friends, a number of whom are almost like family to me, and I really appreciate that. But I'm only going to single out two notable members of our bar, without whose guidance I wouldn't be receiving this award tonight. Professor Milton Handler instilled a love of antitrust law into me that I did not have before taking his course and working on one of his very perceptive law review articles in 1962, co-authored by another great antitrust lawyer, Stanley Robinson, who we are honored to have with us here tonight. Those of us who have learned from or practiced with Professor Handler will always walk in his shadow.

My partner and mentor, Ira Millstein, who isn't here tonight because he's on his way to London, another former stu-

DINNER SPEAKER:

HONORABLE JOEL I. KLEIN

Assistant Attorney General in Charge of the Antitrust Division, United States Department of Justice

MR. MALINA: That is a hard act to follow, but I think we can follow it with an equally first class act. When I first started attending the dinners of this section back in the sixties, it was an annual event to have the Assistant Attorney General in charge of the Antitrust Division address us. I remember the first time I heard that address from Lee Levinger, then from Don Turner and a host of others. In recent years, for a variety of reasons, we haven't been that fortunate. But this year we are. I have been sitting at my desk all week waiting for a telegram from Bill Gates demanding equal time, but I never got it. So we are able to give you Mr. Klein, without opposition.

I don't know Joel that well, and I thought it would be appropriate to have my predecessor, who I suppose since dessert has not been completed is still chair of this section, do the honors and introduce him. So I'll ask Barry Brett to do that for us.

MR. BARRY BRETT: It is a happy assignment. I promised that we would not do any Microsoft jokes. But as you've heard, it has long been a tradition for the Assistant Attorney General of Antitrust to be our speaker. Now, we did get away from it for a few years, and some of my initial remarks have been usurped by Michael, so I'm going to jump right into the middle. And while we can't be too unhappy by having Robert Pitofsky as our speaker last year, I'm delighted we are back on course, bigger and better with an articulate spokesman of antitrust with a global view of a competitive economy and a man who has filled the house for us tonight, as my friends in the theater would say.

The one story I do want to tell you is how we got him to come tonight. When I was elected last year, I wasn't going to take any chance with the annual dinner which would end my tenure. I got to Joel last January, right after his appointment was announced, before the confirmation battle really began. I caught him between two sets of tennis in Hawaii. It was hot, he was totally vulnerable, perspired and trying to catch his breath because he was in competition to win the tournament. He had no place to hide. He accepted the invitation for tonight's dinner just to get rid of me so he could rest before the next set. He didn't realize at the time he really didn't have to rest, because he was playing in a tournament with antitrust lawyers who had spent years learning how to suck up to clients and others, and there was no way he was going to lose that tournament. He would have won even if he wasn't a wonderful player, which he is.

Little did any of us know last January how exciting a year it would be at the antitrust bar. In retrospect, perhaps Joel would have enjoyed a little less controversy, particularly with some of his friends in the Senate and elsewhere. But in his first year in office the division has shown a vigor and courage to fight the good fight and stand its ground in favor of a strong competition policy with a view of the whole world, despite enormous pressures and no matter how formidable the foe might be.

As we know now, largely thanks to Joel, antitrust is in the news in a positive sense. Important issues are being discussed, and it's the most positive and informative kind of information coming out of Washington these days and the best thing to talk about. Dogma has given way to legal and economic analysis, tempered with wisdom and judgment and effective advocacy. The division is really at an exciting time, and I'm told that antitrust is a hot course in the law schools again, and more students want to become antitrust lawyers than want to become sports agents. It's a big move for us.

Our guest speaker is a native New Yorker who attended Columbia University. He was obviously rejected by its law school before he settled for Harvard. He was then law clerk to Chief Judge Baslin on the D.C. Circuit and for Justice Powell on the Supreme Court. He has argued numerous cases before the Supreme Court and succeeded in private practice and government service. Joel's accomplishments, honors and community service activities are many and varied. It is my great pleasure to introduce to you our guest speaker for the evening, the Assistant Attorney General for Antitrust, Joel.

