NYSBA

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Annual Meeting

of the

ANTITRUST LAW SECTION

January 29, 2009
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Introductory Remarks

MS. MAHONEY: Many of you know me. I am Stacey Anne Mahoney, and I am the Chair of the Antitrust Law Section, and I welcome you to our 2009 annual program and meeting. And thanks especially to early birds who are already here and ready with your cup of coffee and your pens and pencils.

Our program chair, Bruce Prager, has worked tremendously hard to put together a great day of tremendously interesting panels that will provide us all with seven CLE credits, including two for ethics. As I said, Bruce has done the impossible by squeezing an entire additional panel into the day.

For your planning purposes, as you can see in your materials, in addition to the panels this morning, at 11:45, just before the lunch break, there will be a 15-minute very important business meeting. It is at this meeting that you vote on your new officers and also on the new Executive Committee members. So I request that each Section member attend that meeting.

Then later, after the lunch break, just before we begin the afternoon sessions, at 1:15, a representative from the New York Bar Foundation will be offering us a brief presentation on the tremendous work that the foundation does.

Then lastly, tonight we are once again hosting our annual dinner at the University Club, commencing with cocktails at 6:00 and dinner at 7:00. The address is in your materials.

At our dinner, we will have the pleasure of bestowing the New York State Association Antitrust Law Section Public Service Award to our own Bob Hubbard, a former Chair of this Section. In addition, the Honorable J. Thomas Rosch has agreed to take time out of his busy schedule as Commissioner of the Federal Trade Commission to be our dinner speaker. We hope to see you there.

So as not to get further in the way of progress, I turn the meeting over to our program Chair, Bruce Prager. Thank you.

MR. PRAGER: Good morning, everybody, and welcome. So glad to see so many of you here right on time. I think people will be straggling in, but as Stacey said, we have a very full day of programs today, so we are not going to wait for those who are even a few moments late.

I am told that the sign-in sheet for CLE credit has not yet arrived. So make sure that you stop at the desk at a break or something to actually sign in once it gets here. I understand they have been taking business cards, but in order to ensure that you get appropriate credit, make sure you stop back at the desk and get the forms and sign in and sign out so that you'll all get the credit that you so richly deserve.

We have got a whole jam-filled day of interesting programs, which is, I hope, why most of you are here. Our schedule involves starting the day with the review of antitrust developments. It will be followed at about nine o'clock with a panel on pharmaceutical and health care issues, particularly the emerging consensus on the treatment of reverse payment—or the lack of consensus, depending upon your perspective. We will have a brief break and then a panel on antitrust in media and advertising.

Then after lunch, we will take a look at the new administration with a round table discussion of antitrust enforcement, talking a little bit about differences between the FTC and DOJ and what we might expect under the new administration that we have in D.C. right now. There will be a short break then.

We will end the day with a fascinating panel on issues relating to attorney/client privilege in cross-border matters, and that program is of special benefit because it grants two ethics credits, which we all know are not so easy to come by.

So also remember to pick up your packet of materials in the back of the room. There is the two-volume pre-bound, but there will be some panels that will have supplementary materials, so check periodically to make sure that, as speakers may leave additional materials out there, you gather those up as well, so you'll have a complete collection.

With very little more, we will start with our annual review of antitrust developments. This, I think, is both one of the most entertaining and most useful programs.

I certainly sat out there in the audience where you all are many years, and I find that all the things that I missed in the advance sheets, the stuff that I never had time to read in BNA or CCH, I find out about in the space of an hour by sitting here. And we have two speakers who are knowledgeable, experienced, erudite and will be, I think, entertaining as well as informative.

Molly is a partner at Debevoise & Plimpton. She practices pretty much anything that has to do with antitrust: litigation, counseling, civil, criminal. I don't know, if there's something that has antitrust connected to it Molly doesn't know, I haven't found it out yet.

She served in the Bureau of Competition of the FTC for a number of years as a senior deputy director and then director. She is clearly a leader in all aspects of antitrust practice and thinking, and we are very pleased to have her doing this again.

And her partner in crime this morning is Irv Scher. Irv is recently anointed senior counsel at Gotshal, having been a partner there for more years than any of us can count, at least if we keep our shoes on.

He, too, specializes in everything antitrust but is one of the leading experts on the planet in distribution issues and is the Robinson-Patman guru—I was going to say "of America," but no one outside of America would even want to know what Robinson-Patman is. So I guess we can fairly say that he is probably the world guru on Robinson-Patman.

And I can tell you that Irv and I have had the pleasures and joys of handling several RPKs together, and the extent of his knowledge is well beyond encyclopedic. He's an adjunct professor at NYU. He has co-chaired PLI programs and is author of the *Antitrust Advisor.* He is a past Chair of this Section and a past Chair of the ABA Antitrust Section, and I won't bore you with the rest of his résumé, because I think it is a lot more interesting to get on with the program.

So Irv, Molly, thank you very much.

We will not have time for questions at the end of this program, just due to scheduling constraints. But Molly and Irv tell me they will be staying around, and you are free to nab them in the hall, and if you bring them a cup of coffee, they will try to answer your questions.

Thanks, Irv.

Annual Review of Antitrust Developments

MR. SCHER: This morning, we are going to discuss antitrust developments during 2008. Last January, there were a number of Supreme Court decisions to talk about. This year we only have a Supreme Court argument. So we are going to summarize lower court decisions and Federal Trade Commission developments.

Antitrust Pleading Standards

I believe that more than a thousand decisions have already cited the Supreme Court's *Twombly* decision,[1] not just in antitrust, but in other cases filed under the federal rules. However, it all started with antitrust, and, therefore, I will limit my discussion today to how *Twombly* has affected antitrust decisions.

Antitrust pleadings were not heightened in *Twombly*. Essentially, the Court said while pleading standards have not been raised, a complaint in a conspiracy case has to be plausible, not just possible.

That, for those who do cartel work, is a very important distinction. However, when you consider the lower court decisions—particularly the district courts—you see them going both ways on motions to dismiss complaints in which the facts alleged are pretty similar.

Kendall v. Visa[2] is probably the most significant Court of Appeals decision on the issue. It involved the credit card industry, where there are four players having different roles.

The complaint in *Kendall* first alleged that Visa and MasterCard conspired as to their credit rates and then added that the banks joined in the conspiracy. However, the complaint nevertheless was dismissed. The allegation that the banks were adopting and following the same practices wasn't enough, said the Ninth Circuit, because there were no allegations as to "who did what to whom (or with whom) and where."

In 2007, the Second Circuit Court of Appeals decided the *Elevator* case.[3] That created quite a stir in the lower courts in the Second Circuit. In particular, Judge Preska wrote a decision involving the digital music industry,[4] which is a concentrated industry with four companies accounting for most of the business. The claim was that they conspired to fix prices for digital recordings. The alleged plus factor essentially was that prices stayed up. Supposedly this was done through joint ventures which weren't challenged as illegal but plaintiffs did contend were "shams." There were restrictions on downloading of digital music, which the defendants argued were intended to protect against pirating. Accordingly, Judge Preska noted there were legitimate business reasons for these restrictions, and, of course, the case involved lawful oligopoly price leadership. Rejecting a recidivist argument as irrelevant, Judge Preska dismissed the complaint.

Resale Price Maintenance in the Aftermath of *Leegin*

There were two decisions in cases against Leegin itself issued in 2008—one in Kansas and one in Tennessee.

Plaintiff's counsel in the Tennessee case[5] contended that there was a hub-and-spoke conspiracy with Leegin's retailer customers, because Leegin also operated its own stores. The Eastern District of Tennessee dismissed that claim on the ground that the complaint didn't claim that the distribution system was organized as a hub-and-spoke conspiracy, but as a vertical arrangement established by Leegin. So the complaint was dismissed on that ground and one other ground: the alleged product market was improperly limited to Leegin products.

The Kansas case[6] was a consumer class action that had been filed prior to the Supreme Court *Leegin* decision. This one was dismissed on summary judgment with a very interesting opinion. According to the Court, the plaintiff failed to establish what the competitive prices would have been but for the alleged conspiracy. The decision demonstrates why a resale price maintenance plaintiff may need an economist if it wants to defeat a summary judgment motion in an RPM case.

The third resale price maintenance case, *Toledo Mack Truck v. Mack Trucks*,[7] is difficult to discuss without a chart. Mack Trucks apparently had the same kind of distribution system as Volvo—which was the subject of the Supreme Court Robinson-Patman Act decision two years ago[8]—under which dealers buy trucks only after they win a contract in a bidding situation.

This decision is interesting, if not only because it demonstrates to plaintiffs' counsel that the place to be in an antitrust case is the Third Circuit. Specifically, this decision falls in line with *LePage's*,[9] *Dentsply*,[10] and *Flat Glass*[11] in that circuit.

The Third Circuit allowed the case against Mack to go to the jury, even though Mack argued that the dealers alone—without Mack's participation—engaged in a geographic market division despite having only primary area geographic contractual rights—not closed territories. The question before the Third Circuit was whether Mack was a party to the conspiracy or was acting independently. In other words, was there a true hub-and-spoke horizontal conspiracy?

After declaring that there was sufficient direct evidence of a dealers' per se unlawful horizontal conspiracy,

the Court ruled that the issues as to Mack's participation were subject to the rule of reason. It seems to me, however, based on *U.S. v. GM*[12] in the 1960s, that a hub-and-spoke conspiracy in which the manufacturer is brought in by dealers is a horizontal conspiracy, because the manufacturer becomes a party to the horizontal arrangement. That's what the Seventh Circuit said in the *Toys 'R' Us* case,[13] which involved a group of suppliers and retailers—the reverse of the Mack Truck situation.

I should also mention the *Baby Age* District Court decision[14] because it received considerable publicity; the president of this company, like the CEO of Whole Foods, had press releases issued.

In *Baby Age*, the District Court concluded that the complaint insufficiently alleged a closed-rim conspiracy among suppliers, concluding instead that the claims alleged only a series of vertical arrangements between Babies 'R' Us and each of its suppliers. The Court refused to dismiss the complaint based on what the Judge considered to be "vertical plus factors"—dealer terminations in response to pricing complaints. However, I doubt that those allegations properly should have been considered "plus factors."

The aftermath of the Federal Trade Commission *Nine West* case last year is interesting because the decision was unanimous. Nine West entered into an RPM consent order in 2000. It returned in 2008, urging the FTC, based on the *Leegin* decision, to remove the RPM prohibitions in the consent order.

Of course, the FTC can enter a consent order that goes beyond the prohibitions of the law. Nine West argued, however, that the law no longer considered RPM to be per se unlawful. It claimed it didn't have market power and established its pricing policy unilaterally. It contended that the facts had none of the trappings that the Supreme Court warned about in *Leegin* with respect to RPM analysis under the rule of reason.

Accordingly, the Commission unanimously terminated the resale price maintenance provisions of the consent order.[15] The Commission pointed out, however, that its actions had no effect on the parallel state consent decrees which, by the way, had already expired.

The *Wall Street Journal* announced last September that the FTC was investigating resale price maintenance in the toy and children's furniture industries. Indeed, it reported that a number of subpoenas had been issued. This was somewhat of a surprise, since neither enforcement agency had brought any resale price maintenance cases in the eight years of the Bush administration. On the other hand, minimum RPM may become a hot issue during the Obama administration.

The states, however, have continued their interest in minimum RPM, and the *Wall Street Journal* noted that state attorneys general were in fact investigating RPM in various industries. And attorneys general in New York and California have made it known that it is their view that RPM remains per se unlawful under their state antitrust laws.

In fact the attorneys general of New York, Illinois and Michigan entered into a consent decree last year with Herman Miller,[16] the manufacturer of the famous Aeron office chair, settling a complaint claiming it had enforced a resale price maintenance scheme through "structured terminations," under which a dealer was terminated—but only for a year—as punishment for discounting.

It is a very interesting complaint, because there is no allegation of market power and no identification of market share, even though both Illinois and Michigan have always applied rule of reason analysis under their state antitrust laws.

I haven't heard of any state RPM cases other than *Herman Miller* since the *Leegin* decision. It is apparent, however, that at least some states likely will be active in the resale price maintenance area.

Sports and Antitrust

There were a number of lower court decisions this past year involving application of the antitrust laws to organized sports. Two of them involved essentially the same thing—sports league licensing arrangements. The Seventh Circuit concluded that *Copperweld* applied to the NFL licensing under section 1 of the Sherman Act.[17] All the teams were considered part of a single enterprise when licensing individual team intellectual property. Moreover, the NFL was considered only a small segment of a larger "entertainment industry" market for purposes of section 2 of the Sherman Act.

Major league baseball licensing in the Second Circuit was examined with a similar result,[18] but the Second Circuit said nothing about this *Copperweld* single-entity issue and went directly into an analysis under the rule of reason. According to the Second Circuit, there was no restriction on output and no injury to competition in the "entertainment industry" market and, therefore, no violation. It is an interesting decision because the third Judge—Judge Sotomayor—concurred with a separate opinion applying an *Addison Pipe* ancillary restraint doctrine analysis. So we have two courts of appeals decisions with three different versions of why joint licensing in organized sports should be reviewed, and likely approved, under a Sherman Act rule of reason analysis.

A third case involves Madison Square Garden and the New York Rangers hockey team.[19] There, however, Judge Preska denied a motion to dismiss, concluding that the issue of whether a professional hockey league is a single entity is a fact issue. She added, however, that it would be

unlikely that the team—which had been refused the right to operate its own Web site—could win. Nevertheless, she let the case go forward into discovery.

There was a fourth sports decision, this time involving a college football coach who was claimed to have engaged in recruiting violations at the University of Kentucky.[20] The coach sued the NCAA and the university. He didn't show up at the hearings on his alleged violations and lost the case on a motion to dismiss. The Sixth Circuit concluded that recruiting of potential college ballplayers is not a commercial activity; therefore, it's not subject to the antitrust laws. According to the Sixth Circuit, it is not a commercial activity because it is designed to "promote and ensure competitiveness."

Dominant Company Cases

My last topic concerns dominant company conduct. Here, there essentially are two major enforcement bodies—one is in Brussels and the other is rooted in Chicago.

After 19 days of joint FTC/DOJ hearings involving many witnesses and panels, only DOJ issued a report last September 14,[21] with three FTC commissioners in effect dissenting within hours by issuing a public statement disagreeing with much of the DOJ's analysis.

The DOJ adopted conduct-specific tests addressed to specific topics rather than any one rule of reason analysis. The agency did not say there should be any exceptions to a monopolist's right to refuse to license or deal with a competitor—it should be an absolute right.

The DOJ report provided for safe harbors and concluded, as to the definition of "below cost," that rather than referring to average variable costs, the courts should apply an average "avoidable" cost standard, which economists understand but has no case support.

As to the rule of reason, the DOJ did not accept the *GTE Sylvania* standard—balancing the pro-competitive and anticompetitive aspects of a practice. Instead, the DOJ recommended a "disproportionality" standard. The anticompetitive effects should be disproportionate to any procompetitive aspects of a practice for there to be a violation. I have never seen that in a decision either, but that was the Bush administration DOJ's view.

The three FTC commissioners disagreed with virtually everything in the report [which has since been discarded by the new administration].

There has been no Supreme Court antitrust decision as of January, but at the argument in the *linkLine* case this past fall, it appeared that *Alcoa*[22] may no longer be the law after this spring.

AT&T argued that its plaintiff competitors at the distribution level should have brought their price-squeeze complaints to the FCC. The Supreme Court has recently indicated that when there's a regulatory agency that can regulate a challenged practice, the antitrust laws should take a backseat. In any event, during argument, Justices questioned why a monopolist that usually can refuse to deal with its competitors, as stated in *Trinko*,[23] must price its product or service at a price that is profitable for its competitor if the monopolist decides to sell to a competitor. Of course, that's exactly what Judge Learned Hand said was the law in *Alcoa*.

N-Data[24] was the FTC case involving a company that 15 years ago had invented great technology for use on the Internet and agreed to offer permanent licenses for $1,000. The inventor thereafter sold its business to N-Data, which decided to raise the licensing rate dramatically. The FTC brought an action under section 5 of the Federal Trade Commission Act, although the complaint did not claim a violation—or even a potential violation—of the Sherman Act. Instead, it claimed that the conduct constituted unfair competition under the antitrust rung of section 5 of the FTC Act and also an unfair trade practice under the consumer protection rung of section 5. Two commissioners dissented to the action.

I want to mention FTC Commissioner Rosch's speech on October 17, 2008, during which he said the *N-Data* case was correctly brought. He stressed that the Supreme Court had endorsed an expansive reading of section 5 in the 1970s in the *S&H* case,[25] declaring that the FTC had broad authority under the provision. Commissioner Rosch noted that the Agency's authority is not unbounded—there has to be some evidence of actual or incipient anticompetitive effects for a violation. He added that the defense bar should not be concerned, because if the practice does not violate the antitrust laws, there is no risk of treble damage actions. However, in the FTC's compact disc case in 2000,[26] there was no allegation of an agreement in violation of the Sherman Act, and over 100 class actions nevertheless followed, claiming both vertical and horizontal price fixing conspiracies.

Thank you.

MS. BOAST: Well, I think that assistant coach from Kentucky who didn't show up at his hearing is probably hanging out with the governor of Illinois right now.

Thanks, Irv, that was incredibly educational, and I also thank Bruce for his kind remarks. Being lumped with Irv Scher is truly an honor because he is truly encyclopedic.

I want to thank also, in my Academy Award moment here, Erica Davila and Jill Teehan, who are associates of mine sitting here who did all of the work on this presentation and the written materials in your book.

As Irv did, we are going to try to hit some of the highlights and cover as many as time permits. But to satisfy Bruce Prager, all the obscure details are in the written ma-

terials in summary form. So what we won't touch on during this presentation, you'll be able to review later.

It's been a really rich year for the FTC, I must say. I obviously have a bit of bias in focusing my lens on FTC work. It has been an extraordinary and interesting year.

I'll start with my favorite case. It is because I'm a litigator that I love this one so much, which was a litigation challenging a merger of two hospital systems in northern Virginia, Inova Health System, with another hospital.

This is an area in which the FTC had been noticeably unsuccessful for many, many years. But in this particular case, the merger was going to give the merged entity over 70 percent of the hospitals in northern Virginia.

After some 18 months or so, at last the FTC went to court to block the merger seeking a TRO. We point to Commissioner Rosch, whom we'll be talking about all day, serving as the Administrative Law Judge. Commissioner Rosch proposed an expedited schedule to bring the administrative case to trial very quickly. At the same time, the hospitals moved for preliminary injunction hearings to be held prior to the administrative proceeding.

The Judge followed the *Heinz* ruling on the District Court's preliminary injunction authority and said that the Court wasn't authorized to determine whether the antitrust laws were violated, but, rather, that was left to the FTC in the first instance.

He also said that the standard was that the FTC only had to raise "serious questions" about the merger's potential harm to win a preliminary injunction and held that there was no likelihood of success on the merits test in order for the FTC to prevail at the preliminary injunction stage.

So while this is going on in the District Court, we go back to the FTC. Back at the ranch, as they call it. Inova filed a motion to stay the administrative proceeding pending the preliminary injunction hearing; and Commissioner Rosch denied that motion, saying that the administrative proceeding should have proceeded in a parallel track with the federal court action, chided Inova for having it backward or arguing that the federal court proceeding should have some primacy over the administrative proceeding and noted that the section 13(b) standard was enacted by Congress precisely to strengthen the power given to the FTC.

So pulling all of this together, what we have is the parties arguing in federal court that the court should make a preliminary ruling, hoping, obviously, to get a result that would influence the FTC; i.e., the FTC coming in and saying, Your Honor, we already have an administrative proceeding going, we are putting it on a fast track. The normal argument that the merger will fall apart because of the delay of the administrative trial at the FTC really doesn't apply here.

It is hard to tell whether the Judge was influenced by that or was just applying the law as he understood it—bearing in mind that he was in the Fourth Circuit, not in the D.C. Circuit—in the way he resolved the preliminary injunction motion.

Let me make this point. If you remember, back in the Pitofsky days, the FTC had articulated a policy and then followed it, saying it would stay the administrative proceedings if administrative complaints were filed but then stay it while federal court proceedings went through.

Many of those merger cases were pretty substantial litigation, so a lot depended on what the judge's tolerance level was. But generally, the FTC would take the position that what merging parties wanted in the way of timing was acceptable. If the parties wanted the trial in two weeks, the FTC would try to meet that schedule. But if they wanted six or eight weeks in discovery, that's the way it would go. But that seems to no longer be the mode that the FTC is following.

What ended up happening, after all of this procedural maneuvering and after almost two years since the time the merger agreement was signed, was that Inova withdrew its bid, and that was a win for the FTC. Inova said it thought the administrative proceeding would result in a long and expensive process. No doubt that's true, but two years had already elapsed, so it does make you wonder whether, on the merits, they had some concerns.

Everyone is familiar with the *Whole Foods* case, but in the category of looking at the 13(b) standard, this is obviously a very important opinion.

Just to refresh everybody's memory a little bit: Whole Foods announced it was going to buy a competing chain in February of '07, and the FTC went to court on a preliminary injunction motion arguing that the two stores were the leading premium natural and organic supermarkets, focusing on several locales where they owned such stores.

The FTC lost that case in the District Court because the District Court Judge found that Whole Foods and Wild Oats were competing in the broader market, and that there were other substitutes for the kinds of products those purchasers who wanted premium organic products could use. And the district court focused on the marginal customer who would switch to a traditional supermarket in the case of a price increase.

When we discussed this last year, we also talked about the fact that the court spent a considerable amount of its time on the economic evidence at the expense of some of the other evidence.

The case then was appealed to Court of Appeals, and there are a number of interesting points that come out in

this year's decision. First of all, there are three opinions in this decision, so articulating what the precedent is, is actually a real challenge.

The first opinion is by Judge Brown, who says there are some core or committed customers who are entitled to protection. It is not just the marginal customer analysis we should be looking at.

The second opinion is by Judge Tatel, who actually does not embrace the core customer proposition, at least, not obviously to me, but rather runs through a bunch of *Brown Shoe*-type factors to reach the same result as Judge Brown, that is, the FTC wins.

And both of those judges read the precedent in the D.C. Circuit to say, again, the FTC does not have to show a likelihood of success on the merits to win a preliminary injunction. But they then say this is supposed to preserve the status quo while the FTC goes out and develops its ultimate case.

They sent the case back to the district court with the instruction that the court should consider the equities that the district court didn't reach, for obvious reasons, and they make the specific point of saying that, since the merger, by this time, has been consummated, the court has to consider and weigh the public equities flowing from the completed merger, whatever those are.

The dissenting Judge, Judge Kavanaugh, is pretty blunt in his criticism. First of all, he says, the District Court is correct. He points out the fact that this splintered opinion isn't going to give anyone any guidance and said why didn't you just leave well enough alone?

He also quarrels with the other two Judges on their reading of the 13(b) standard. He says the FTC can't just snap its fingers and block the merger.

He seems to miss the point they are articulating, which is they are not snapping their fingers and blocking the merger; they are snapping their fingers so they can take it back to the administrative court and litigate it there.

There's been continuing litigation out of this *Whole Foods* decision. Rehearing en banc was denied a few months ago.

On remand, they brought another motion before the appellate court, arguing that they had been denied due process and equal protection because there were two standards operating in the preliminary injunction setting and because the FTC couldn't act as prosecutor and judge at the same time.

The injunctive case was denied, I think this week or last, by the D.C. Circuit. So at this point the case is set for administrative trial on a relatively fast track in April, consistent with changes the FTC has put in place to move the administrative proceedings along.

Now, the core customer issue, as I mentioned, was the focal point of the first Judge's opinion, Judge Brown. These core customers were the customers who are so committed to specific kinds of shopping "patterns"—I guess I would call it—that they wouldn't be likely to switch. And the Judge gives some examples of the kinds of core customer shopping habits that might make the core customer a so-called submarket.

But as many have pointed out, the same prices are charged to the core customers as the marginal customers, so I actually, frankly, can see why Judge Tatel did not endorse this particular framework.

In terms of precedent, again, it is only one judge's opinion. I think the decision gets written or talked about as standing for this core customer proposition, but I respectfully submit that it doesn't.

There is clearly a majority of this particular panel reading *Heinz*, again, on the FTC's ability to obtain a preliminary injunction, to say there's no requirement that the FTC settle on market definition at this stage.

And as I also mentioned, the dissent also reads *Heinz* differently and said, you have to read *Heinz* in light of the statute itself.

The statute says the FTC can obtain a preliminary injunction on a proper showing and likelihood of ultimate success. So it is a really interesting decision. And I suspect this year, next year at this time, we will be talking about the case again, but talking about the remedy. Because since the merger is consummated, the challenges are substantial.

I thought it would be appropriate to at least address one DOJ merger case. With all due respect to our colleagues who are here, the FTC has been a little bit more active in merger enforcement than DOJ. But this was a very high-profile merger and has been under review for a very long time.

XM and Sirius were the only two—now they are one—satellite radio companies in the country. They held two licenses, I should say, and they proposed a merger that went under considerable scrutiny at the FCC, on the Hill and at the DOJ.

As is often the case, the FCC, which could have blocked this merger itself, did not act until the DOJ had reached its ultimate decision. And so in March, the DOJ cleared the transaction and issued a statement about the reasons why it wasn't opposing the merger.

It pointed to a number of things, taken together, that probably do justify the result. But if you look at those sort of one by one, it is a little bit odd.

First of all, DOJ said there are many segments of the market where they are not really competing. Well, why is

that? Part of that is a significant channel for satellite radio is automobiles. Of course, they have contracts with the manufacturers and those are relatively long-term. It is not as though you can just drive into Chevy and say, "You know what, I don't want XM. I want Sirius." It comes with the car. And the equipment, of course, only receives one signal.

Secondly—and this was really the parties' main argument—satellite radio competes with terrestrial radio, particularly advertising, which is market driven.

And thirdly, there are some technologies that are emerging that will essentially compete with satellite radio.

The problem I have with this result is that I think the contracts, the OEM contracts that are probably 60 or 70 percent of satellite radio sales—or customers, rather, are essentially short-term from a merger perspective, whereas the technologies that the DOJ was pointing to are, at least as described, fairly uncertain.

Certainly in this economy, one would never have any degree of comfort that they would ultimately emerge. But as I said, taken altogether, these arguments may well support the result.

I wanted to go back to a couple of FTC matters. This is another really fascinating case. This is a case in which the FTC is pursuing a disgorgement remedy, and when you see the facts, we can understand why they are.

This case involves a drug that is not particularly well known. There are probably 30,000 uses of it a year, but it is a drug that treats a particular condition in premature babies. Merck was the original manufacturer of this product, and Ovation purchased the product from Merck in 2005 and then acquired the second product in 2006.

The third bullet point here actually matters as far as looking at what may happen to this case. The price increase that Ovation put in place of 1300 percent took place after the first acquisition. And then, when Ovation purchased the second product, it actually priced it essentially the same way.

But the challenge was brought under both section 7 and section 5: section 7, in support of the divestiture remedy, directed at the second acquisition; and section 5 in support of the disgorgement remedy, seeking disgorgement of the profits from both drugs. That makes sense because the price went up, but it is still a little bit odd that the first acquisition wasn't challenged.

Of course, this leads then to a concurrence from our favorite commissioner, Commissioner Rosch, who writes in interesting detail why he believes there may be a basis for having challenged the first acquisition. My reading of it—and again, we have experts here, including one of the attorneys involved in this, so maybe we will be enlightened at some point—is that he has a theory and it is probably triggered by something he's seen in the record, but it hasn't been flushed out in the facts.

So he articulates this theory: There is reason to believe we could bring this case and see whether my theory holds up under discovery. The theory basically is Merck was selling a multi-product line. This was a niche drug in the brand portfolio of Merck's products. Either because it was a niche product and nobody was paying attention, or because Merck's reputation, if it tried to raise prices on a product that was treating premature infants, would be harmed . . . it just chose not to take advantage of the price increases that were available.

The other case that's worth looking at for purposes of a remedy was a consent that involved back office systems. This company is called TALX, and it is now owned by Equifax. This was a case where the argument was that the entry barriers were high because there were long-term contracts and non-competes in place. And instead of requiring divestiture—these were consummated transactions that had taken place over a number of years—the FTC required TALX to terminate the long-term contracts and terminate the noncompetes and lower the entry barriers and see who else would come in.

It is obvious from the facts that that's one way to go here. But I think, if you look back at the consummated merger cases—last year, we talked about the Evanston hospital case—you'll see that in all of these cases the FTC had struggled to find a remedy short of dismantling the merger, and that's one reason we will be talking about this next year.

I'm not going to spend time on the reverse payments cases since you have a whole program on that, except for people who, for one reason or another, are not going to be able to stay for the panel, to note that in the *Cipro* case, the federal circuit has now joined the Second and Eleventh Circuits in holding that reverse payments are not unlawful if they are limited to the exclusionary zone of the patent, and going further by essentially saying there is no requirement of the court to litigate the scope of the patent. It is what it is. Therefore, whatever the patent term is becomes the exclusionary zone.

It distinguishes *Cardizem* because *Cardizem* involved a prohibition on the use of the forfeiture of the exclusivity period under the Hatch-Waxman Act. So I think we now have *Cardizem*, because of its particular facts, in a category of its own.

Undeterred, the FTC has now brought the *Cephalon* case using a section 2 theory and clearly has signaled, both through this litigation and other activities and statements, that this is an area that is of great importance.

And I think, apropos of Irv's comments about *N-Data*, we will probably see the FTC trying to find some space under section 5 that is beyond what the case law currently says to try to pursue these agreements, which they believe

are very troubling. And there is also a potential legislative solution.

This may be the last FTC case I'm talking about this morning. Again, *Rambus* needs no introduction to any of you. But for those who aren't familiar with it or just want their recollection refreshed, you'll remember that the FTC sued Rambus, arguing that it had failed to disclose to a standards-setting organization that the standard it was about to adopt was, in fact, covered by patents owned by Rambus.

This case was litigated in the FTC's administrative forum. The Administrative Law Judge, as I recall, ruled against complaint counsel; the Commission reversed; and then the case went up to the D.C. Circuit on Rambus's appeal, and the D.C. Circuit reversed the Commission.

This was a big loss, actually. First of all, the Court said that the conduct didn't actually cause the adoption of the standards, or at least that hasn't been initially proven by the FTC.

Secondly, the Court said this was a monopolist just using deception to obtain higher prices; there's nothing exclusionary about that. That doesn't really have any market effect in a structural sense. And similarly the Court noted the absence of any injury to competition. The FTC was arguing that, absent this behavior, this standard-setting organization would have tried to negotiate favorable licensing terms for its members, and the Court said the loss of an opportunity to obtain more favorable terms wasn't the kind of harm to competition, that is, structural harm, that the Court would recognize.

The Court goes on and says there has been some discussion in oral argument about the breadth of section 5, and whether this case would fit within the parameters of penumbra, and says you can try that, but there are evidentiary problems in the record even under pure section 5 theory. So, ultimately, the FTC went back, and a remedy came out of it.

Now away from mergers and to an interesting and important class certification case.

The Third Circuit, when Irv and I were growing up, was where the wolf pack lived, and a considerable number of important antitrust cases were litigated there and brought there. One of the reasons was in the class action arena, there was a decision called *Bogosian* that basically was understood to stand for the proposition that in a price-fixing case, presumption of impact applies. The Third Circuit is now starting to dismantle this whole line of cases, and this is the most important of decisions.

There was another one this week, or least in the same line. Basically, under the new rules for class certification, looking at the predominance requirement, which is where most of the litigation activity often plays out in a class action, having said that the court can't accept an assertion that common proof will suffice to prove a class impact if there is a genuine dispute about the viability of the so-called common proof, the court has to resolve this on the class certification motion, even though it might look like a merits determination, which, ordinarily, is not part of a class certification decision. In this particular case the lower court said the two experts' opinions are irreconcilable, and, therefore, the court didn't rule on which one was right but simply accepted plaintiff's explanation and said well, that suffices at that stage.

The appellate court said no, you've got to go back, figure out which expert is actually right on this, and you can do that at this stage.

Secondly, they said you also have to go back and consider whether the *Bogosian* presumption—that is, the presumption that, in a price-fixing case, the impact affects everyone the same—"actually applies."

That's a case-by-case determination.

Ross v. Bank of America

We focus on this case only because it is a Second Circuit decision. This case involved a suit against credit card companies challenging the inclusion of arbitration provisions and the provision that requires cardholders to give up their opportunity to participate in a class action.

The District Court had dismissed the case on standing grounds saying that nobody has actually tried to trigger an arbitration, or nobody is compelled to go to arbitration, so it is completely speculative.

The Second Circuit reversed and said that since plaintiffs had argued that these provisions reduced consumer choice and innovation, that was sufficient injury to meet the low threshold for injury in fact, and standing was appropriate.

A case that came up more recently, which is not covered in the materials, involved the Discover Card. And there the defendants argued that they have a provision in their card that gives you 30 days to opt out of the mandatory arbitration provision. And they, therefore, said there is consumer choice. This was actually a decision on class certification, but it was before the same judge, and he disposed of that argument in light of the Second Circuit's treatment of the *Ross* case.

We always have to have one Ninth Circuit decision, but I'm not going to spend time on this one, because I have two minutes left. So you should definitely take a look at the written materials on the *NewCal* case. It ends up taking *Kodak* to the next level.

This is a case where there was leased equipment and then later contracts were entered for service. The court said those contracts form a separate market, and the single brand can be a separate market. And if there were

contracts entered totally voluntarily, there would be no claim, but there were sufficient allegations of coercion here to let the case go forward.

Why are we cheering *Costco*? This is another case we won't have time to discuss at length. But *Costco* is trying to reduce the pricing barriers on alcohol. And the case involves a really interesting preemption issue where the court—as you probably know, most states have archaic pricing systems for liquor—and the case is whether they were preempted by the Sherman Act or ultimately saved by the 21st Amendment.

In this particular case, the district court ruled against Costco, but Costco ultimately won in the Ninth Circuit and has struck down the so-called "post and hold" for prices.

The rule seems to be that preemption only takes place where there is per se illegality in the state restraint. But here, the court points not to any per se illegality because there was no horizontal agreement in their arrangement, but rather to facilitation, collusion, as a rationale and also vertical price fixing, which it fails to recognize is no longer per se illegal. So it is a really interesting decision, but probably not that applicable to most of our lives.

Finally, I'm sure you have read the new amnesty guidance from the DOJ. This comes out of my favorite case, which I will no longer be able to talk about anymore, *Stolt-Nielsen*, and the revocation of amnesty.

Ultimately, that was tried, and DOJ lost as a matter of factual proof at trial. And rather than appealing, it went back and took a look at the amnesty program and published new model conditional amnesty letters and an FAQ on the amnesty program, which is now one-stop shopping on leniency.

There are a few changes that are highlighted in this slide that clearly reflect the experience in the *Stolt-Nielsen* case. But as a tool for the public, it is an extraordinarily well-done piece of work.

Thank you very much. I'm sorry for rushing through so much of this. But as Bruce said, we'll be around to talk about all of this later. Thanks.

MR. PRAGER: Thank you so much, Molly and Irv.

So even if you were all sleeping for the last year, you're now pretty well caught up on what you missed during your long nap.

One of the things that you might have missed was that there has been an evolution in issues related to health care and particular to the pharmaceutical industry. So why doesn't our next panel start coming on up with their materials and beverages.