HONORABLE JOEL I. KLEIN: Thank you. I'm delighted to be here tonight to talk with you about antitrust enforcement from the perspective of the Department of Justice. These are exciting times at the Antitrust Division, as well as in the American economy, and preparing these remarks has afforded me the opportunity to take stock of where we are in antitrust and where we're heading. Some of you may recall that, when I first took over as head of the division, I announced a three part agenda—reduced to a sound bite, I termed it, “developing legal doctrine and practices for an age of globalization, deregulation and technological change.” In the past year, we've been doing just that and there is a lot to report on all three fronts. After briefly reviewing what's been going on generally, I will then spend the bulk of my time talking about the third of these challenges—the role of antitrust enforcement in our high-tech, fast-moving economy. I've been interested in

this last issue for some time and, in the wake of our consent decree enforcement action against Microsoft, many others appear to have become interested in it as well. While several questions have been raised, there are two points that I want to focus on this evening: first, whether our industrial-age antitrust laws need to be rewritten to cope with today's information-based economy; and second, whether there is any role at all for antitrust enforcement, given the fast-moving, innovative nature of these new markets.

I. Developing Legal Doctrine and Practices to Address Globalization, Deregulation and Changing Technologies

A. Globalization

As we anticipated, developments on the international front have been moving extremely rapidly. In the past half dozen years, the portion of the Antitrust Division's cases having an international dimension has increased from less than 5 percent to more than 30 percent.

Most notably, we are now engaged in an extensive and very sophisticated international cartel-enforcement effort, building on our significant accomplishments in the *Archer Daniels Midland* case. Today, we have more than 30 grand juries throughout the nation looking at cartels involving companies in more than 20 different countries, some in industries that do over a billion dollars of annual commerce in the U.S. alone. In our last fiscal year (ending on September 30, 1997), we brought in more than \$200 million in criminal fines—five times greater than our previous high—and I expect that we will soon see guilty pleas or prosecutions in some additional, high-visibility cases. Based on our efforts in this area, moreover, the Organisation for Economic Cooperation & Development (OECD) is about to adopt a proposal, supported by all the major industrial countries, endorsing cooperation among competition authorities with respect to cartel enforcement. I view this as a major step forward, one that will help us expand our efforts to get evidence and reach witnesses throughout the world. The crimes we are pursuing are global and, to be truly effective, our territorial reach must be commensurate. In addition, we're finding that our enforcement agenda increasingly includes mergers that are also being considered by foreign competition authorities—for example, right now we and DG IV of the European Union are both reviewing the American Airlines/British Airlines alliance and the two Big-6 accounting-firm mergers; and indications are that the Japanese Fair Trade Commission is likely to seek to extend its jurisdiction to cover these kinds of multinational mergers as well. In mentioning this matter, of course, I am immediately reminded of the significant problems that arose last summer when the U.S. Federal Trade Commission and the DG IV reached very

different conclusions with respect to the Boeing/McDonnell-Douglas merger. While that kind of sharp divergence is unique in our experience, we still must explore ways to avoid any recurrence and, to that end, we and the FTC have been working closely with DG IV. Given the understandable concerns about national sovereignty, navigating these waters—along with other issues raised by multi-jurisdictional merger review—will not be easy. And, finally, on the international front, the issues at the intersection of trade and competition are becoming increasingly important and, frankly, potentially the most difficult to solve. Impairment of market access by private business restraints raises significant concerns that are relevant both to trade and to competition policy. Some of these issues, as you know, are swirling around in the shadows of Kodak's trade case in the World Trade Organization (WTO), which specifically involves charges of governmental barriers that have blocked access to the Japanese film and photographic paper markets. At the same time, the WTO has decided to look directly at non-governmental, private markets restraints—in a very preliminary way, I should add; and I should also make clear that, at least as I see it, these efforts are unlikely to lead in the near future to some form of international dispute resolution, although I suspect that some countries may seek such action. For our part, we have been pressing ahead with the concept of positive comity, where one enforcement authority refers a market-access issue to the agency whose market is most directly affected by the denial of access. We will soon execute a detailed agreement with the Europeans, outlining a formal protocol for such cases and, in the meantime, we have referred our first positive comity case to them—a case involving allegations that several European airlines engaged in anti-competitive behavior designed to thwart competition by Sabre, the computer reservations system affiliated with American Airlines. Positive comity is a very encouraging development and certainly represents a sound conceptual approach. The current problem, which I anticipate will lessen over time, is that many competition authorities are either insufficiently independent or otherwise too weak to bring market access cases that might benefit foreign competitors. As even this brief summary makes clear, these international issues are as complex as they are important. While I think we have articulated a clear and sensible policy to deal with them—for now, relying principally on bilateral cooperation agreements with our counterparts, coupled with some multilateral efforts at the OECD and some very preliminary discussions at the WTO—I think we need to develop a long-term vision as well. To that end, I have recently established a 12-member Federal Advisory Committee, which I have charged with taking an independent look at these matters and preparing a proposed blueprint for the division. The group, called the International Competition Policy Advisory Committee, is chaired by two well-known players in the area of trade and competition, Jim Rill and Paula Stern, and