Endnotes

1. *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007).
2. *Kendall v. Visa U.S.A., Inc.*, 518 F.3d 1042 (9th Cir. 2008).
3. *In re Elevator Antitrust Litig.*, 502 F.3d 47 (2d Cir.2007).
4. *In re Digital Music Antitrust Litig.*, No. 06 MDL 1780, 2008 WL 453182 (S.D.N.Y. Oct. 9, 2008).
5. *Spahr v. Leegin Creative Leather Prods., Inc.*, 2008 WL 3914461 (E.D. Tenn. 2008).
6. *Creative Leather Prods. v. Leegin* (Ks. Dist. Ct. July 2008) (unpublished).
7. *Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc.*, 530 F.3d 204 (3d Cir. 2008).
8. *Volvo Trucks NA, Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006).
9. *LePage's, Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003), *cert. denied*, 124 S. Ct. 2932 (2004).
10. *United States v. Dentsply*, 399 F.3d 181 (3d Cir. 2005).
11. *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 357–58 (3d Cir. 2004).
12. *United States v. General Motors Corp.*, 384 U.S. 127 (1966).
13. *Toys 'R' Us v. FTC*, 221 F.3d 928 (7th Cir. 2000).
14. *BabyAge.Com, Inc. v. Babies 'R' Us, Inc.*, 2008 WL 4372790 (M.D. Pa. 2008).
15. *Nine West Group, Inc.* (FTC May 6, 2007) (Consent Order Modification).
16. *State of N.Y. v. Herman Miller, Inc.*, Civ. No. 0802977 (S.D.N.Y. Mar. 21, 2008) (Consent Decree).
17. *American Needle v. National Football League*, 538 F3d 736 (7th Cir. 2008).
18. *Major League Baseball Properties v. Salvino*, 542 F.3d 290 (2d Cir. 2008).
19. *Madison Square Garden, L.P. v. National Hockey League*, 2008-2 Trade Cas. ¶76,346 (S.D.N.Y. 2008).
20. *Bassett v. National Collegiate Athletic Association*, 528 F.3d 426 (6th Cir. 2008).
21. DOJ, Report, Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act (September 8, 2008).
22. *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).
23. *Verizon Comm. Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004).
24. *In re N-Data Solutions, LCC*, Docket No. C-4234 (FTC Sept. 22, 2008) (Consent Order).
25. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).
26. *Capitol Records, Inc.*, Dkt. No. C-3975 (FTC, Sept. 6, 2000).

Pharmaceuticals, Healthcare and Antitrust

MR. PRAGER: The Chair for this program is a long-time friend of this Section and well known to many of you: Bill Rooney, a partner at Willkie Farr & Gallagher, head of their antitrust practice, a former Chair of this Section and the person who is probably solely or at least most responsible for the existence of the Section's brown bag lunch programs, which have been extremely well received.

Those of you who have not yet had an opportunity to participate, they are done about once every couple of months on topics of current interest. They tend to be physically conducted at the Wilkie Farr offices, which are really very nice offices. And Bill provides beverages and cookies. Cookies are a lifesaver because, the first one, I didn't have time to stop and bring a lunch. So the cookies kept me going.

Or you can just dial in. The number gets circulated to everybody who is a member of this Section or anybody who asks for it by signing up. There has not been CLE granted in the past, but maybe we can look into changing that this year. And they have been extremely interesting.

So I think we now have a computer setup. We have a panel here, and we have Bill ready to go.

MR. ROONEY: Actually, I should hire Bruce as my agent. Thank you very much for that false introduction.

All right, our subject is Pharmaceuticals, Healthcare and Antitrust. That's a pretty broad subject, so we figured the right way to attack this was to try to narrow it a bit. We have chosen the ever-evolving topic of reverse-payment settlements in patent-infringement pharmaceutical cases. Now, some of you know this issue inside and out, although there are always new developments. Others of you may say What is a reverse payment settlement? And why do we really care in the antitrust world?

Well, I am not going to dispel that mystery for you at this minute. I will leave that to our first speaker, Elai Katz, a partner at Cahill Gordon & Reindel, with lots of experience in pharmaceutical litigation. Elai will explain the complex, confused litigation history of the reverse-payment settlements, and, of course, he will make it crystal clear in no less than 15 minutes.

The subject has many dimensions, including economic dimensions, and we have Dr. Anne Layne-Farrar, who is a director at LECG, with us today, and she will explain the various economic and policy aspects of reverse-payment settlements.

We have Michael Kades, who is the commercial advisor for Commissioner John Leibowitz, who, we know, has been in the news lately. And Michael will identify the legislative and policy aspects of reverse-payment settlements.

And, of course, we also have an international dimension, and we are honored to have with us today Marc van der Woude, who is a partner in the European law group Stibbe. Marc is also a professor of competition law at the University of Rotterdam. And Marc will speak about reverse-payment settlements in the European context and, particularly, in the context of the pharmaceutical sector report, which has just come out in preliminary fashion from the European Commission and will come out in the final form later this spring.

So with that, why don't we have Elai kick us off and begin the description of reverse payment settlements in the litigation context? Thank you.

MR. KATZ: Good morning, everyone. While I start off, I think we are going to get the computer connected. But I'll start in the old-fashioned way: looking at my piece of paper.

As Bill had said earlier on, and Molly Boast as well had said this morning, this has been an area that's been very busy and also controversial. I know there are many people out here who know a lot about it. But I also have a sense that some people may not know so much, so I'll explain the basics.

One way I would like to start talking and thinking about this area is to describe two related regulatory schemes that impact these kinds of agreements—these kinds of restraints. One is the patent laws, of course we are all familiar with, and the other is the Hatch-Waxman Act, which is an act that was meant to encourage the introduction of generic drugs and to accelerate the pace at which generic drugs are brought to the market.

Obviously, it is a very important public policy issue, well beyond the interests of antitrust, and I think that's part of why this is an important area that people will talk about and think about a lot.

So just a moment on patents. This is important for many courts that have thought about this, especially the later decisions I'll be talking about. What a patent right gives you is actually not the right to do the thing that you invented; it is actually a right to exclude others from doing the thing that you invented for a limited period of time.

And it is granted in exchange for your telling the world what the invention is. That's why you make a patent application and it ends up being public. The only right that you receive is to exclude others from doing that thing.

So the Hatch-Waxman Act, as I said, it was meant to facilitate generic entry. A couple of things were done. Under the old regime, if you wanted to introduce a generic drug, you had to go through the same process to get an NDA—new drug application—from the Food and Drug Administration (FDA). This was changed substantially. You could get an ANDA, which is an abbreviated process, and it's much quicker.

In addition, there was a method provided under a paragraph IV certification that can kick off infringement or validity litigation, so as to enable a quick challenge to the branded drug patent. Also, a six-month or 180-day exclusivity period was given to the first generic to make such a filing. That was encouraging them to take this risk, because it is a risk of litigation against a major pharmaceutical company. As you can see, the major-brand pharmaceutical companies fight hard to defend their patents.

At the same time, a 30-month stay is put in place as soon as the litigation commences, so to counterbalance that. That means that, while that litigation progresses through the courts, there are 30 months that the generic cannot start selling the product.

However, after that 30-month stay ends, even if the litigation is ongoing, by law, at least, under the Hatch-Waxman Act, the generic drug company may start selling their drug. They may be doing that through the risk of an infringement action, but they may start selling the drug.

In light of a lot of the concerns that we will be talking about, there were, in 2003, some amendments. The amendments were meant to try to temper some of these concerns. Just keep in mind there have been some amendments, and some people say they accomplish something, and others say they haven't.

I want to start with the FTC and a few enforcement actions that they brought in 2000 and 2001. One is the *Hytrin* case, and the other one is *Cardizem*. I think instead of going through a lot of the details of each of these, I'll describe kind of a hypothetical that won't apply specifically to facts of any of these stories but will tell the basic facts that are necessary. And here's the story.

A drug company that has a branded drug of one kind or another sees the generic competition coming along. They see it because they see the paragraph IV certification and they are involved in litigation to defend their patent. The litigation usually is about whether the patent is valid or whether the generic drug company can sell the generic equivalent without infringing on that patent, or both sometimes.

As that litigation proceeds, they decide, as often occurs during litigation, to settle the case. And the terms of the settlement are very important and somewhat unusual in patent infringement situations. The pioneer or the brand-name drug company pays some amount—often in the tens of millions of dollars or even more in some cases, tens of millions per month or hundreds of millions as a one time fee, very large amounts.

In exchange for that, the generic drug company agrees not to bring the drug to market at the earliest date that it could under the Hatch-Waxman provisions that I described earlier. And there are a lot of bells and whistles involved here.

Sometimes there are some additional rights exchanged, sometimes not. But the basic point is that the person who has been allegedly an infringer of the patent is the person who receives money rather than the person who pays money to get a license, which is the more common way that a patent dispute gets settled.

The first case that made its way up through the courts was the *Cardizem* case in the Sixth Circuit. Now, as night follows day and day follows night, when there were FTC enforcement actions, there were also civil actions brought. And the civil actions, the first one that made its way up was the *Cardizem* case. There, the court had said, you have a brand-name company that has a monopoly, and it sees somebody coming to compete with it. It pays it money, a substantial amount of money here, $10 million a quarter, in exchange for not entering the market. It sounds like a sharing of the monopoly. Sounds like a classic per se violation.

And I think that it's fair to say that a lot of people in the antitrust community—probably not everyone, but many people—looked at it and said, this may be right. And they counseled their clients to be cautious about this sort of thing.

Another case that was making its way up—I'll talk about two together, because they both end up at the Eleventh Circuit. One is a private case, one is an FTC case. But one after the other, the Eleventh Circuit dealt with *Valley Drug* and *Schering-Plough*.

The *Valley Drug* case should be discussed first. As that case made its way up, it was first in the Southern District of Florida. And the Southern District of Florida said this sounds per se.

When it made its way up to the Eleventh Circuit, the Appellate Court thought differently of it. They said we are going to step back and started looking at it from the perspective of a patent.

You'll recall, when I started, all that a patent does is allow you to exclude others from using your invention. They said when we start thinking about what the anticompetitive effects are here, we really need to understand what legal patent rights one has to exclude others before we get into whether this agreement is or isn't unlawful. They said therefore, you can't judge this to be automatically per se.

The Eleventh Circuit came up with a three-step analysis. They said first, you have to ascertain what the exclu-

sionary scope of the patent is; then you need to determine whether the settlement terms exceed that scope; and then you consider the resulting anticompetitive effects.

Now, as this was going on, the FTC had an administrative case involving Schering-Plough. The Administrative Law Judge ruled against the FTC complaint counsel. It went up to the Commission, which found in favor of the complaint counsel, then it was appealed.

The defendants, having read the *Valley Drug* decision, appealed to the Eleventh Circuit—which is what one can do when the FTC rules against you, you can choose which circuit to appeal to—and the Eleventh Circuit stuck to their analysis in *Valley Drug* and gave this basic three-step analysis.

The *Valley Drug* case, which is the Hytrin case, has gone on and on. And I want to take a very short detour to mention something very interesting and relevant to think about. That case went back down. Even after the Eleventh Circuit said it wasn't per se, it went back down.

The district court in Florida actually found for the plaintiffs after that, and then some part of the case went back to the California district court where it was tried. The jury found there was no injury. The reason they found no injury is they believed—apparently, the evidence presented to them—that the generic drug company would not have brought the drug to market, even in the absence of the settlement agreement, because they feared the risk of an infringement action.

As we will hear later, and I'll let the others describe it in more detail, the risks are quite great just because of the difference between the price that you sell a brand-name drug for and the price that you sell a generic drug for. So the cost of losing such a case could be great.

The decision, *Kaiser Foundation Health Plan Inc. v. Abbott Laboratories Inc.*, 2009 WL 69269 (9th Cir. Jan. 13, 2009), actually talks about other issues, evidentiary issues, and issues of privilege and whether it is waived or not. But the reason I bring it to your attention is really because of that issue of injury which has come up in some other cases as well.

The next case that I want to talk briefly about is the Second Circuit *Tamoxifen* case. There was an appeal from a decision in the Eastern District of New York. And the Second Circuit essentially followed the reasoning from the Eleventh Circuit in *Valley Drug* and *Schering-Plough*, but they actually went beyond.

The way they formulated it is they said there is no antitrust violation if the settlement terms don't exceed the scope of the patent, assuming there is no sham litigation or fraud on the Patent and Trademark Office.

The shift here is there is even less of a concern about the strength of the underlying patent. Because remember, we step back, this whole process is a process for the generic drug company to say I don't think this is a very good patent, or I don't think that I'm infringing this patent.

Very recently, the Federal Circuit decided a case called *Cipro*, which was mentioned earlier by Molly in her very nice presentation. The Federal Circuit—as one might expect, because the Federal Circuit is the court assigned to hear all patent appeals—looked at this again from the patent perspective, not from the perspective of a monopoly being shared by two people, and the monopolist is paying off someone not to come in and ruin its monopoly.

Instead, they said well, wait a minute here. There is a patent. They said there is a doctrine of patent immunity: anything you do within the scope of the patent shouldn't be subject to antitrust law. Even if we go through a typical rule of reason analysis where we need to see what are the anticompetitive effects of this particular restraint we are examining, there are no anticompetitive effects because they are already built into the patent, and we need to presume the patents are valid.

I think I should try to bring this to a close because there are others who are going to speak more about the controversies of policy going forward. But I would like to say two things. There is the *Cephalon* case the FTC has recently brought. This case has made its way to the Eastern District of Pennsylvania and will end up in the Third Circuit. This is a circuit that has not yet ruled and a circuit that in the past—you think of the *LePage's* case and other cases—has ruled in favor of plaintiffs often. That will be an interesting case to see. The FTC made the deliberate choice not to bring this as an administrative action but to bring it directly to the federal court.

Lastly, is there going to be a Supreme Court review? Obviously, I don't know. As far as the *Cipro* case goes, we have until March 23rd to see what the petition for cert. looks like. I'm not sure. I want to remind you—many of you will recall this—of the *Schering-Plough* decision, which was very controversial. There was a debate between the FTC and DOJ as to whether the Court should hear that case. The FTC very strongly thought they should; the DOJ under the prior administration said no, the Court shouldn't take the case.

I think it's fair to assume under this new administration, the rift between the FTC and DOJ may not be as wide. But I don't know how this will all play out.

In the past, the Court did not want to hear these cases. There is much change going on in Washington, but the Supreme Court hasn't changed yet, and looking at what it has done over the last bunch of years, it has done a couple of things. If you look at trends, it has said to us in the Antitrust Bar: When there is a regulatory scheme out there, be it the *Billing* case talking about SEC regulations, or the *Trinko* case talking about the Telecommunications

Act, the antitrust laws should, to one extent or another, step aside where those regulatory schemes are trying to regulate competition.

At the same time, the Supreme Court has steered away from calling many kinds of arrangements per se, even things that for a hundred years we have called per se.

When you look at all those trends, I'm not sure how the Court will rule, but I'm not sure if the direction that I've described is going to change course, and there may be some other ways that the FTC and those who are advocating for other kinds of challenges to reverse payments may try to address it.

And I'll turn it over to Anne.

MR. ROONEY: Thank you, Elai. So to keep the story line: reverse payments occur when brands pay generics a lot of money to settle a case. The FTC says that can't be lawful. The Sixth Circuit seems to agree. The Second, Eleventh, and Federal circuits say it is okay as long as the restriction is within the scope of the patent.

Now we'll hear about the economic dimensions of the issue.

DR. LAYNE-FARRAR: So I wanted to focus on the incentives involved for the parties and maybe how some of those incentives have been changing over time. As Bill mentioned at the beginning, this is sort of a perennial topic at seminars that stems because there's a huge debate going on.

Essentially there are two camps. One side says that reverse payments should be per se illegal. I think it is summed up pretty clearly by Professor Carl Shapiro in a 2003 paper which says, "Presumably the patent holder would not pay more than the avoided litigation costs unless it believed that it was buying later entry than it expects to face through the litigation alternative."

In other words, it is paying for delay. There are a whole bunch of people in this camp, including the FTC.

On the other side of the debate are people who say wait a minute. There are circumstances under which reverse payments are not necessarily anticompetitive, even if you abstract from all of this within-the-scope-of-the-patent stuff.

For example, in a paper just released last year, several authors argued there were important economic realities that made reverse payments not only anticompetitive but actually procompetitive. In particular, things like risk aversion on the part of the branded firm, information asymmetries between the two parties negotiating, different expectations over the outcomes of the litigation, different discount rates for future profits and other factors of that sort. And there's a bunch of people in this camp, as well, that have written on this.

So the debate is raging over what the real impacts are and what the economics are for reverse payments. The intensity is easy to understand because the stakes are very high. This chart shows how prices fall with generic entry. So that first bar is one generic entrant, and it shows the average generic price versus the brand price—actually, I think that bar is higher, because it includes things like authorized generics that the brand firm actually puts out itself. So the price falls pretty precipitously as generics enter. A lot of money is on the line.

An example for Merck shows how much money can be on the line. With Zocor, during its exclusivity period, Merck was earning roughly $5 billion a year in revenues. After the first generics entered in 2006, those revenues fell to just under $3 billion. And after two years of basic generic competition, they were below $1 billion.

So the profits fell dramatically, and at the same time as the pie charts on the right show, market shares shrunk fairly quickly. Other examples will show even greater erosion of market share.

Anybody that has followed reverse payments is already familiar with—but it is really important to repeat them because they have a very important consequence economically. That is that the discrepancy between what the brand firm can earn during an exclusivity period versus what it can earn facing generic competition defines the amount of money that that brand firm is willing to pay to a generic to prevent entry. That's what is on the line for the branded firm.

On the other side, the generic firm has far less earnings on the line. Say—just a hypothetical example—that we are talking about a drug of $1 billion in revenues. Then it suggests the generic version will earn roughly $150 million. So anything above $150 million and the generic firm is going to find it's in its own private interests to accept the reverse payment.

So in other words, with most of these drugs, any drug that has a significant amount of revenues, the brand firm can always make a deal the generic firm cannot refuse. So clearly, there are very strong incentives for these private parties to enter into reverse payments. They are not trying to subvert their own profit motives.

So unless we can really change these private financial incentives, my view is firms are going to try to find ways to make these reverse payments happen. It is in their own interest to do so.

From the evidence, if the brand firm earns at least $500 million in sales, it is going to challenge a paragraph IV filing to make some sort of reverse payment or settlement to make the generic go away.

Now, that said, some of the rules and perhaps some of these private financial incentives may be changing now. And the idea I want to talk to you about for the remainder

of my time is that it might be possible for multiple generic filers to at least chip away at the prevalence of some of these reverse payments.

So to understand why, let's step back and look at some forces that were in place that prevented some of these multiple filers from emerging.

In its 2002 study, the FTC expressed concerns over what it termed generic entry "parking." This is the notion that a first generic filer comes in, is granted a 180-day exclusivity period, but then never actually markets the drug before the patent expires. So it sort of wastes its time period.