has Merit Janow, a distinguished professor from Columbia University, as its executive director. The other ten members are outstanding leaders from business, labor, government and academia. Their first meeting will be February 26, and I expect that their deliberations will continue over the next couple of years. The committee's meetings will be open to the public and we welcome participation from the bar. I look forward to very significant contributions from this group.

B. Deregulation

During the past 25 years, the Antitrust Division has played an important role in facilitating competition and assisting deregulatory efforts in a number of monopoly industries, including telecommunications and electric power. In recognition of that background, and given our experience in the AT&T litigation, Congress called on us to assist in the implementation of the Telecommunications Act of 1996. I have said a great deal about what's been going on in this area in published speeches and congressional testimony, so rather than reiterate the division's views here, I would simply refer you to our Web site for the details.

In the meantime, in order to eliminate the suspense before you get the opportunity to go on-line, let me at least summarize our position. Contrary to the views of the skeptics, including many in the popular press, I believe that, in general, the process is moving forward constructively and that, if we stay the course, the Telecom Act will bring real benefits to America's consumers. Despite the overly optimistic rhetoric sounded by industry participants during the debates leading up to the passage of the act, it should come as no surprise to sophisticated observers that long-standing monopoly markets take time to open, especially when widespread competition depends, at least for the near-term, on the shared use of an incumbent monopolist's facilities. Lots of money is at issue here, and shared facilities raise complex issues of pricing, access and ensuring affordable universal service. As a result, we're seeing a lot of litigation by the affected business interests. But what's less visible is that market forces are moving forward; in particular, the incumbent monopolists, while not yet losing a lot of customers, are losing some of their most lucrative customers. And those forces, in my opinion, will lead to significant increased competition and innovation in the next few years, as the Regional Bell Operating Companies (RBOCs) come to conclude that it makes more sense to open their markets fully, so that they can then get into the long-distance market, rather than to litigate, which often leads to increased uncertainty and delay. I should also mention that, in addition to implementing the Telecom Act, the division is now actively involved in considering possible federal legislation aimed at deregulating the electricity industry. As an historical matter, these are remarkable developments. Two industries,

long thought to be natural monopolies, are now undergoing significant structural change, which will lead to real competition over time. By the way, one of the more interesting issues to have arisen as we have engaged these deregulatory efforts is how to think about the relationship between merger policy and deregulation. I gave a speech last week before the Federal Energy Regulatory Commission (FERC) in which I raised some of my concerns in this regard—asking whether, for example, Congress should consider shifting the burden of proof for certain narrowly defined categories of electricity mergers during the early years of restructuring. I hope you will look at those remarks and let us know what you think. The issues are important, and I will candidly acknowledge that the solutions aren't easy.

C. Technological Changes

As I mentioned at the outset, I plan to spend most of my time this evening on the role of antitrust in high-tech industries, but let me first make a few brief comments generally about what's going on in terms of antitrust doctrine and the use of litigation at the division. A big part of our agenda has been to focus on, and clearly set forth our views with respect to, important doctrinal issues in antitrust enforcement, such as the application of the unilateral effects, coordinated effects and network effects doctrines. We do this through a variety of vehicles: in speeches, in formal guidelines, in competitive impact statements and in court filings.

And, as I have also made clear, we are especially interested in pursuing new doctrinal issues by re-engaging the federal courts, which, for the past two decades, have experienced relatively few cases (save in the criminal area) being litigated by the Antitrust Division. Currently, we have four civil non-merger cases in active litigation—surely the largest number in several decades—and in the past six months we filed three contested merger challenges, also something of a modern-day record. Several of these cases raise important issues relating to high-tech industries—Microsoft, obviously, but also our case against General Electric, which involves limitations on intellectual property licenses. These are encouraging developments and I believe that they reflect a renewed vitality in the antitrust field.