Later filers, later generic firms trying to enter, were blocked from that timetable because the 180 days hasn't started tolling yet. As a result, the brand firms really only have one generic to deal with. As we saw from the earlier slides, that's pretty easy, always the money to pay off the one generic.

This parking seems to have occurred from a combination of rules and regulations that were in place at the time. For example, if there was more than one patent required for the practice of the particular drug, the brand firm may only sue the generic for infringement of one or two of those, leaving some uncertainty as to whether or not the generic would be hit with an infringement from the other. Later filers, the courts weren't viewing them as having standing for filing declaratory judgment for validity of infringement proceedings. And finally, unilateral covenants not to sue from the brand firm were seen as removing all threat and therefore removing standing as well.

Many of these obstacles have since been removed; some involved changes to the Hatch-Waxman Act. Now there is only one three-month stay per drug permitted, where you could have however many before. It is possible, now, the first filer may forfeit its exclusivity if it doesn't seem to be acting appropriately. And finally there's a potential counterclaim to delist patents.

The last piece that fell into place was just last summer in a ruling from the Court of Appeals from the Federal Circuit, which, in essence—I'm boiling down the decision—gave the opinion that any Paragraph IV filing, ANDA filing, satisfies the standing requirements. If you file the Paragraph IV ANDA, you have standing to challenge the patent validity. Moreover, any sort of unilateral covenant not to sue from the brand firm didn't remove the threat and therefore didn't remove the action.

So these changes have the implication that a second generic filer may actually be able to trigger the 180-day exclusivity for the first filer even if the first filer's decision hasn't been made yet.

So what does this mean, then, for the incentives of firms participating? I think if there are enough of these Paragraph IV ANDA filers emerging, it is possible that brand firms may no longer find it financially feasible or in their own economic interests to offer settlements to all of the filers that then preclude generic entry before the patent expires.

Now, it's not enough just to have the multiple filers. You need some other conditions as well. And in particular, I believe you need to have the case that the difference between what the brand firm can earn as a monopoly during exclusivity versus what it can earn when generics come in can't be so great. The bigger that pool is, the more money to pay off generics.

This is what I'm currently working on; it's a work in progress. But I think that we will be able to develop a model that shows there are certain circumstances in which the difference is big enough to make the brand firm care, but not so big that it can pay off every single generic who wants to file—perhaps because of high-risk drugs in which doctors are more likely to write "prescribe as written" or where consumers have perceptions of quality for the brand versus the generic.

So do these changes in the rules then mean some sort of end to reverse payments? No, I don't think that's going to happen. But depending on how likely these conditions are, how prevalent they are, where it creates the scenario that multiple filers coming in make it no longer economic for the brand firm to pay off all the generics, we could very well see a reduction in the prevalence of reverse payments.

I think even at this preliminary stage, where we don't understand entirely what all of these conditions are and how likely they might be, their possibility suggests an important policy question. We are focused so much on whether reverse payments are per se illegal or not, maybe we should be thinking about other routes to dealing with the reverse payment problem, if you want to view it as a problem. And that is should we think about other kinds of incentives, ways to align incentives for the parties to encourage multiple filers, perhaps all at once or sequentially? But do we need additional carrots for these generics on top of the one that we are already providing first filers in the form of 180-day exclusivity?

And here, I will turn it over to the FTC.

MR. ROONEY: Thank you, Anne. That gives us a bit of insight into the economic origins or reasons that we are seeing reverse payments. Now we'll hear whether they are a good or bad thing. You can guess the answer.

MR. KADES: Good morning. I have to say, as I was listening to Molly's presentation, I had this moment of great optimism, because as Molly talked about the *Inova* case and the FTC's victory in that hospital case, I realized when I first started at the commission, the first case I worked on was the *Poplar Bluff* merger, where the Eighth Circuit slapped the FTC very hard, and the second—no,

the third—big case was the *Schering* case for the Eleventh Circuit that was very unimpressed with the Federal Trade Commission.

But after no longer working on hospital cases, the Commission has won two cases. And now I no longer work on the daily litigation of reverse payments, I am considering that I am the key factor.

Anyway, I should start with my standard disclaimer: What I say today represents solely my views and not necessarily those views of the Commission. And as my boss says, I emphasize, certainly, not his views.

There's a saying, "whistling by the graveyard." This goes back to the notion behind this is that when people walk in the dark, by graveyards, they are scared, the way they make themselves feel better is they whistle. So that describes where the courts are headed on patent settlements. Because the last two cases are really moving us forward to a rule of functional per se legality, regardless of what they wish to call it.

That is the devastating impact, more devastating than any other issue in antitrust today on the cost of health care and what people pay for prescription drugs. To the degree we think the market will correct itself, that's a little bit like whistling past the graveyard. I'm going to try to explain what might happen on the legislative front and explain those points today.

Essentially, in both the *Tamoxifen* and the *Ciprofloxacin* decisions, the Court is saying as long as your patent is not the result of fraud, as long as the litigation is not a sham; brand, you can pay whatever you want to, and generic, you can agree to stay off until patent expiration, that is legal. That's what the Court is saying: as long as you don't agree on a bunch of totally unrelated products.

So why do we care about that? Let's talk about the problem and why does the government care so much about this? It's really quite simple. If you look before the generic filing, the brand is earning these rich profits, and they are not sharing them with anybody. If the generic's entry makes it to market, the brand loses substantial sales overnight to the generic. But the generic's profits are less than what the brand loses, because they are selling at a lower price.

The difference over there on that competition pie is the blue slice is what consumers save by buying the lower cost generic. So it is sort of obvious in antitrust law that the parties would always be better off avoiding that nasty, ugly competition thing; eliminating consumer savings; and sharing the profits by having the brand simply pay the generic. This is why we have section 1 of the Sherman Act: to prevent this sort of thing from occurring.

Now, in these patent settlements that the FTC has challenged, this is what it is concerned about. Because even if there is a patent, at the time of the litigation, it is not clear who is going to win. It is uncertain, and these payment incentives still exist. They are all discounted by the strength of the patent. But there is always the benefit of eliminating the possibility of consumer savings—i.e., taking the benefit of eliminating competition and sharing it between the incumbent and the enterer.

In these settlements that the FTC has challenged, its concern is that the patent holder is sharing its economic profit to prevent competition. The legal question should be Does the patent include the right to use your economic profits to prevent competition?

I would say, since the Supreme Court, just a couple years ago, said a patent doesn't necessarily convey economic monopoly power, it is a little hard to argue that the patent rights then should also include the right to use those profits to eliminate competition. That is the antitrust theory of it.

If you have worked with the government for the last eight years, there's a lot of court decisions you don't like. But why is this one such a problem? The issue is What is the impact of these rules over the long-term?

Take six drugs, totally separate; six different brand companies; six different generics; what happens? Let's say in each case, to be simple, the brand has a one-third chance of winning. If all of these cases go to litigation, you expect two of the brands win; keep generics out, four of them lose, competition occurs.

Now, some of these cases might settle. So if they settle, you actually expect, if they sort of agreed on an entry date, it would roughly reflect the strength of the patent, right? So the brand holder would be able to protect a third of the life of the patent, and then there would be competition.

Now, going back, if you remember those pie charts, if you allow the brand to pay the generic, what should be happening in all of these cases? You have no entry prior to patent expiration, regardless of the strength of the patent. And the implications for that are astounding, because most people get how important generic entry is to save you money.

What's a little less understood is how important generic entry prior to patent expiration has been to controlling health care costs to the degree that they are controllable. So here, we have a little chart which I like to call "Greatest Hits of Blockbusters of the 1990s." These are all cases where generics and brands went to court on a patent case. Generics won—brought a product to market. And in each case, you can see consumers saved billions of dollars.

The question I ask you is If *Cipro* and *Tamoxifen* decided in 1996, instead of when they were, would any of these brand companies have let those cases go to trial, or would they have started putting money on the table to try to find a way to convince the generic to stay off the market?

What would have been lost if that had been the rule of the day is all that consumer savings would have disappeared. We currently spend $227 billion a year on prescription drugs. If we go this route, that number would skyrocket because the generic entry that has been occurring will become less and less and later and later. So that's why the FTC has been so involved in this issue.

Now, oftentimes in response to anticompetitive concerns, we have heard that the market can correct itself eventually. In fact, the "eventually" is always, by definition, faster than whatever the Government and courts can do. This is a situation where I think the market is unlikely to correct itself.

Anne sort of talked about a possibility here, which is yes, it's true that the brand will pay a generic, but if you get too many generics, it gets too expensive. The notion being that what needs to happen is, we need to fix this problem of 180 days preventing subsequent filers from being able to challenge the patent. So if every filer challenges the patent, it will get too expensive to pay off all the generics.

There are two reasons why that's unlikely to be successful. The first: even if you get a bunch of filers, it actually becomes easier to pay them off because the implication of multiple filers is that the generic price drops like a rock.

I used a different study than Anne, but it essentially shows how far prices go down. The first generic sells at about a 30 percent discount, but by the time you get down to the fifth, you're looking at a price that is 35 percent of the brand price. If you face five generics, they are going to earn a lot less in total than the one.

To put some numbers on that, let's take a brand, a $1 billion product. The brand earns about $1 billion a year. Using the numbers from that study, assuming the generic eats up about 80 percent of the brand's market, which is in the ballpark, a single generic is going to earn about $540 million—roughly half. If you get five, the total profits of those five—not by each company, but totally—they earn $257 million. In total those five generics are going to earn less than half of what that one generic will.

For the brand facing five generics, it is actually a lot cheaper for them to pay off all five. You don't have the usual problem of having to go out and find your competitor, because here, your competitor had to tell you I'm the generic, and I am challenging your patent in litigation. So you couldn't ask for an easier place to pay off your competitor. The more you've got, the easier it is.

The second issue is that even where it might be not possible to pay them off, it is still not clear that you're going to get successive filers even if the law has been fixed in the way Anne was talking about. Here is the problem: you guys who represent the brands are way too smart compared to us poor government enforcers. We are always, like, eight steps behind.

What's become common in the industry is the generic acceleration clause, which is the first filer's settlement involves a delay of entry. On top of that, the brand says to the generic oh, by the way, if anybody else challenges our patent and wins, we will accelerate your entry to when they win.

The issue here is that really eliminates the incentive of subsequent filers to pursue the litigation. Because the benefit of the subsequent filer is well, the first filer settled. If I win, that will cause the forfeiture of the 180 days, and I can be the first mover and get an advantage there.

With the acceleration clause, that doesn't happen because what happens is, the way the law is set up, you forfeit your 180 days if you don't market within 75 days of a Court of Appeals decision finding the patent invalid.

With the generic acceleration clause, even if the second filer goes to trial, and even if it wins, that triggers the acceleration clause. Within 75 days, the first filer is on the market. They get the 180 days; the second filer is going to enter 181 days after the first filer, which is exactly what they do if they take a settlement that says you enter 181 days after the first filer. That generic acceleration clause is virtually ubiquitous.

You've also seen over the years that where there is compensation, it is overwhelmingly to the first filer, not subsequent filers. All of this is consistent with the fact that it is very hard to create the right incentives for subsequent filers to challenge the patent.

If we are going to fix this problem, the FTC will continue to challenge those agreements it thinks are anticompetitive, but the Commission has asked Congress to step in. I want to talk about three different ways you might solve the problem. Two are substantive and one is procedural in terms of legislation.

What the Commission endorsed is the Kohl-Obama bill on the Senate side, the Rush-Dingell-Brackley bill on the House side. And the approach to those bills is essentially the bright-line with safe harbors. So you come up with a very simple ban on settlements with payments and compensation. Then, if you think there are certain types of compensation that are acceptable, like entry prior to patent expiration, you just carve those out.

And you can negotiate, make the bill more or less lenient based on what your safe harbors are. So things like if the payment is less than, say, attorney's fees, you might say as a matter of policy, if you're not really making a big payment, we don't care. If the generic is not agreeing to stay off for very long, we don't care.

The benefit from the enforcer standpoint of that sort of approach is we know what we are getting up front. You

know this type of settlement is going to be clearly prohibited, and that type of settlement is going to be clearly not prohibited.

What Senator Specter was pushing was a case-by-case approach, which is, you have some broad prohibition on some things that are anticompetitive then put 40 or 50 criteria the court has to include, which includes virtually everything from the strength of the patent to whether it is a complicated transaction to whether the payment fair market value. You have to consider the social benefits of the settlement, whether giving a payment made the generic a better competitor in the long-term. Virtually any factor you want to think of has popped up in some proposal.

The problem with that is that's not clear it is going to do anything except create a lot of mud, which, in my more cynical moments, I would say that's the whole point of those proposals. So that's the second.

The third thing is sort of a little more process. As bad as the recent court decisions are, if you saw *Schoolhouse Rock!* you know getting a bill passed is a pretty difficult thing. I actually think, in this Congress, there is reason to think it is looking more likely—which is not to say likely, but more likely than the average bill.

Number one, not only did Senator Obama support this bill, in his statement to the AAI he identified patent settlements that delay competition need to be eliminated. We went from an administration that was silent to an administration that sees a problem.

Number two, health care is going to be a major issue, so that can provide a vehicle where you may see some sort of bill passed.

And three, and finally, some in the generic industry want to ban authorized generics during the first 180 days. Clearly, one doesn't have to be superbrilliant to understand that may be a creative compromise, but not on the substance. If you accept the ban on authorized generics, if you get that, maybe the cost is you have to give up your right to get big, fat payments from the brand.

So that's where I leave you today, since I am already out of time. Thank you.

MR. ROONEY: Thank you, Michael, for explaining very well and articulately the reason the FTC thought from the get-go and still thinks there is something wrong with reverse payments.

Let's hear the European perspective. After Marc speaks, we will have whatever time we have left for questions. So if you wish to ask some questions, please have them prepared. We won't have a lot of time at the end but would very much like to engage the audience.

As you wish.

MR. VAN DER WOUDE: Thank you, Bill. First, I must say I came from Europe with empty hands. I've been listening to this debate upon reverse payments and settlements. I regret to say that we don't have any European case law on this topic. So it is a completely new issue for us. My presentation will therefore be prospective in nature by studying the question as to whether reverse payments and settlements will ever become an issue under EU competition law.

But nevertheless, I managed to find some case law which could be relevant for the assessment of settlement agreements. Presenting this case law is the first thing I would like to do. The first set of cases concern the settlement of trademark infringements. These cases are interesting, therefore the topic of today, because the courts and the Commission all focus on the question whether there was a genuine trademark dispute. This same question can also be relevant to assess settlements in the pharmaceutical field in Europe. Is there a real dispute that needs to be settled, or is the dispute just an excuse to veil anticompetitive intentions?

The second element that plays a role in trademark settlement cases is a typically European one; does the settlement lead to a partitioning of the internal market? As you know, we have 27 member states with 27 different markets. Settlements should be settlements for the whole of Europe but not artificially perpetuate national markets.

The second set of cases which I found concern so-called "no challenge" clauses. As a rule, no-challenge clauses in licensing agreements are considered with suspicion. They used to be so-called "black" clauses, i.e., black clauses which were necessarily prohibited under article 81(1) EC and which would rarely benefit from an exemption within the meaning of article 81(3) EC. That inflexible approach has changed over the time.

For example, the technology transfer regulation does not preclude no-challenge clauses. There is also a judgment of 1988 which states that no-challenge clauses do not raise competition concerns if the license is granted for free. This suggests an element of financial compensation, which also plays a role in the assessment of the settlements in the pharmaceutical industry.

It results from this analysis of these cases that settlements and no-challenge clauses do not lead to per se infringements of article 81EC, comparable to the per se approach under U.S. law. We don't have the equivalent of this tough line in Europe. In my view, the early case law suggests a more case-by-case approach. So these were the early beginnings.

Now, things may change. On November 28, the Commission published a very thick report, 421 pages in total, about the pharmaceutical sector and the problem of delayed generic entry and the costs which that entails for

society. Of course, you will ask: What is a sector inquiry and why this report? As you know, European competition rules changed in 2004. The idea underlying this change was to have a more proactive enforcement of competition rules. The Commission would proactively look for problems rather than reacting to complaints and notifications. Sector inquiries offer an effective tool to look for potential competition problems. There have been sector inquiries in a couple of sectors, banking, and insurance, energy and now pharmaceuticals.

A sector inquiry will enable the regulator to identify competition issues and then to focus its enforcement activity on these issues. Often, you will see that sector inquiries are immediately followed by enforcement action. At this moment, we have already seen the first inspections organized as a follow-up to the report. And I'm informed that some of the cases which are now being investigated concern settlements and reverse payments.

The report is basically about three issues. The first is competition between originator and generic companies. Obviously, that's the topic for today. But that's not the only topic for the report.

There's also a significant part that deals with competition between originator companies and a detailed explanation of the regulatory framework, which is particularly complex in Europe, as you may expect. This regulatory framework does not contain the equivalent of the Hatch-Waxman Act. This is an important difference that may interfere with the assessment of settlements.

What's the timing of this whole exercise? As Bill said, we will have a final report in spring 2009, and there will be follow-up cases. The pharmaceutical inquiry, however, seems to me, in comparison to other inquiries, not very well timed.

I wonder whether the Commission will really find specific cases, as it did, for example, in the energy sector, because the report is so general in nature. It is very factual. The Commission doesn't really define its views on the issues discussed in the report. One may therefore fear that the whole exercise could lead to nothing. But that's perhaps a bit of a pessimistic view.

The issue on competition between originator and generic companies essentially deals with the tactics followed by originator companies to delay generic entry. This includes in the first place multiple patent filings for one and the same invention. Of course, there is nothing wrong with a patent. On the contrary, the report acknowledges the importance of patents for innovation in the pharmaceutical sector. Without the patent the industry would not thrive. There would be no inventions which turn generic at the end of the day. The report does not intend to stifle innovation or to bully the pharmaceutical industry.

Litigation strategies also offer a possibility to delay generic entry. We will find that, in 27 jurisdictions, blockbuster drugs are defended ferociously by originator companies. You will find some data here. The litigation costs totaled €420 million for litigation regarding 68 drugs between 2000 and 2007. This is a considerable amount.