II. Going Forward—Antitrust Enforcement in a High-Tech, Information-Based Economy

Although, as I've just been describing, the implementation of our three-part agenda has been robust, and I believe effective, the truth is that interest in these matters has largely been limited to antitrust lawyers and affected businesses. That all changed, of course, when the media began reporting on the Microsoft case. At its core, the public debate that ensued has

raised the fundamental question whether there is a role for antitrust enforcement in our current economy. I have been wanting to talk about this issue for some time and figured that if I were to ask the question about relevance here tonight—and then answered it in the affirmative—I would receive a warm reception, if for no other reason than that most of you make your living in this field and so I assume that you'd like to be reassured that we have a future. Well, I believe we do. To be sure, as I will explain, the role for antitrust in high-tech industries is likely to be modest in scope and surgical in application. But, in my view, that hardly makes it unimportant. Quite to the contrary, the economic qualities that tend to characterize market behavior in high-tech industries are such that we will almost certainly see companies come to enjoy very significant market power, which in turn is likely to lead to antitrust scrutiny (though, I should be careful to note, not necessarily antitrust condemnation). More generally, as I will explain in a moment, there is nothing so different about these new technology-based markets that could possibly support abandoning this nation's long-standing belief—a belief based on lots of experience—that competitive markets work best for consumers and antitrust enforcement is essential for sustaining competitive markets.

A. The U.S. Economy Today

Whatever else we may agree or disagree about, we certainly can find common ground by starting with the fact that the U.S. economy is remarkably strong today—much stronger, I would suggest, than most of us would have predicted a half-dozen years ago. Unemployment has been below 5 percent for close to a year and below 6 percent for three years; our growth rate has been almost 3 percent over the past six years; and, given these two numbers, perhaps the most remarkable fact is that inflation is essentially non-existent. This wasn't suppose to happen. In fact, the economists told us that it couldn't happen. Under various models, first referred to as the Phillips curve and later refined to the Non-Accelerating Inflation Rate of Unemployment, we were led to believe that, at these levels of growth and unemployment, we would have serious inflation. Why haven't the economists' predictions been borne out?

Several factors doubtless help to explain this remarkable set of economic developments, including President Clinton's leadership and the fine work of Secretary Rubin and Chairman Greenspan. But there is one other factor that is sometimes ignored but should also be noted here, and that is that our economy is more competitive today than it has been in a long, long time. Over the past several decades, we have experienced a steadily increasing national commitment to competitive markets and away from a regulatory approach. Whether it is airlines, surface transportation, energy or telecommunications, our faith in competition has triumphed time and again. And, to the same effect, we have repeatedly opened our markets to for-

eign firms, often leading to renewed competitive vigor in industries that were previously characterized by oligopolistic lethargy—the automobile industry perhaps being the most obvious example. It is no mere coincidence, I would suggest, that at a time when our economy is the most competitive economy in the world, it is also the strongest. Indeed, when thinking about the relationship between competition policy and the current strength of our economy, it's especially instructive to compare our policies with those of our major trading partners, some of whom—like the Japanese and Koreans, for example—are now experiencing rough times. These other economies have been characterized much more by regulatory, sometimes even cartel-like arrangements, embodied in notions like rationalization cartels and the promotion of a single “national champion” within a given industry so that it could best compete in the international arena; and some of these countries have also experienced structural or even cultural barriers to foreign competition, such as the *keiretsu* arrangements that continue to dominate significant parts of the Japanese economy, for example. The effects of these structural differences in the major national economies were thoroughly analyzed by Michael Porter, a distinguished economist at the Harvard Business School, in his landmark book, *The Competitive Advantage of Nations*. Almost a decade ago, Porter concluded—again, before it was fashionable to say so—that “active domestic rivalry is strongly associated with international success,” whereas “creating a competitor rarely results in international competitive advantage.” In light of recent economic developments, I think it's fair to say that Porter was right and that the United States is very fortunate to have embraced competition policy with as much vigor as we did.