And settlement agreements are also discussed as a part of these delaying tactics. The part of the report dealing with settlement agreements counts approximately a hundred pages. Despite its length, the Commission's report is purely factual and descriptive. It analyzes 207 agreements concluded between 2000 and 2007. The interesting thing about this analysis is that settlements do not necessarily lead to a limitation of generic entry. In fact, the majority does not lead to delay of generic at all.

On top of that, you can see on the slide that there are settlements with value transfer and settlements without. So, the scenario of reverse payments in the sense that the originator pays the generic not to enter the market, which is the scenario which you are debating here in the United States, is only one scenario amongst many others. You also have the opposite scenarios where the generic pays the originator. Payments can take place in both directions: from originator to generic and, vice versa, from generic to originator.

The sector inquiry report also refers to U.S. case law but specifies that case law is not immediately transposable to the European situation. It refers explicitly to the *Schering-Plough* and several other cases that were discussed earlier on.

Another interesting element of the report concerns the reason why originator companies and generic companies enter into settlements with or without a value transfer.

You will see that, for an originator company, the strength of the patent is the key consideration. Ninety-five percent of originator respondents indicated this factor as the most important reason to enter into a settlement agreement. This means that lack of confidence about patent may induce originators to enter into a settlement. For the generics, costs are the key consideration. This is clearly confirmed by this report. Generic firms incur huge litigation in Europe when they are sued by an originator company.

Some comments on the value transfer in the reports. As I said already, you will find payments from the originator to the generic entrant, but also the other way around, from the generic to the originator company. The considerations for entering into a settlement with a value transfer not only relate to the parties to the agreement, but also to third parties. An interesting consideration was that, if an originator enters into a settlement agreement,

its patents remain valid and can thus always be used as a barrier against third parties. Alternatively, ongoing litigation has a risk. The originator may lose the case and may therefore lose the value of its patent entirely.

Now, regarding value transfer, the report mentions that there can be a good reason for compensation. For example, where the case had involved a damages claim, the reverse payment may have a purely legitimate cause. Also, if the generic company already has constituted stocks, which have to be taken away, it may be legitimate to require the originator to reimburse the costs of these stocks.

That's, in a nutshell, what the report says.

Now, what will happen? Of course, at this stage, it is too soon to say something about that. My prediction is that it will not lead to a per se or hard-core approach, as we have seen predicated by some in the United States. As mentioned before, cases have been assessed in their individual economic contexts. Paragraph 574 on the report offers a clear indication of this case-by-case approach: Reverse payments must be assessed in their economic context.

What kind of questions could be relevant for such an analysis? First, is there an entry limit on the generic company? If there is no limit on generic entry, then there is no competition issue and no reason to intervene.

The second point is, even if there is a limit on one company, are there other contestants that could come and enter the market? If there are others ready to come and ready to contest the incumbent, I don't see a competition problem either. One should bear in mind that we don't have a Hatch-Waxman Act where you can have one privileged entrant as you have in the United States.

Third, if the settlement and the reverse payments also affect third parties, I think the Commission would have to make an *ex ante* assessment of the mutual risks. What would be the alternative if the patent had been enforced? In other words, what's the counterfactual scenario? And, of course, the enforcement should be proportionate to the issues not covered by the patent.

Fourth, was there a good reason to enter into a settlement and to offer reverse payments? Are there reasons why the parties had these payments?

And last, the point is that settlements may facilitate a patent challenge. If you are too bullish on the settlements, people may be deterred to challenge the patents at all.

Finally, some few remarks on the possible relevance of this European study for the United States. As I already said, the Commission considers that U.S. practice is not directly transposable to Europe. Another complicating factor is that patents are still national in scope. So, if you have a settlement deal in the United States, it will not necessarily be recognized in Europe and vice versa. Transatlantic issues, as we see, for example, in merger and cartel cases are less likely to occur as a result of this territorial limitation. But if you have global settlements with global reverse payments to make an end to global disputes, of course, then, there would be an issue.

I thank you for your attention and hospitality. Thank you.

MR. ROONEY: Thank you, Marc.

Thank you, panelists.

And now, questions. Yes, Stacey?

MS. MAHONEY: I had a question for Marc.

I recall reading in the report that if the Commission seemed to be inclined, if it were to perceive challenges, to go after the patent holder as well as the generic for the settlement, it would be anticompetitive. That seems a little different than our regulatory regime where we always go after the patent holder.

Do you have any impression about whether that implication in the report is likely to come to pass as a practical matter, based on maybe the investigations and the noise that you're hearing now?

MR. VAN DER WOUDE: First, I'm not so sure that—at least, I have not the same impression after reading the document, that the Commission would go after settlements, but they are after settlements for the moment. And it is true they also organized inspections with generic companies. So both parties to the agreements must come to an understanding with the regulator.

MR. ROONEY: Yes.

SPEAKER FROM AUDIENCE: Yes, this is a question to Michael Kades.

In discussing the cases, nobody mentioned that, for example, in *Tamoxifen*, that patent had been struck down after trial and was on appeal. And the reverse payment was allegedly more than the generic would have made had it won the case and gone to market.

So how about considering a possible per se rule of reverse payments in excess of what the generic would have made had they won the case and gone to market? Because by definition, how could it be a settlement if you're getting paid more than if you won your case?

MR. KADES: Well, that would certainly be an improvement to where we are today. You know, the issue is, even if the patent holder—I mean, even if there is, say, a 50 percent chance, if you pay the generic half of what it expects to earn if it wins, and they agree to stay out, you're functionally in the same place. You've eliminated the potential competition, and the generics basically get paid to stay out of the market. It is an improvement but doesn't solve the problem. That, from the generic's per-

spective, if they are offered half of what they expect to make if they win, and they think they have a 50 percent chance, they will always take that deal. All that changes is the size of the payment.

SPEAKER FROM AUDIENCE: But in response to the court's concern of settling pending litigation, how can it be a settlement if one of the parties is getting more than it asks for in the litigation? That was the point.

MR. KADES: No, I like that argument.

SPEAKER FROM AUDIENCE: I want to add one thing. *Tamoxifen* included the fact that there were other challengers, and they were unsuccessful. The first one was successful, the others were unsuccessful, which brings us back to an important point: it is hard to know—a patent is initially drafted as a monopoly, and any patent—think of some of the greatest patents in our country's industry to propel us forward—could have been challenged. And if you tried the case a hundred times, some of the times they would have lost, and some of the times they would have won. That's a perspective that has to be kept in mind.

When you talk about calibrating how much would or wouldn't be appropriate, keep in mind many of us litigate cases we don't always know how they are going to turn out and know that, if we get a different judge or jury, they may come out a different way. It is hard to predict in advance or determine after the fact that they were a terrible settlement because we don't know all the factors that come into play when you're trying to determine litigation.

MR. ROONEY: Yes—in the back.

SPEAKER FROM AUDIENCE: Following up on that question, Elai, I find it interesting that in describing the settlement, particularly the *Hytrin* and *Cardizem* cases, everyone seems to be glossing over the fact the payments were interim payments while the litigation progressed, and under both of those agreements, this was supposed to be a court ruling on the infringement issues.

The question for Michael, I guess, is had there been any consideration of a procedural approach to this that doesn't come down so much on the brand or the generic but actually institutes rules that allow them to get quicker resolution of the patent case?

MR. KADES: Yes, in the sense that, when you face decisions like *Tamoxifen* and *Ciprofloxacin*, people try to think of all sorts of ways to solve the problem. The only way you can do that would be to essentially have Congress pass a statute similar to the Speedy Trial Act in criminal cases. I think there are policy reasons why that would be a good idea.

I know there are those out there saying the FTC is full of itself and totally out of control, but I don't think we think we can dictate to the federal courts what they can and can't do . . . at least yet.

MR. ROONEY: Yes.

SPEAKER FROM AUDIENCE: I have a question for Michael.

I don't understand why the Federal Trade Commission views the prospect of per se legality with some horror. But, I guess, what's wrong with the rule of reason, given that some of these settlements arguably do result in the generic coming to market sooner than if the litigation had been allowed to play out? And to the extent that anybody is paying money to branded, it's not consumers who would be paying or losing all of the welfare. In fact, the patents were upheld and generic did not come out for another five or seven years.

MR. KADES: Look at it this way, all right? One issue is many of these settlements will offer entry prior to patent expiration. I have heard that argued before.

There are a couple of reasons why I think that's not very compelling on a policy level. One, oftentimes, the date of entry, although it is before patent expiration, there is the likelihood that, by that point, the brand has launched its follow-on product—moved the franchise. So consumers get no benefit of that entry. The fact that you're offering early entry, the fact that there's entry before patent expiration, it doesn't necessarily mean consumers in that situation have gotten a benefit.

Secondly, if what we are dealing with is that the Court is convinced the plan proves that what's going on here is the sharing of monopoly profits is driving the settlement, it can't be the case that the brand is going to share its monopoly profit to allow earlier entry. That just makes no sense.

It must be that that entry date, from the brand's perspective, provides less competition than it thinks will result from the likely outcome of litigation. And similarly, the generic, if it requires a payment to accept that entry date, thinks that entry date is less than a fair result of the litigation.

Whether they agree on what the probabilities are, they both agree that this date is worse than what the likely outcome would be in terms of competition. So if those two parties both think the outcome is worse, there should be a delay.

MR. PRAGER: I don't mean to pile on, but a follow-onto that, Michael.

It seems to me that the FTC preference in dealing with these cases is to almost assume away the actual controversy between the generic and the brand at about patent validity. In most patent litigation, you begin with an assumption under the patent laws of validity. You don't accept that assumption but also don't want to make any independent assessment at the FTC of patent validity or strength.

And it seems to me, if I understand your position accurately, you also don't want to make an assessment or even consider the issue of the likelihood of actual at-risk entry by the generic, which is a huge gamble on the part of the generic. Because if they enter at-risk and the patent is upheld, they stand to lose far more than the total revenue than they got because of the exact numbers that you put up on the board that show that their total revenue is less than half of the profit of the uncontested branded product.

So it seems to me that when we just heard the European perspective that was going to provide—if it ever goes forward—with a weighing of all of those factors, and the FTC seems to try to avoid or evade facing any of them.

My question is Other than the fact that you want to win, why is that the correct regulatory outcome?

MR. KADES: It is a very good question, and I don't think the Commission avoided those. So let me go to the first part about whether there should be an independent assessment of patent.

Let's say there are 10 years left on the patent. And the brand thinks there's a 50 percent chance it wins. The generic thinks there's a 70 percent chance it wins. So the brand isn't going to pay money to the generic to settle unless it gets an entry date beyond 5 years, because, otherwise, it is better going on litigating. And the generic is not going to accept a date later than 3 years unless it gets paid.

If there's both a payment required and a payment willing to give those two parties, the best inference is that they both think that this settlement provides less competition than the expected outcome of the litigation. And these are the two parties with the most information with entirely diametric interests before they settle. If they both think that this date provides less competition than the patent marriage really dictated.

Why would we think that anybody else could do a better job second-guessing that? So it's not a question of whether or not we want to try patent merits. But I think from a notion of what the right way to think about this is, the best evidence here is the parties' own actions and what it tells you about the fact that the brand is willing and the generic demands a payment.

Now I've forgotten the second part of your question.

MR. PRAGER: The assessment of the likelihood of at-risk entry by the generic.

MR. KADES: So, one, I think the industry has changed on this. There is more at-risk entry. I think part of it—at least in theory, because I don't want to step on the toes of people actually litigating—our position wasn't that there would have been at-risk entry. Whether there would have been at-risk entry or not, the total amount of competition allowed under the settlement and the payment was less than what the patent alone would have resulted in because of this payment.

So I'm not sure that we are saying the fact that at-risk entry is sort of critical, necessarily, to how we pursued cases in the past. I won't say anything about cases in the future.

MR. ROONEY: One more question, and then a warning to the panelists who will have an opportunity for a one-sentence last comment before we close.

SPEAKER FROM AUDIENCE: Thank you.

I'm confused about that syllogism, sir. I understand why it is that the patent holder would rather see later entry than the expected date of entry on the litigation, but I don't understand the other side of what you are saying. Surely, the generic wants to come in earlier; I'm sure it would like to have more time in the market than the expected time, should they go to litigation.

They are not both agreeing this is a bad deal for consumers. The generic is on the side of consumers because the generic wants to come in earlier, have a shot at the market and create some competition. They don't agree. They are at odds. One is in favor of more profit, the other is in favor of more competition. Both of them agree that litigation is expensive; both agree that risk is bad. And in that respect, settlement is good for both of them as it is for the system. So I appreciate your entire presentation but not the syllogism that you seem to be relying upon.

MR. KADES: All right, so what you say is true if the generic is not going to be paid. Once the payment offered to the generic is more than what it expects to make, it doesn't want to get in early. It is better off not competing and getting the payment. So if it requires a payment to take the settlement, it must think that entry date absent the payment isn't a very good settlement. So it is the payment that makes it agree to that entry date.

MR. ROONEY: So I don't get in trouble with Bruce, we are out of time here. But before we close, in hearing this dialogue, Elai, do you have a final comment?

MR. KATZ: My final comment is this: This all starts out with the Hatch-Waxman Act that says c'mon, guys, litigate. Generics, go litigate. Try to challenge patents.

They go and try to challenge patents and then there are a variety of incentives out there that lead to a particular settlement. But now the FTC says those settlements you arrived at, with all the different incentives out there, those are unlawful.

It is really a question more than a comment. Is the answer that, these must be litigated all the way to the end always? They can't be settled because we understand the

economic incentives lead to settlements that we are told are anticompetitive.

Or is the better approach to just go right back to the beginning and say we tried to put together a regulatory scheme to introduce more generics more quickly. There are some problems with that scheme. Let's try to calibrate that a little better, and we may have to try again rather than use the antitrust courts throughout the land and administrative courts in Washington to solve these problems after the parties have reached a settlement that they thought was the right thing to do.

MR. ROONEY: Anne, an economic sentence.

DR. LAYNE-FARRAR: I will tell you, absent from much of this discussion, especially a lot of the FTC analysis, is the effect it has on incentives for innovation to invest in R&D. And when you look around at how settlements can happen and how litigation goes forward and take some options off the table, you're going to affect the risks the branded firms have for investing in these things in the first place. The big pot of money is going to move a lot as this goes forward.

MR. ROONEY: And Michael, on behalf of consumers?

MR. KADES: Thank you. I like that.

The FTC's position has never been there can't be settlements. It has been you can't use your monopoly profits to settle.

In the period between *Cardizem* and *Hytrin* and *Shearing* there were plenty of settlements, and there was no evidence that there was a fewer percentage of settlements. They just didn't have payments. You may agree with us or not, but it is unfair to say we are opposed to settlements.

As to the innovation point, it is up to this: Congress should be deciding how much innovation is appropriate. If you don't think it is enough, expand the patent and give the generics more exclusivity. That's for Congress to decide.

MR. ROONEY: And Marc has the last word.

MR. VAN DER WOUDE: It's curious that, normally, the U.S. is more market oriented in its competition approach than the Europeans. But with this particular topic, I have the feeling that it goes the other way around. The Commission seems to be more open, at least my first finding after reading of this report, to see whether the rule of reason approach might be better.

The last point on the assumption is that the justification for per se rule, which is to say it is not our position to second-guess what the parties would have done; I don't think you can say that they deliberately excluded potential competitors. The report shows, at least in Europe, there are many other considerations in light of reverse payments. And payments can take place in both directions; so why would a payment in one direction be illegal, and why would a payment in the other direction not be illegal?

MR. ROONEY: And thank you to our lively and hospitable audience.

MR. PRAGER: I hope you all agree that was a superb panel.

Michael, I apologize if you felt you were getting ganged up on, but you were the one that presented the FTC opinion. We are going to take a short 10-minute break. We will start promptly in 10 minutes, and if we could get the media panel to come up, that would be great.

Media, Markets, Advertising and Antitrust

MR. PRAGER: This panel is on media. We have tried today to identify some of the critical issues that we are facing in antitrust in the coming years. And, clearly, after pharmaceuticals and health care more broadly, the media is one of the most rapidly changing and evolving areas of American society. And of course, we had planned out today long before we knew we were going to be in the midst of an economic crisis, but certainly, our current economy puts even more focus on the need for information, on the importance of advertising, and the interface between media and the rest of the economy.

So this panel has been put together by Kevin Hart and James Bailey and Michael Weiner, and we very much appreciate it.

Kevin is going to moderate the panel. He's with the U.S. Department of Justice in the New York field office. He has been with the Antitrust Division for about a decade or more. Served as a Special Assistant for the Director of Enforcement in Washington before moving up here to New York to make the world safer in this part of the country.

So Kevin, I'm going to turn the panel over to you. I think we will be as rapt with this discussion as we were the last.

MR. HART: Thank you very much, Bruce.

Welcome to the Media, Markets and Advertising Panel.

The advent and emergence of the Internet and other electronic solutions has caused a paradigm shift in the media industry. Traditional notions of media markets may no longer apply. Issues such as market definition, media consolidation and applicability of section 2 claims need to be revisited. How these complex issues are ultimately resolved will significantly affect how attorneys advise clients. Fortunately, we have a distinguished panel of four experts willing to share their great insights.

First, we have Steven Douse, partner in the antitrust firm King & Ballow. He is a graduate of Michigan State University and the University of Michigan Law School, where he was an editor of the *University of Michigan Journal of Law Reform*. After graduating from law school, Mr. Douse served as a law clerk for the Honorable John Feikens, United States District Court for the Eastern District of Michigan. For over a decade, Mr. Douse was Trial Attorney and Assistant Chief in the Antitrust Division and also served on the staff of the National Commission for Antitrust Law Procedures. Since joining King & Ballow, Mr. Douse has handled complex litigations and currently represents parties in the ongoing JOA litigation in Charleston, and he will be addressing the issues of market definition from a newspaper perspective.

Next, we are fortunate to have Allen Grunes. Mr. Grunes is a shareholder in Brownstein Hyatt Farber Schreck's litigation, antitrust and competition group in Washington. He also is an alumnus of the Antitrust Division. For over a decade, he focused primarily on antitrust enforcement policy. He will be addressing the government's perspective and approach.

Next, we have Mike Weiner. Mr. Weiner is a partner in Skadden, Arps. He represents clients in antitrust matters arising from mergers and acquisitions and does everything antitrust. He's a frequent author and lecturer on a variety of antitrust topics. He served as counsel for Yahoo during the recent Yahoo-with-Google matter. And he will discuss whether there are separate markets for online and offline markets.

Finally, Professor Robert Willig. He holds the position of Professor of Economics at Princeton and served as Faculty Chair of the Public Affairs program. He served as deputy assistant attorney general for economics at the U.S. Department of Justice before joining the Princeton faculty. He was supervisor of the Economic Research Department of Bell Labs. He will also be addressing the online and offline market definition.

So with that, the stage is yours.

MR. DOUSE: Thank you, Kevin.

Years and years ago, I was with the Department of Justice. We always had to begin with a disclaimer and tell people the views we were about to express were our own and not those of the Department of Justice.

After spending many years representing media companies, particularly newspapers, in their dealings with the department, I can confidently make the same disclaimer. Which is to say the views I am about to express are not those of the Department of Justice.

I think it is helpful to begin with a reminder about why it is that we engage in this exercise of defining markets. The purpose is not as an end itself but to identify market power.

Now, there are theoretically more direct ways that you can measure market power. You can look at price-cost ratios or elasticity of demand, but these are notoriously hard to measure for reasons both practical and theoretical. So we are almost always thrown back to the circumstantial proof of market power through identifying persistently high shares in well-defined markets.

To do this, we use the Merger Guidelines paradigm, the hypothetical monopolist test, which defines the market as a group of products such that the only seller of those products could impose a small but significant non-transitory increase

in price, which generally translates to 5 percent for the foreseeable future.

If you do this right, you should end up with a market that includes all good substitutes for whatever product you start with, which is to say all those that buyers will turn to in sufficient numbers to defeat a price increase. And that is not to say that all buyers of the product have to have the same willingness to substitute but just enough to make a price increase unprofitable.

So if we turn to media markets and apply this paradigm, there are several characteristics of those markets that are important to take note of right at the outset. One is these are two-sided markets. Newspapers and other mass media are competing in two complementary spaces.

One is to satisfy consumer demands for information and entertainment; the other is to serve the needs of advertisers for access to audiences. Both sources of demand are volatile, and they interact, which makes this a very complex exercise.

The volatility comes from the fact that consumer tastes and advertiser demands have changed—sometimes dramatically—over time, and sometimes in very short periods of time. This has been connected to the fact that information technology has evolved with increasing rapidity, and there are now a wide variety of media through which information and entertainment can be delivered.

If you go back to the early 1900s, newspapers had the field all to themselves. They were the only game in town. They were the only mass medium until the 1920s and '30s, with the advent of AM radio. That was followed in later years by broadcast television, by FM radio, by cable, satellite, the Internet, and a wide variety of still-evolving delivery vehicles.

At the same time this has been going on, there have been significant changes in the demographics and lifestyle of information consumers. These two trends have operated together to fragment what had once been a unitary market.

The complexities this poses for market definition are particularly evident in newspapers. If you go back to 1982, in the *Sentinel Star* case, the government complaint alleged two markets: one consisting of local print advertising and one consisting of all local advertising. This was advertising directed at Osceola County, Florida, which is where the daily newspaper in Orlando was acquiring a chain of shoppers and weekly newspapers.

Of course, the market had to be defined more broadly than daily newspapers to encompass the acquired companies. Despite the fact this was a successful case, as far as I'm aware the Antitrust Division has not since that time defined a market in which newspapers compete as broader than daily newspapers.

This was most recently the case in Charleston, where the government has alleged two markets: one for the sale of local daily newspapers to readers and the other for sale of access to those readers to advertisers.

The newspapers in Charleston are in a joint operating arrangement, which some of you may know provides an antitrust exemption for newspapers under the Newspaper Preservation Act, allowing them to combine all of their business operations as long as they preserve editorial independence.

There have been as many as 30 JOAs over the years. Most of those are now gone. There are currently only 9 remaining and there are likely to be fewer by the end of this year as, in three of those cases, one of the newspaper owners has announced an intention to sell or close its newspaper.

The case in Charleston challenges a transfer of economic interest between the JOA partners and challenges it as a violation of section 1, section 2 and section 7. There are some very interesting nonmarket issues in the case, but the definition of the market, particularly product market, will be at issue if the case is ultimately tried. And if it is, it will provide the first market test, if you will, of the definition the Antitrust Division has been using for years of daily-newspaper-only markets.

Several problems will be posed for the court in trying to define the appropriate market. One important one is the fact that, as I mentioned earlier, the demand for content and the demand from advertisers for access to readers interact. That is to say that readers value advertising. Advertisers value readers. And an increase in advertising, for example, is likely to result in—or may result in—increasing readership. As readers value the newspaper more, leading to an increase in readership, the increased circulation is likely to be valued by advertisers and may result in an increase in advertising.

Unfortunately, this feedback loop of mutually reinforcing trends works on the downside as well. This is the famous downward spiral that has led to demise of many newspapers over the years, and that's one of the complications of market definition in this industry.

A second one is that the content that readers can turn to as an alternative is oftentimes free. And because it is not bought and sold in a market transaction, as is the case with most broadcast media and the Internet, for example, it means there are severe difficulties of measurement and comparison across media.

A third issue is whether the editorial competition that survives in a joint operating arrangement has competitive significance under the antitrust laws. This is a theory that Allen Grunes has advocated for years, that the marketplace of ideas has antitrust significance apart from its commercial

dimensions. That will be an issue that will be tested in the Charleston case.

And, of course, there are all the difficulties posed by any dynamic marketplace, any marketplace in which technology is rapidly changing, as is true in the media marketplace. And so the court has to cope with technological innovation, which is ongoing and increasing in pace. It has to cope with changes in demographics and lifestyle and consumer tastes and preferences.

Another issue that affects the evaluation of market power and, indirectly, market definition, is Are there economies of scale? Like most other mass media, newspapers have very high fixed costs. They incur most of their costs in putting out the first copy of the paper, and the incremental cost of publishing and distributing additional copies is relatively low by comparison.

What this means is that you will find very few newspapers competing in exactly the same space for exactly the same readers. They tend to be highly differentiated in various ways, geographically being the most obvious. And this poses all the problems that you get in defining a market where you have highly differentiated products.

Finally, there is the difficulty posed by the fact that substitution patterns vary dramatically from one consumer to the next, both on the readership side and on the advertising side. For anyone who has ever interviewed a variety of advertisers about their demand for advertising and their substitution patterns, it is easy to see that there are tremendous differences caused by the different characteristics and needs of the business. Each business has its own particular needs, depending on whether it is a retailer or manufacturer, whether it is local or national, and all of this feeds into its willingness to substitute one type of advertising for another.

Of all these things, probably the biggest challenge for a court in defining markets today is the significant change that you see in newspaper business as a result of all these trends. It is certainly not news to anybody that there have been dramatic losses of both readers and advertisers by daily newspapers. They have been losing circulation and losing advertising.

What's key here is that these losses have not been to other newspapers but have been to other media. This is illustrated by the fact that the younger generation simply doesn't read newspapers. They prefer the Internet as a source of news and information, and, not surprisingly, advertisers have followed their audience as it has shifted.

This can be seen very dramatically in the area of classified advertising, where Craigslist and its imitators have taken most of the business away from newspapers. Craigslist didn't really exist as an advertising medium until 1999. It does this with a staff of a couple dozen people. It runs a nationwide operation and has been able to take down most newspapers' classified sections in dramatic fashion.

As a result of all this, companies that own newspapers are experiencing serious financial difficulties, and these difficulties were evident well before the recent economic downturn. Although the recession has aggravated it, this crisis has been in the making for many years.

The consequence of all this is that for both readers and advertisers, there have been regular increases in the quality-adjusted prices they pay. And when you see that and you observe substitution away from newspapers to other media as a result, there is a very strong suggestion that the market is broader than just daily newspapers.

I would like to let Judge Walker have the last word on this. This is from the first *Reilly* case back in 2000 in which he took a look at media markets. The case involved the daily newspapers in San Francisco.

This was nearly a decade ago. Even back then, Judge Walker was able to conclude that changes in markets for information and advertising since 1965 raised serious questions about plaintiff's ability to make a prima facie showing of anticompetitive effect:

> The market power of once-dominant daily newspapers has been drastically reduced by a steep increase in available sources of information and advertising such as radio, television and Internet. The presence and importance of non-newspaper media in the market for information has exploded. The Internet has opened a staggering array of news sources. These new media provide new outlets for advertisers as well.

So, if you stay tuned, I predict that you will see courts increasingly willing to recognize broader media markets, and that newspapers compete not with just other newspapers but in these broader markets.

MR. HART: Given your experience with the Department, is what Steven saying true? What has been the Department of Justice's approach?

MR. GRUNES: I think, to respond to that last point, consider the source.

And consider this question: If the daily newspapers in New York City all announced tomorrow that they were merging, would the existence of Craigslist justify that merger?

I'm going to talk about advertising and the DOJ view of traditional advertising markets. I'll try to keep it short.

Advertisers understand that there are benefits to primacy and recency; that you remember the first and last things that you hear. So in that spirit, let me start with this (singing): "I'd like to teach the world to sing in perfect harmony." What's that an ad for?

AUDIENCE MEMBER: Coke.

MR. GRUNES: Now on to the stuff you're going to forget.

The DOJ tends to look at traditional media primarily as advertising markets. That's where the big economic action takes place. In newspapers, there's also a readership or subscribership market. In radio cases, typically it's only advertising. Some of the other traditional media like billboards, it is only advertising, obviously, because there is no editorial content, news, or information or entertainment.

In a merger of large media companies and television, DOJ might also look at programming markets. But the thrust has been, traditionally, and right up to the present, that advertising is the main area of interest there.

I confess, when I began working on the Westinghouse-Infinity merger in 1996, the fact that we were talking only about advertising markets came as a little bit of a surprise to me. But after all, radio and other media exist to sell ears or eyeballs or readers to advertisers. And the advertiser is where the big economic action takes place generally. The advertiser is the consumer.

So some of the questions that DOJ asks are How do the advertisers use various media—we'll talk about that a bit later—and in the context of a merger, the questions are What are the good substitutes available to an advertiser? If prices went up (because price is the central focus), could advertisers effectively shift money into other media?

The important words here from the DOJ standpoint are "good substitutes" and "effectively shift." I think you can imagine if Rupert Murdoch had managed to acquire *Newsday*, and the prices of advertisements went up in *Newsday*, you wouldn't have a Long Island jeweler suddenly advertising on the CBS Evening News. It's not a good substitute.

At DOJ, we were fortunate: we actually had a lawyer who worked in an ad agency. So generally, at the beginning of investigations, we'd bring all the staff together and do a little Advertising 101 class.

I'm not going to do that class, because we don't have time; but I will say that different media traditionally have been used for different purposes. For example, television is a broad reach medium; it is used frequently for branding purposes, as in the jingle I sang or in "Wazzup?" Or "Ford Trucks: Built Ford Tough."

Radio is a much more local medium. It is targeted, more targeted than television, because radio stations have differentiated themselves by format to appeal to different audiences. It is listened to a lot in the car, and it is used to drive media purchase decisions because of that.

Newspapers offer a chance of getting detailed information in one place. Unlike radio and television, newspapers—people actually buy newspapers or at least used to buy newspapers for the advertising content, to get sale prices in grocery stores, or to see the list of open houses on Sunday. So in advertising parlance, newspapers are "invited" into the home.

Billboards are highly visual limited information.

These characterizations are what you'll see if you look at DOJ consent decrees involving these traditional media.

I'm going to leave Internet for later, because that's its own animal.

This is going back a bit. Bruce had a radio matter with me years ago, and his hair was curly at that point. That's how far back it is.

But there are a couple of features about radio that made it interesting from the government's perspective. For one, prices were individually negotiated between the radio station and advertisers, which meant that the radio stations understood who the target audience was that the advertiser was seeking to reach—it was males 25 to 34 or females 19 to 49 or categories like that—and therefore could have a pretty good sense of what other substitutes were available to the advertiser.

The DOJ competitive effects story was fairly simple and straightforward: if you had a merger of radio stations that were similar—because those were really what you worried about—had the advertisers been able to play them off each other to get better rates or terms? Or, if there was a group of stations involved in a merger, could advertisers find acceptable alternatives to reach their goals—and "goals" were expressed in terms of frequency and reach and various qualitative things—or were they stuck buying the group? In other words, could they "buy around" the group?

Because the real issue in these cases, as in the other DOJ advertising cases, is concern for the advertisers who would be stuck paying a price increase. If an advertiser could shift money to other media or to shift money around within the same media, it wasn't a problem. But if you had advertisers who—to use the parlance in radio—were "radio dependent," and they had to pay more or get less, those were the ones that the concern was about.

Along the same lines, there had to be enough of these affected advertisers to make a price increase stick. Maybe we'll talk about the economics of why that works, but it was a unilateral effects, next-best substitutes analysis.

So, at DOJ, how did we do this?

Well, we talked to a lot of advertisers. In the radio cases, we actually had them do hypothetical ad buys, to see whether they could meet their goals without buying the merging stations.

For a while, we actually had advertising-buying software in-house, and I got pretty good at using it, which in hindsight is kind of scary. But I really scared somebody when I brought it to a deposition at one point.

We looked at the documents. Documents, obviously, tell you things like Who do the parties think their competitors are? What are they saying about the advantages of one media versus another?

And then, there were commercially available data sources in radio, such as Arbitron, that assembled information about market shares, listenership breakdowns per station, duplication of audience; and you could do a next-best substitute analysis based on the audience.

How effective has the DOJ enforcement been? Well, judging from this FCC study, not particularly effective.

There are probably a couple reasons for this. One, I imagine, is that the DOJ allowed radio station mergers to get up to about 40 percent of revenue shares, which means two or three competitors per market, and that arguably wasn't enough to keep enough price competition going.

I'll give you a fairly recent quote by Mel Karmazin, the head of Sirius XM, who acknowledged that commercial radio after the Telecom Act passed became totally homogenized. He said that he advocated radio consolidation strictly for business reasons. "No one asked me if it was good for consumers."

As Steve pointed out, there have been relatively few litigated cases in this area. Since he put up Vaughn Walker, I'm putting up *Northwest Arkansas*, where the Eighth Circuit—admittedly some years ago—said that there was no way to justify a finding other than that daily newspapers were in their own product market with the evidence that DOJ put forth in that case.

This is the last fully litigated newspaper case, I think, up to *Charleston*. And the reason for that is on large transactions, it is easier to settle—especially in a media case—than litigate. Since 1996, there was exactly one litigated radio case, and that one settled shortly after suit was filed because there was another acquisition.

But I think Steve raises a very good question, which is Would this result be the same today in a newspaper case, and we may find that out in *Charleston*.

My last thought I'd like to talk about is a few issues that the new administration is going to face. President Obama is already on the record indicating an interest in preventing further media consolidation. Hopefully, he'll have a little time to deal with that amidst the other challenges facing him.

Ownership and cross-ownership limits are primarily an FCC matter, but it is important. Women and minority ownership, I think, unquestionably declined due to consolidation. The fate of newspapers is an important question.

And last is the marketplace of ideas. I just wanted to say that years ago, Maurice Stucke and I wrote an article on this, and I looked back at the legislative history and I found that there was actually express testimony in there that was meant to make sure that towns had two newspapers, i.e., competing viewpoints.

So there was some recognition of the relevance of editorial competition, or what you might call viewpoint diversity, to the antitrust analysis. That position really didn't get much play in the last eight years. But I think that it may get a little more play in this administration.

Finally, since successful advertising involves primacy and recency, and it is important to make sure people hear things three times, I just wanted to mention that Maurice Stucke and I have a new article, "Toward a Better Competition Policy for the Media," a working paper now available on the SSRN Web site. Toward a Better Competition Policy, Toward a Better Competition Policy, Toward a Better Competition Policy, SSRN.

MR. HART: Next we turn from old media to new media. What impact has the Internet had on the analysis? Michael?

MR. WEINER: Forms of media advertising. There are all sorts of forms. Rather than getting into things like direct mail, I sort of divided the list into off-line and on-line.

Off-line, you remember newspapers, they used to be around. Nobody reads them anymore if you're under the age of 25.

On-line, there is also a wide variety of different forms of on-line advertising. You got your search engines; you got your contextual, display, behavioral, other targeted advertising, rich media; and mobile. You probably don't know what these forms of on-line advertising are. So let's take a look at what some of them are.

Here is an example of search advertising. If you have great vision in the back of the room, you can see someone pecked in the word "camera" in a search bar. In response to that query, the screen was immediately populated with both contextual ads to the search results, which can be found in the black box on the left-hand corner, as well as search ads in the north and some ads on the right. They are usually set off in light blue. They're either going to be in the head or right and sometimes way down at the bottom of the page.

The ads on the top and right are sponsored-search ads. They are typically purchased by advertisers at auction. There will often be some minimum reserve prices set in that auction, sometimes a pure auction. But if you talk to the search engine companies, they will tell you that those minimum search prices are at least set up to ensure relevance for the viewers, because these ads are really free to advertisers unless someone clicks on them. Then you have someone bidding an awful lot of money and getting lots of appearances on a page but no click-throughs if the ad that they have purchased is not relevant to the user because it has nothing to do, in this case, with cameras.

I'll use this page very quickly to tell you about the structure of the Yahoo-Google deal, which I'm not going to talk a lot about.

It is interesting that Molly, in her outline, put this on the merger page because it was anything but a merger. In fact, in some ways, it was designed to avoid a merger. But what that deal was—or would have been—was a nonexclusive: Yahoo would have obtained a nonexclusive right to ask Google for some search ads. And Yahoo had asked for them where Yahoo had no search ads to place on a page or where they had only a couple of search ads, to fill out the space with some ads or where Yahoo didn't have ads of its own.

It was a short-term deal. It was a very low cap on the amount of Yahoo's revenues that it could obtain from Google. Yahoo would get a percentage of the revenues that Google earned that people put through on ads that Google supplied. There was no pricing coordination, no information on specific bids. Advertisers who didn't like it could opt out of having Yahoo participate in the Google network for them. And Yahoo would have controlled when to request ads from Google, how many ads to request, and the appearance of those requests. So this is an example of search advertising.

Here's another form of online advertising: contextual advertising. This is a WashingtonPost.com page here, and the article is on work house laptops. And the computer has read that article and decided, Hmmm, look at these ads on the right.