B. Antitrust Enforcement

While Porter's analysis is generally accepted today, it is less clear what antitrust has to do with all this. Porter had little doubt about that question as well. In a part of his work that has received somewhat less attention, he concludes that “a strong antitrust policy . . . is essential to the role of upgrading any economy.” But why should that be? The answer, I believe, is that, contrary to the view in some quarters, the natural state of markets is not to move towards increasing competition. Market power, rather than a competitive market, is something that every business understandably wants because it allows a business to increase its profitability at the expense of the consuming public. And, if the antitrust enforcers closed shop, I have little doubt that the competitive structure of our economy would erode significantly; mergers and other agreements to achieve market power would occur in a heartbeat; and market power that had been legitimately achieved, through the development of intellectual property, for example, quickly would be used to extend or protect a monopoly position. While often for-

gotten, none of this is new. If you go all the way back to Adam Smith's seminal work, *The Wealth of Nations*, you will see that, despite his pro-market, laissez-faire take on the economy, he fully recognized that the government has a crucial role to play in assuring that businesses do not attempt to end-run the competitive process. More recently—now we're only talking 60 years ago—Thurman Arnold, one of the great antitrust thinkers in this nation's history, as well as the head of the Antitrust Division from 1939-43, explained, "The maintenance of a free market is as much a matter of constant policing as the flow of traffic on a busy intersection. It does not stay orderly by trusting to the good intentions of the drivers or by preaching to them. It is a simple problem of policing, but a continuous one." Arnold was also fond of another metaphor, one that I find especially congenial for today's economy: "The competitive struggle without effective antitrust enforcement," he wrote, "is like a fight without a referee." I like this way of putting it because it highlights what I consider to be the two essential points about effective antitrust enforcement—first, that it should not be abandoned; and second, that it should not be overdone. In other words, while it's true that you need a referee in a sporting match, it's equally important understand that the referee's role must be appropriately circumscribed. If you don't let the players play—or in market terms, if you try to over-regulate the competitive process—you can ruin the game. Markets are rough places and, though competition is not always pretty, allowing it to flourish is ultimately in our best interest. As Arnold put it, "[t]he economic philosophy behind the antitrust laws is a tough philosophy. [Those laws] recognize that competition means someone may go bankrupt. They do not contemplate a game in which everyone who plays can win."

To elaborate on this last point, let me be clear in saying that I believe a great mistake is made when the antitrust laws are used to protect competitors rather than competition, as has occurred too often in our history. It may make sense to assign handicaps in a golf game or to require certain horses to carry weights in their saddlebags during a race, but that kind of handicapping is not appropriate in the market. In keeping a watchful eye on the marketplace, we are concerned with consumers, not competitors, and even if it's boring to see the same person win over and over again, as long as those victories are based on economic efficiency, it will be good for consumers, and the antitrust enforcers ought to stay out of the way.

In the same vein, it's important to emphasize that big is not necessarily bad when it comes to antitrust enforcement. Bigness can lead to efficiency—though a synergistic merger, for example—which in turn is good for consumers. Arnold emphasized this point as well, having explained that "it is as meaningless to say that small [business] units are better than big units as it is to say that small buildings are better than big

ones." And, he added, if the antitrust laws were to become "simply a religion which condemns largeness as economic sin," they would soon be "an anachronism." Nevertheless, even today, there are those who would fault us for not doing enough to block large aggregations of economic capital, pure and simple, even when they are economically efficient. I want to assure you that we will resist any such temptation. These kinds of notions—antitrust ought to help weaker competitors, or big is bad—simply have no place in a sensible enforcement program. We didn't challenge the Bell Atlantic/NYNEX merger—even though it was one of the largest mergers in our nation's history—because we concluded that, while it was a difficult case, on balance the merger was likely to benefit consumers in that the resulting efficiencies would lead to improved services. But, as I said earlier, just as using antitrust law to implement social policy is a mistake, so too is a religious faith in self-correcting markets. There is a need for antitrust enforcement to aid the free market and, at its legitimate core, such a role focuses on assuring that market power doesn't restrain competition that consumers would otherwise enjoy. And a properly focused concern about market power, in turn, requires surgical intervention precisely because businesses benefit from efficiency and market power alike, whereas consumers benefit from the former but not the latter. So our job is to make sure that we take out the fat (market power) without taking out the muscle (efficiency).

C. The Sherman and the Clayton Acts

All of that history is well and good, some say, but they then go on to question whether the existing antitrust laws can possibly be relevant to today's economy. The Sherman Act was passed in 1890 in response to the nationwide industrial trusts that the railroads had made possible, and the Clayton Act was passed in 1914 and was aimed largely at retailing and wholesaling practices in localized markets. How, then, can these ancient statutes be relevant to a 21st century, information-based economy? I get asked that question, especially by non-antitrust lawyers, probably more than any other. And I answer, unhesitatingly, that the laws are just fine, precisely because, unlike most contemporary statutes, they are common-law provisions and, therefore, they are not locked in text or time. People today don't fully appreciate the genius of the common law, but I believe that we in the antitrust field are fortunate to be a part of this declining heritage.

To take an analogy that I find apt, the freedom of speech and press clauses of the First Amendment to our Constitution were enacted at a time when speech and print were the only two media. Today, of course, we have radio, TV, cable, satellite, the Internet, etc. Yet, no one really thinks that we need a new First Amendment. The core principles of that provision, developed through over two centuries of case law, have been

effectively and sensibly applied to these new media, just as they were once applied in a world without them. In this fundamental respect, as Chief Justice Charles Evans Hughes (among many others) correctly recognized, “[a]s a charter of freedom, the antitrust laws have a generality and adaptability comparable to that found to be desirable in constitutional provisions.” When it comes to the antitrust laws, the core principle, as I just mentioned, is to prevent agreements or mergers that create or increase market power, or unilateral actions that use existing market power to protect or expand a monopoly. As you know, of course, that’s what the three key statutory provisions actually do: section 1 of the Sherman Act bars anti-competitive agreements, section 7 of the Clayton Act bars anti-competitive mergers and section 2 of the Sherman Act prohibits the abuse of monopoly power. In combination, these provisions are fully adequate to deal with the contemporary economy. Indeed, as I will now show, many of the so-called “new” economic issues really aren’t so new to antitrust enforcement after all. As with the First Amendment, we have a venerable body of case law—not every one rightly decided, but as a corpus rich in detail and complexity—that we can and will draw on as we work through antitrust issues in the new economy.

D. Antitrust Enforcement in the New Economy

Let me then turn to the software industry, which is obviously paradigmatic of the new economy, and discuss some of the issues currently on our agenda. As I have already suggested, the core principle about market power that animates our concern here should be no different from what it has been since the inception of the antitrust laws: competition is good and market power can undermine it. To be sure, in analyzing market power issues, we must take cognizance of any differences that might characterize the specific market under consideration. So, for example, in high tech markets, we need to determine whether the market is likely to experience a tipping point as a result of so-called “network effects,” or whether it is likely to be marked by price competition, innovation competition or both. (For those who are not familiar with the latest jargon, the concept of network effects refers to those markets in which particular services or products become more valuable as more people use the network, be it a telephone network or electronic mail.)

Although these potential new wrinkles in high-tech markets raise important questions, I want to make clear that they are hardly so novel—and certainly not nearly as intractable—as some have suggested. Indeed, in 1936, the Antitrust Division won a tying case against IBM involving tabulating machines and cards in what was surely then considered a

“new” industry. And some 40 years ago, we brought a case involving network effects in the floral delivery market and secured relief that made competing networks possible. By the same token, while price competition has generally been the paramount focus of antitrust enforcement, innovation competition, which appears to be very important in the new economy, is no stranger to our field either. On the contrary, if you go back and study some of the earliest monopoly cases, such as *Alcoa* and *Kodak*, you’ll see that the courts were concerned with technology innovation and suppression as well as with price competition. And almost 30 years ago, the Justice Department brought what was probably the first pure innovation case, concerning a horizontal agreement among automakers not to develop certain pollution technologies. Soon thereafter, innovation issues were a key part of the resolution of the *AT&T* case, as reflected in the equipment-manufacturing provisions of the judgment. And today, of course, cases involving innovation (or R&D) markets are quite common—such as, for example, the FTC’s recent action in the *Ciba-Geigy/Sandoz* merger and our action in the *General Motors/ZF Friedrichshafen* merger. Nor is there any reason to think that our customary concerns about price competition are somehow irrelevant in high-tech industries. In high-tech industries, as in others, market power often leads to price increases. For instance, just recently, *Business Week* reported that “[n]ow that [Microsoft’s] Office [software] has 87 percent of the suite market and thousands of businesses rely on it, the cost of a corporate license in most cases is headed up.” On the other hand, some commentators have argued that it makes no sense for us to be challenging a practice like Microsoft’s tying of its browser to its operating system when it gives away the browser for free. But if the products are tied together and sold at a single price, how can anyone say that the browser is free? More importantly, even assuming Microsoft gives away its browser, that is, of course, a traditional, long-standing antitrust concern—though not necessarily a violation—because free is a curious price. After all, Microsoft spends a lot of money developing and marketing its browser. So why would it give it away for free? There are two potential reasons—one legitimate, one not. The former is that revenues from an ancillary or future stream of commerce make a for-free strategy economically rational. For example, a newspaper may be given away in order to build up a large base of subscribers, which, in turn, will attract advertisers that pay enough to justify a for-free subscription price. It is also possible, however, as many cases have found, that a no-cost product is one intended to protect or establish monopoly power and, if that’s what’s going on, then the strategy is predatory and it violates the antitrust laws. This