Here are some ads for cheap laptop reviewers, consumersearch.com, Dell.com, Lenovo.com. It has read the context of the article and decided to populate the space on the right with some ads that relate to the context of the page. These ads look just like the ads that were on the search page.

They also generate click-throughs, but getting there through a different mechanism, not by someone typing in a request in a search box, but by a computer reading the context of a page.

Here are examples of display ads. This again is a WashingtonPost.com page, looks like it is the front page of their travel section. There are ads for Lowes Home Improvement that appear in the top and right. They are also direct media interactive. They both say "Roll Over for Everyday Low Prices." If you roll over them, you'll find low prices and get directly to Lowes.com.

In the bottom right, you see there are also some contextual ads. There are ads here for travelthrough.com and Orbitz and other travel sites that are being populated on the page because they are contextually relevant to the WashingtonPost.com travel page.

We also have on this page an example of a demographically targeted display ad. You've got MLB *Rumblings and Grumblings* on ESPN.com. And, gee, this is a male-oriented page. You're reading about Jorge Posada's shoulder, and if you are a guy and want to learn what men use to impress women, we've got ads here for Nivea for Men body wash.

Other forms of online advertising which I mention up front are rich media and video. Those are the ads that you now watch before you get to watch the video clip that you want to see. Sometimes you watch those ads during the middle of the video clip you want to see. That's a rapidly growing area.

Finally, mobile, which is a new form of targeting. You're not targeting on the basis of what a viewer is typing in or reading or the last three pages that the viewer has seen, but here you're targeting based on where you are; that the servers know—because you're on a mobile phone—where you are.

So these are all forms of targeted advertising. And the questions might be Gee, are these all one big advertising market? Are there separate markets? Search versus contextual, versus behavioral, etcetera, etcetera. And then we will get a little into what is on-line and competing off-line as well.

Let's talk about some similarities and differences, first, in various points of on-line advertising. There are some similar uses.

There is some concept out there that you use display ads to build a brand image and use a search ad for direct response. Well, that's not necessarily the case. We have seen examples of display ads that do motivate a direct response; no reason why they can't.

Also, two of the purchasers of tons of search ads are Amazon and eBay, which want to link you to—if you type in anything and find something on eBay, they are doing that for branding purposes, so that you are constantly having eBay and Amazon in the front of your mind when you're searching for things on the Internet. These are good, general, all-purposes places to buy stuff. So similar uses that can be direct response can be branding, can be both.

All these forms of online advertising, are they determiners of user intent? Well, yes. Search is probably the most direct, someone is taking the positive act of typing in a search query. But there are other forms of targeting that are also pretty effective, as the science is getting better at targeting, looking at where you've been on the Internet, who you are, where you are, etcetera.

Measurability. All these formats of online advertising do have either instant or almost instantaneous feedback to advertisers who can make real-time adjustments on how much to spend. Again, many of these forms, certainly some forms, are contextual and are sold on a cost-per-click basis. They are free unless a viewer clicks on them. Some forms of display advertising are currently sold on a CPM or cost-per-thousand-impressions basis. It doesn't have to be that way. There does seem to be some convergence.

So measurability and method of sale, yes, there are some differences among these today. Those differences seem to be narrowing, and there's nothing inherent in the differences now. The point is that all these forms of online advertising are rapidly evolving. There is tremendous growth in some.

There is some blurring of on-line and off-line. Is WebTV on-line advertising or off-line media? These are all pretty open questions.

Let's take a look at what advertisers and publishers want. What advertisers want are customers, they want to make sales. Their primary concern really is the cost per acquisition. Advertisers buy ads from all sources as long as they make money by purchasing those ads. On-line may be a little bit unique in that they have a better ability to measure how effective their ad spending is, but I don't see a lot of difference between the forms of on-line and off-line advertisement.

Publishers. What publishers want, they want to maximize the revenue from their Internet real estate. From advertisers, all forms of ads really are effective substitutes where you have both display, contextual and search ads on the same page.

In practice, there is no one case on point which doesn't include the statement that there's no logical basis for distinguishing the search ad market for the larger market for Internet advertising.

Note, by the way, that the case that Allen just put up from the Eighth Circuit which talked about a market limited to newspapers was about 10 years ago, when Bruce's hair was curly. So that's sort of old.

Trends in on-line advertising: the various forms of on-line advertising seem to be growing at different rates. The real growth seems to be in rich media and video, social media.

Tactics on which U.S. markets are focused on advertising budgets. In 2009, on-line video is number one; social media number two. These are the growth areas that are in on-line advertising.

But as I said, this is a very dynamic area. Not only are the advertising spins somewhat dynamic, but even the views of some of the industry participants are somewhat dynamic. Just go back to 2007, when you were in the context of Google/DoubleClick, Yahoo, and you've got Microsoft looking at display ads and contextual ads. They look the same; they serve the same purpose; are they in the same market?

It is a very subjective question. If the price of one goes up, will publishers switch to another? We think the answer is yes. You also have Robert Hahn and Hal Singer in a study that was sponsored by Microsoft and AT&T, the prime movers in the *Wired* article called "The Plot to Kill Google," doing the study that concludes that a large percentage of search and text advertising customers would substitute graphic ads in response to a relative change in prices, indicating that consumers perceive these on an advertising channel to be substitutes.

On the other hand, we have three government entities that have looked at the issue of market definition, the FTC statement in the context of Google/DoubleClick, which did discuss separate markets for search and intermediated sold advertising, which is display. The conclusion there is the markets are rapidly evolving, and it is going to be complicated. That's undoubtedly true.

You have the EC in 2008 in their decision on Google/DoubleClick deciding that there are markets for the provision of on-line advertising space that could possibly be further subdivided into markets for search advertising and for nonsearch advertising. Okay, that's very clear.

Finally, the DOJ statement in the context of Google/Yahoo in which the department stated that it would have alleged a market for Internet search advertising limited to Internet page search advertising, and Internet syndication services in which Google would have been, by far, the dominant player.

So the lesson from this is that market definition in the on-line space is difficult. It is very dynamic, and traditional tests are very hard to apply.

Let's talk just for a couple of minutes about on-line versus off-line advertising, because there is a real shift going on here, as Steven had indicated.

This is 2007. Newspapers are still the big line in 2007. Internet is number three. Significant shifts: Television from 2009 is number one. Magazines and on-line are tied for two.

The *Wall Street Journal*, 2008: looking forward to what's happening in our current economy, so many cuts are going to be for newspapers, magazines and radio as advertisers shift dollars to digital media. The *New York Times* 10K talks about the competition with on-line that Steve and Allen spoke to already. IAB, the Interactive Advertising Bureau—same end result: the traditional media platforms are getting hit severely; the newspapers are down 17 percent; TV, 15.5, etcetera; visual media will be least affected by budget cuts.

So the conclusion is—pretty soft conclusion—is that the precise market definition is extremely complicated and uncertain in the context of this very dynamic environment here. We need to be disciplined and be realistic and look at what's really happening.

From my perspective, and I don't speak for the client or any client—and I'm not even sure I'm speaking for myself tomorrow—but what you need to do is focus on where the actual competition is and look at the competitive effects when looking at market definition in these areas.

I think that's a good lead-in to Bobby's comments.

MR. HART: Following Bobby's comments, we will have a short question-and-answer period, if time permits.

PROFESSOR WILLIG: Thank you.

Well, this is all very fascinating and a little bit confusing. In my profession, my role—my job—is to articulate principles that will just work and lead you to the truth.

The fun part is that we start with everyday antitrust principles we know well. For relevant markets, we look for substitution, substitution, substitution. Like New York real estate, it is all about location. Here, it is all about substitution. The fun part is when it comes to media markets, that there are some special principles that are particular forms of the substitution principle.

What I want to do with my very limited time and even more limited patience by the audience—we will talk about here that will keep everybody awake—there are some three cases with big surprises that I've been involved with that are on my personal list of market definition greatest hits.

This is the way you keep a class awake. Do the greatest hits.

There are three media market greatest hits that come out of these general principles on the slide. Just to give you the table of contents, one involves sports markets; another involves the marquis; and the third is back to the topic we have been addressing, namely, on-line and the special example about sponsored-search ads. And there are some big surprises in each of these three domains if we just follow the principles.

So the first principal is follow the money. If we are doing relevant markets for media, there's a lot of stuff going on: content, image, money. For antitrust relevant markets, it is the commerce that matters for the government, for the consumer and for the economist.

Where is the money? What's the important money? Let's follow it. Who is the payor of the money and what is their business purpose of actually doing the payments? Or for the consumer, What's the personal purpose?

So we need the money and the purpose behind the money. And in media markets, we want to know whose eyeballs are we talking about—or in the good old days, when people used to listen—whose ears? And in the name of substitution, where else might those eyeballs wander? Because that is the kernel of substitution when it comes to the audience in media markets.

So let's talk about sports markets. What is the relevant market for NCAA basketball? This is not a theoretical question because there's been a lot of antitrust action involving the NCAA.

You might think, with your antitrust hats—or sneakers on, as the case maybe—that the answer to this question is totally obvious. I thought so too until I heard the testimony of my opposing expert in New York involving the NCAA March Madness basketball product. And my opposing expert, who was a good economist—I've known him all my life—it turns out he was also an even better basketball player than he is an economist—he turned to the judge and said, in essence, Your Honor, relevant market? You've seen the ball, right? Basketball, big and round; football, different. And look at me, Your Honor, I played basketball in college. Let me show you my clips. I'm tall and skinny. Those football players may be muscular on a good day but don't have the height—that stringiness. Tell me, is that market confined to basketball, wouldn't you say, Your Honor? And she was nodding from the bench.

We had a problem in court and the parties settled the case.

But let's follow the money. Let's use some organized principles.

Where is the commercial side of March Madness? The answer is from broadcast TV revenues. It is a very, very big money package that is sold by the NCAA and used for excellent purposes—scholarships and so forth. There's a lot of money involved. And the customer is the TV network that does the buy.

The TV network isn't just throwing the money at the colleges. The TV network slices up the time and sells it to advertisers. Turns out, the advertisers are not so interested in basketball as a sport or the body types of the players, but it turns out they are interested in the eyeballs and demographics behind the eyeballs.

So what does an economist do? We look for substitution. Turns out Pepsi went from sponsoring March Madness to NFL instead. Coke went the other direction, from NFL to NCAA. Sprint went from NCAA to NFL. A lot of substitution in response to marketplace phenomena; that's the gist of it.

It is not just all basketball. It seems to include football, too. Different products that compete with each other in their own marketplace sponsor different sports. Yes, it is true AT&T Cingular at the time of the study was sponsoring March Madness. At the same time, Sprint was sponsoring golf and Nextel was sponsoring NASCAR. Market participants are not just on the court but, rather, are the other things those same eyeballs are engaged by.

Finally, as you may have heard from your economist friends, we love natural experiments these days; something that happens that's external to the market that's being studied but that has ramifications that illuminate the phenomena that we care about.

So the NHL—this time, it is not a ball, it is like this little flat thing flying around—the NHL had a strike, not to help the economists, but it created data. So when there was no more NHL available to show on TV, what happened? Well, NBC went from hockey to skiing, skating and lacrosse. ESPN went to college basketball; same relevant market

there. Meanwhile, Fox went to some college basketball, college hockey and classic hockey games. Again, showing through a natural experiment what kind of substitution there is and what is the ambit of the possibilities that others turn to when they don't want to go with the product in question.

So all of this adds up to the proof that when it comes to the broadcast revenues, which is where the money is, there's no such thing as a single-sport-specific relevant market. Legal scholars will remember the Supreme Court had a different view of this in a famous NCAA football case. But economics has its own methods of proof, and hopefully you're all persuaded by them. That's the first surprise.

The marquis market is a fascinating thing. It goes back a little ways to the time when Time Warner bought Turner Enterprises. The big hit on Time Warner that generated the most money was HBO, and the big hit for Turner Enterprises at that time was CNN.

If you're in the mood to get some news on-line or on TV, you might go to CNN. You're probably not going to go to HBO for news, although sometimes they seem very similar. But from the point of view of the eyeballs, they have very different functionality. Does that mean they are not substitutes in the relevant market? Follow the money. Who is paying HBO and CNN?

In those days, the payor was the cable network or the satellite company and today, in addition, the phone company that delivers video. But it is the network that does the buy and the network that then markets to the end users. The entity that most often pays the money to HBO and to CNN is one or another cable network.

In those days—this goes back to 1995—the cable companies would in essence say, Listen, I know to the viewer they are different, but to us, we have to have one or the other. We can't go to subscribers and expect them to pay monthly bills to us if we can't offer them at least either HBO or CNN. Even if we forgo CNN, we have to have HBO. Or if we go the other way and forgo CNN, we must have HBO. We can't be missing both without many of our subscribers thinking we are too rinky-dink for them to pay their 30 bucks a month for the basic subscription fee.

Every cable company we talked to had that same tale to tell. There is a marquis market. All or almost all of the big name programs have to be available. Other members of the marquis were MTV and ESPN at this time. You have to populate the marquis—maybe not 100 percent, but at least 80, 90 percent. You can't do your business as a cable company unless you have that, and consequently HBO and CNN are substitutes for filling out the marquis.

On that theory, the FTC challenged the deal and got an elaborate consent that actually forbade the merged entity from exclusively bundling HBO and CNN into one package at a very elevated price. That remedy actually seemed to be effective after the fact.

Let's go to the Internet, where my third surprise is about sponsored search. I might type in "digital camera" because I am generally interested and because I have just heard about some new features that I do not yet comprehend. On the search return page after my query, alongside the list of sites and their descriptions that the search offers up, are many paid ads for cameras and their producers. For me, for my functionality, those are brand-promoting kinds of ads because I'm just not ready to buy and am still figuring out what the space is all about

The businesses involved in sponsored search know that some of the eyeballs that are exposed to the paid advertising are just targets for brand-emotional advertising rather than for immediately encouraged purchasing. That's the kind of advertising we experience on billboards, TV, radio, magazines, other Internet sites and all over the place. There is a very broad market of media to exhibit brand-promoting advertising

What makes sponsored-search advertising very special is that 5, 10, 20 percent of the time, depending upon the search term, the searcher is ready for action. For example, I may be ready to buy that digital camera, or I have figured out that I want one and I am ready to decide exactly which model and where to go to buy it. Then, when I type in "digital camera," I'm ready to go—I'm a candidate for direct response.

Exposures of ads to such direct-response candidates who are ready to go are what makes sponsored search so valuable to advertisers. If you are considering whether or not to plunk down money for a sponsored-search ad, you might say 5 percent of the time the audience is ready to buy, and my profit margin is $50. Since 5 percent of 50 bucks is $2.50, I'm ready to pay up to $2.50 for each pair of eyeballs on that ad.

As Michael reminded you twice—but it might not have landed—a sponsored-search advertiser pays only for each click. The advertiser doesn't pay generally, like for a billboard. So, for example, if 5 percent of the clicks on the ad are from those who will purchase the item with the $50 margin, then the ad is worth a price up to $2.50 per click to the advertiser.

That's a lot of money. Sponsored search is a big-money business due to the value of the clicks on millions of ads resulting from enormous numbers of searches. Following the money leads to this recognition of the source of the commercial value of sponsored search.

The antitrust-relevant market question is What's the substitution surrounding that commercial opportunity? Should we worry about some sort of deal between Yahoo and Google? Is there important competition over that flow of value that would be lost? No such deal in fact transpired, but the antitrust question remains.

These questions have fascinating and surprising answers: One fact from third-party research is that those who put "digital camera" into the search box on Google are most likely to stay with Google over that entire search session. Those dissatisfied with the first search returns do not change to a different search engine. They might change the search term or start clicking on a separate page, but they do not move to Microsoft or Yahoo to get a different set of search results.

A second empirical fact is that if you're going to "convert"—which is the trade term for "buy"—or for making whatever response the advertiser was hoping for, the searcher is apt to do so right then and there during that search session. So if the searcher is going to convert, it will likely happen before the searcher switches search engines. If the searcher has begun to search on Yahoo, that searcher is going to stay with Yahoo for that entire search session. And if there's going to be a resulting on-line purchase by that searcher, it is going to occur before the searcher has moved on to a possible use of a different search engine.

In what way is there competition among Google, Microsoft and Yahoo for that commercial opportunity for the advertiser? The eyeballs are going to stay with the first search engine employed for the session. The commercial opportunity is going to remain attributed to that engine. So the active competition is over the appeal of the engine over the placement of the engine on the screen to induce the searcher to come employ the engine in the first place.

But once the searcher is there, and the session is launched, it is a done deal. There is really no competition among engines once the searcher has been engaged in the session. So the substitutability is among the engines in terms of which is on the searcher's screen.

There is substitutability in terms of the general reputation of the engines, and in terms of the placements of the search portals on the Internet sites that are viewed by many attractive eyeballs. At those levels there may be significant competition, but for the actual expenditures of sponsored-search advertising dollars that really matter, there is very little unique substitutability for direct-response audiences. This follows logically from the empirical facts just discussed and from the logic that advertisers are motivated to pay for the clicks on any engine's search pages that are sufficiently likely to yield compensatory margins from conversion.

Well, how would one verify that logical proposition with an empirical test? One way to test it is to assemble evidence on whether the advertisers are only looking at the economics of the conversion percentage times the margin compared to the ad's price per click? Or are they setting an overall budget for their search advertising and then making substitution decisions among the various items that fall into the same budget?

The data reveal that most money spent for sponsored-search ads is not actually confined by an active budget constraint. When the driven on-line business is rolling well, the advertiser spends more, and obversely. This is not consistent with the view that there is a budget for advertising that the advertiser juggles among different advertising possibilities. The most persuasive evidence was a concomitant of another natural experiment. Last spring, Yahoo decided to change the structure of its reservation prices in the auctions for the sponsored-search ad slots. The reservation prices affect choices of bids and the prices that the bidders have to pay. In Yahoo's restructuring of its reservation prices, some went up, some went down and some stayed the same. The data showed that where Yahoo increased its reservation prices, the prices that Yahoo advertisers paid rose accordingly, and the volume of search advertising on Yahoo fell off to a pronounced degree.