kind of fact-based question about predation is as old as the antitrust laws themselves.

What all of this proves, I believe, is that the issues raised by antitrust enforcement in high-tech industries are not nearly so new as some may think. Ironically, perhaps the most novel of the phenomena that tend to characterize the software industry in particular—i.e., the strong presence of network effects—would appear to warrant increased antitrust concern over certain kinds of monopolistic practices, because network effects can make it especially difficult for a new entrant to penetrate the market.

E. The Department's Recent Action Against Microsoft

Moving beyond some of the general issues raised by applying the antitrust laws to a high-tech industry like software, I now want to address the specifics of the Microsoft case itself. Let me start with the fact that it is clear to us and, I believe, generally agreed by most observers, that Microsoft currently has a monopoly in personal computer operating systems. Operating systems are the kind of products that are characterized by network effects, and Microsoft has such a large installed base of customers that it is not going to be easy for a potential competitor to challenge its monopoly. Now, beginning from this understanding of Microsoft's market position, let's turn to the issue of new products and how they are bundled or tied to the operating system. And let's think—as the Antitrust Division must think when it makes policy—not only about browsers but about other products as well—for example, personal finance or electronic commerce software. I don't want to analyze all of those issues tonight but, as we move forward, I would like you to be thinking whether there are different competitive considerations relevant to each of these prod-

ucts or whether Microsoft should be allowed to bundle any and all of them with its operating system. I would also like you to think about whether such bundling, especially in a network industry, makes it harder and harder for a new entrant to challenge Microsoft's monopoly position in operating systems.

In the consent decree case that we brought, we identified two related anti-competitive effects that concerned us. First, there was a specific browser effect, as to which some people have asked, "What's the big deal, anyone who wants Netscape's browser can get it?" Even aside from the fact that bundling can distort allocative efficiency, forcing consumers to take a more expensive or lesser quality product, the basic premise of this argument can be very shortsighted in that consumers who prefer the alternative product soon may find that it's no longer available. It's entirely possible, for example, that browsers, like operating systems, will end up tipping and that only one company's product will survive. Think back not so long ago to the days when there were both Betamax and VHS VCRs. Today, of course, consumers can only get VHS. If you accept that the market for browsers is likely to tip, the initial competitive concern is that, by forcing computer manufacturers to take Microsoft's browser as a condition of getting its monopoly operating system, the market could tip to a product that consumers would not have preferred in the absence of the forced tie. Consider the following hypothetical (which I use simply to illustrate the issue but not to represent the facts of this case): suppose that half the consumers get their browser from the Original Equipment Manufacturer (OEM) channel and half through other distribution channels (such as by downloading from the Internet). And suppose further that, in the non-OEM channels—where there is no opportunity for monopoly tying—browser A is preferred over browser B by three-to-two, while in the OEM channel, due to bundling, browser B is preferred by four-to-one. Overall, 60 percent of



New York State Bar Association
One Elk Street

ANTITRUST LAW SECTION SYMPOSIUM

Editor: Robert L. Hubbard
Attorney General's Office
120 Broadway, Suite 2601
New York, NY 10271

SECTION OFFICERS

Chair: Barry J. Brett
Parker Chapin et al.
1211 Avenue of the Americas
New York, NY 10036

Vice-Chair: Michael Malina
Kaye Scholer et al.
425 Park Avenue
New York, NY 10022

Secretary: Robert L. Hubbard
Attorney General's Office
120 Broadway, Suite 2601
New York, NY 10271

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