Well, how does an analyst discern whether there's substitution between sponsored search and money spent on Yahoo and sponsored search and money spent on, say, Google? Why do the Coke drinkers go to Pepsi when the price of Coke goes up? This is Antitrust 101 on the topic of substitution. When the prices of Yahoo sponsored-search ads went up, was there a movement of those who left Yahoo over to Google? And the answer was no.

The diminution in search-advertising volume on Yahoo had no corresponding addition of extra search-advertising volume over on Google, and no advertising price reaction on Google—totally flat, no response whatsoever. Quite unlike the case with ads placed on basketball, football and hockey programming in the sports market, and quite unlike the case for Coke and Pepsi sales volumes, there was no sign of substitution between search-ad volume on Yahoo and Google. The underlying reasons explained earlier are supported by the empirical findings and make a great deal of sense on the basis of the fundamental drivers of this media market.

Follow the money and follow the eyeballs are principles that work. Then turn to economics for rigorous logic and for empirical proof. Sometimes, especially in media markets, there's a really exciting surprise to be uncovered.

MR. HART: I would like to open it up to the floor for any questions.

(No response)

On behalf of the New York State Bar Association, I would like to thank our distinguished panel for providing their keen insights and perspectives.

MS. MAHONEY: I would like to thank all of our panelists this morning and also the folks who arranged the panels. I really appreciate all of your hard work, and I know all the audience members do as well.

Section Business Meeting, Election of Officers and Members of the Executive Committee

MS. MAHONEY: As I indicated earlier, we now have our business meeting. So for all of you who are members of the Section, I request that you stay. And for those of you who are not possibly yet members of the Section, I request that you join. Both the Association and the Section offer our members very valuable services, including CLE programs like the ones you are attending today, as well as many additional services and opportunities to meet and network with folks who operate in your practice area and beyond your own practice area. So if you have any questions about membership, please feel free to talk to Bruce or me today.

The two items we have on our agenda are the election of officers and the new Executive Committee members. Meg Gifford, who has—for some years now—been the head of our Nominating Committee, will present the report from that Committee.

MS. GIFFORD: As usual, I'll try to make this brief. I am not aware of whether there was supposed to be an actual report out on the desk. In the event there is, then I will not read all of the individual names at the expense of all of those present.

The Nominating Committee has proposed a list of current members of the Executive Committee for re-election to two-year terms, ending at the Annual Meeting in 2011. If you would like to know the names of all of those individuals who are current members who are being re-nominated, that is in the memorandum that's available on the desk outside. So those, I will not read.

In addition, the Nominating Committee proposes the following individuals for election to new terms on the Executive Committee—and I will read those names—for the length of term that is set next to their names, also available outside.

Those individuals are:

- Len Gordon of the Federal Trade Commission;
- Andy Frackman of O'Melveny & Meyers;
- Nick Gaglio of Axinn, Veltrop & Harkrider;
- Jayma Meyer, Simpson Thacher & Bartlett;
- Joel Mitnick, Sidley Austin; and
- Chul Pak of Wilson Sonsini.

May I have a motion and second to elect those individuals as well as those who are being nominated for re-election?

SPEAKER FROM AUDIENCE: So moved.

MS. MAHONEY: Second.

MS. GIFFORD: All in favor.

(Audience votes aye.)

MS. GIFFORD: Now to close the business, the Nominating Committee has nominated the following members of the Executive Committee for one-year terms to the offices I will identify Bruce Prager as Chair, Steve Madsen as Vice Chair and April Tabor as Secretary.

May I have a motion and second for their election?

MS. MAHONEY: So moved.

AUDIENCE MEMBER: Second.

MS. GIFFORD: All in favor?

(Audience votes aye.)

MS. GIFFORD: Thank you. That closes the Nominating Committee report.

MS. MAHONEY: Thank you, Meg. Short and sweet.

We will reconvene at 1:15 for the presentation of the Foundation. And at 1:30, we will start with our afternoon panels.

A Roundtable Preview of Antitrust Enforcement in the Obama Administration: Is Harmonization on the Agenda?

MR. PRAGER: We are going to get right to the heart of the day, and that is—looking ahead, in case any of you have been not only hibernating for the past year and therefore learned all of your current events this morning but don't know it, we actually have a new president in Washington, that's the capital. And with that new president comes changes in both the Antitrust Division at the Justice Department. As I'm sure you know, Chris Varney has been nominated by President Obama to be the new Assistant Attorney General for antitrust. He has not yet shared with me or anyone I know who the chairperson of the Federal Trade Commission will be. So there will be additional changes to come.

The first panel this afternoon—I believe it is going to be something of a discussion back and forth rather than pure talking heads—is going to talk about antitrust enforcement in the Obama administration and some focus specifically on what you're probably aware has been a growing split between the FTC and Department of Justice on significant antitrust issues and the question of whether that's likely to continue and some advice for those taking office in Washington on how they ought to be dealing with such issues.

David Copeland is going to be moderating this panel. He's a partner at Kaye Scholer. He has been very active in this Section for quite a long time. He has—for such a young guy—about 20 years of experience doing the kinds of stuff that we all talk about doing. And he has a lot that he can share with us.

His panel, he will introduce, and I'm sure that we will be educated and entertained for the next 90 minutes or so.

Thank you, David.

MR. COPELAND: Our title is "A Roundtable Preview of Antitrust Enforcement in the Obama Administration: Is Harmonization on the Agenda?"

Originally, we had a somewhat more colorful title, referring to a McLaughlin-style view of this. Somehow that was taken out. I don't know who the person was, but I think his initials are Bruce Prager. In any event, we are going to try to have a little bit of fun as well as substance here today. We will see if we succeed.

Let me tell you a little about the people who are going to be giving you the answers to some of these questions, which is the easy part of my job.

Dr. Sumanth Addanki is a senior vice president at the very prominent NERA Consulting Group. And my anecdote to sort of describe Dr. Addanki's rise to prominence in his profession is, in about the year 2000, I was involved in an antitrust lawsuit that our client, R.J. Reynolds, brought against Philip Morris, based upon some of the retail practices that they were doing. We learned that the economist on the other side was going to be somebody named Dr. Sumanth Addanki, and we said, "Who is that?"

The point of that is nobody would ever ask that question today. In fact, our first question would probably be Can we hire Dr. Addanki? Very, very prominent and very knowledgeable individual in many of the areas that I'm involved in, the antitrust intellectual property being one of them.

So we try to have Dr. Addanki be the voice of economic reason, efficiency and all those good things economists like to talk about.

We are very pleased to have with us today Alden Abbott, the Associate Director of the Bureau of Competition of the Federal Trade Commission. Technically, I don't know what material has been circulated before. Ken Glazer was initially slotted for this panel but is not able to be here for personal reasons, but I am personally delighted that we are now having Alden Abbott here, particularly after I have gone through his bio, which tells us he has been an integral part of the FTC since 2001. He's presently Associate Director in the FTC's Bureau of Competition.

I am delighted to have his historical perspective. Too often, we look at these things in snapshots and forget where the issues have arisen from.

In addition, he took either time off or did it at the same time. April through June of 2005, Mr. Abbott was a Visiting Fellow at All Souls College, Oxford University, where he lectured on American antitrust law and wrote articles on comparative antitrust topics. I think he brings that kind of perspective to his remarks.

I'm pleased to have somebody I feel like I've grown up with as an antitrust lawyer here on the panel today, David Meyer, who has most recently served as Deputy Assistant Attorney General and Deputy Attorney General for Civil Enforcement in the Antitrust Division of the U.S. Department of Justice. Prior to that, we knew each other well; we were representing our respective clients in the Brand Name Prescription Drugs antitrust litigation, a litigation in which I think I met almost every prominent economist in the United States.

We are also pleased to have at the table April Tabor, a newly minted partner in the antitrust competition practice group at McDermott Will & Emery who has a lot of background at the FTC herself. She served as attorney advisor

to Commissioner Pamela Jones Harbour and also has a lengthy résumé related to other work at the FTC and, I think, the DOJ.

Just as importantly, at least for the purposes of the Antitrust Section, she currently serves as Secretary of the New York State Bar Association's Antitrust Section as well as Chair of the Section's Membership Committee and Section Liaison for the Young Lawyers Section. So if there's anybody in this crowd that is not presently a member of the Antitrust Section and would like to be, talk to April after our discussion.

I also should note, and I noticed this in her CV as well, as many of you know, the FTC has a consumer protection arm to the agency as well as pure antitrust, and April has a lot of experience in that area.

So what I would like to do is jump right in with our panel and go right into certain areas in which there may or may not be different views between the FTC and the DOJ.

The nice thing about antitrust law is, even though it is supposed to be really complicated, it has these really easy-to-remember statutes, like section 1 and section 2 and section 5. So we are going to start by talking about section 2 of the Sherman Act. And what I would like to begin with is by asking David Meyer to tell us a little bit about the section 2 report issued by the DOJ in September 2008. That document is actually in your materials.

So, David, what was that about?

MR. MEYER: It's about section 2, David.

Thank you, David, for that introduction and the question.

First, I want to start by saying I no longer represent the views of the Department of Justice. I am speaking on my own behalf here. But let me see if I can summarize and provide some insights from a DOJ perspective at least.

The way to understand—first I should say, when it comes to understanding the DOJ section 2 report, don't believe everything you read, unless you have actually read the report. I strongly commend the report to everyone. I don't think most of the people who commented on it have actually read it. It's worth a read.

I think, to understand the section 2 report, it is useful to step back and ask what process led to it.

Several years ago, the DOJ and FTC jointly commenced hearings on the subject of section 2, appropriate standards for enforcing section 2, state of the law of section 2, issues raised by section 2, etcetera.

There was a perception—and for those who counsel clients in the area, I hope you'll share my view, because I did. There was a reality that section 2 standards were the least well-developed in the courts. Witness the *LePage's* case as the poster child perhaps of a lack of concrete standards that practitioners, business people and others could sink their teeth into. And that was having real-world consequences, because firms operating unilaterally out in the business world need to know what the rules of the game are. If they are told there is this thing called section 2 that kicks in whenever you have a significant share in any market, and markets, by the way, are often defined narrowly. And you're told there are a whole set of rules which courts will only let you know when they apply ex-post, and you will know whether you violated it only after the fact once you've made the decisions about how to behave, it is a situation that creates uncertainty and that is very difficult to deal with. That was the perception. I think that was the reality and continues to be in many areas. The uncertainty was one of the principal motivations for the agencies to conduct these hearings to understand better section 2 enforcement and unilateral behavior generally, and then ultimately to report on the findings of those hearings, with the aim not just of describing what the law is and what people's views are, but at least from the perspective of DOJ with the aim of helping to influence or advance the law toward a better-functioning regime. The DOJ perspective of what better functioning was, where possible and consistent with the important aim of enforcing the law against anticompetitive unilateral conduct to attempt to embed in the law standards that are relatively transparent, relatively knowable, relatively objective.

So the hearings were held, and the staffs at the agency—these are career staffs, mind you—went to work drafting up their respective reports. The FTC staff and the DOJ staff were working together very closely, drafting various components of the report. And the time came to finalize the report, as is reflected in the fact that this was issued by the DOJ alone, the FTC opted not to join. I'm not going to try and summarize all of the statements or the content of the report. It is quite a useful document, I think, if you simply want to understand the evolution in the last several decades, the state of the law when it comes to various topics such as general standards for section 2: the requirement that there be monopoly power or dangerous probability of its achievement, and the general standards for determining what conduct by a monopolist or would be monopolist under the law. There is also a chapter-by-chapter assessment of the application of section 2 in a number of areas that are of particular interest or reoccur commonly, like predatory pricing, exclusive dealing, bundled rebates and loyalty discounts—topics that have been controversial in recent years, where a lot has been said by a lot of people. The report attempts to synthesize much of what has been said and, I think, in a relatively unbiased way. But then it also opines as to what the appropriate manner of antitrust enforcement ought to be in each of those areas.

MR. COPELAND: David, let me jump in here for a second. The FTC, as David has indicated, did not sign on. In fact, there were two separate statements issued; one was by FTC Chairman Kovacic, the other one was a separate statement signed by commissioners Harbour,

Leibowitz and Rosch. My question for you, Alden, Can you tell us about the differences between the FTC and the DOJ on the subject?

MR. ABBOTT: Okay, I'll be glad to do that, David. And I should start with a bureaucrat's traditional disclaimer that the views are my own and are not necessarily the views of the FTC or any FTC commissioner.

The separate statements by three commissioners, Rosch, Leibowitz and Harbour, really said in the views of the commissioner, that there were four sort of general themes branching out of the section 2 report which they did not feel they could endorse. First was they thought that the report understated the problems that monopolies tend toward inefficiency. The report talked about the role of monopoly profits, the possibility of getting monopoly profits as incentive to innovate and compete. That is referred to by Justice Scalia in the *Trinko* case. But the four said, the three commissioners said, don't forget there are also real risks in monopoly in terms of harm and lack of innovation. They thought that had been underestimated and underemphasized.

Second, they said the risk of overenforcement, false positives—which I think most commentators have seen as implicit in the DOJ report—they thought that was overstated and that public enforcers and the private bar are up to the task of deciding which section 2 claims are appropriate.

Third, the three commissioners disagreed with reports concerning costs of administration and needs to try and minimize and reduce those costs, saying there is no methodology for comparing relative costs to business and consumers of section 2 enforcement.

And fourth, this statement called into question the emphasis on bright-line rules for legality; that is, safe harbors, saying the clear benefits of safe harbors must be balanced against the benefits of effective law enforcement in the absence of safe harbors.

Given that the three commissioners said they were not able to endorse the specific recommendations regarding specific practices found in the report. Also—one general thing—a number of the specific recommendations in the report have as a sort of default balancing test the disproportionate weighing of costs versus benefits. That is, you wouldn't want to strike down single-firm conduct unless the anticompetitive costs are disproportionately larger than the procompetitive efficiencies. And the three commissioners said in general they did not support that sort of weighing test.

Chairman Kovacic basically, very briefly, said that he thought more empirical work was needed. More study about the real effects of false positives and false negatives, that more research was needed. Not a lot was known. He also raised the possibility that rules developed by the Supreme Court in recent years, procedural rules, have made it harder to bring private section 2 cases. He understood why that happened, perhaps fear of untrammeled class action suits, but he argued there was a danger that such rules might in effect apply to government actions implicitly. There was sort of a view that the spirit that drove the Supreme Court to try to limit private litigation really shouldn't apply to government suits which are brought in the public interest. So that's a quick and dirty summary of what the three commissioners and their statement and chairman Kovacic in his statement had to say.

MR. COPELAND: So let's zero in on this concept of false positives and false negatives. As I understand it, the concept of false positives is you don't want to automatically run in, condemn conduct which in so doing you might actually chill conduct that is good for competition and for the economy. On the other hand, a false negative might be where in a desire to avoid the risks inherent in false positives, you don't go forward with pursuing an investigation or litigation, and the net result of that is the conduct continues undeterred to the detriment of the economy. So I want to turn the questioning over right now to Dr. Addanki and ask him, from an economic perspective, What should we be most concerned about here, false positives or false negatives? Also, to throw in another sort of issue of the times, if one of the lessons of the last half year is that there has been an underregulation of private activity leading to the sudden but really calamitous economic downturn, should we be so eager to underenforce the antitrust laws at this point. Sixty seconds.

DR. ADDANKI: Well, not 60 seconds. I think it is tempting for us to believe that we can find one monolithic answer to this very vexing false positives-false negatives problem. The truth is there isn't one, because the nature of the false positive and false negative really depends quite a lot on the kind of conduct that's being called into question. Let me give you two examples which I think will make this very clear.

Again, as David pointed out, the concern we have is by aggressively pursuing and seeking to condemn certain kinds of unilateral conduct by firms; we may end up chilling their desired incentive to engage in that kind of conduct. If that conduct is frequently not harmful but, in fact, is beneficial, then we may have ended up doing more harm than good. So one good example of things that people have thought about for a long time is when you have intellectual property, like patents and copyrights and so on, and trade secrets even, if you interfere with a company's ability to exploit that intellectual property to its ultimate extent, then you're chilling the incentives that the company would have to invest in that property in the first place, and you may then unwittingly slow the pace of innovation because of engaging in policies of that kind. That's a debate that has gone back and forth—where the pendulum has swung back and forth. The truth is, it is a difficult trade-off to make. Because you're trading off very long-term harm by overenforcement from the prospect of

very short-run, immediate and very visible benefits from prosecuting behavior that is creating short-run harms. I think there it is hard to say where exactly to draw the line. I don't think that it is a question that economics can answer readily. But I will say that a variety of types of conduct that have been pursued pretty aggressively and the kinds of uncertainty that the *3M* case—*LePage v. 3M* case—brought about, that David referred to, is a good example. When you've got conduct which in the short run is expanding output and redounding to the benefit of consumers and customers, that is conduct that you want to be particularly careful about chilling. So if you have pricing programs, discount programs, just all-out price wars, you want to be very careful about pursuing conduct of that kind very aggressively, because you're trading off short-run benefit very immediately and very transparently. In fact this is something that the Supreme Court warned in *Matsushita*: that price competition is the essence of competition, and things that make products more cheaply available to customers, conduct of that kind is conduct that you really want to respect as much as possible.

MR. COPELAND: Let me stop you there for a minute. Because what you just articulated is why the concern about false positives emerged as a significant issue in the context of predatory pricing claims and the like. But the question is Should it go beyond that? You mentioned intellectual property holders. Many of us represent intellectual property holders. The Supreme Court taught us in *Independent Ink* that the ownership of a patent does not necessarily confer monopoly power on the owner, but it often does. One of the reasons that we have *Walker Process* claims for fraud on the PTO and claims like that is the recognition that if somebody acquires patent rights through stealth or improper conduct, they have gotten themselves on an inappropriate road to monopoly power.

I'll let anybody take this question, but why should the concern over false positives go so much beyond, go anywhere beyond the pricing context when an argument can be made we should be just as worried about false negatives?

MR. MEYER: I'll field part of that question. Two things. First, as Sumanth said about the different settings in which a concern about false positives might arise, if you look at the section 2 report, it is sensitive to the fact that in different arenas, different types of conduct by monopolists, you might be more or less concerned about false positives. For example, the test that's indicated for intellectual property licensing: unconditional refusal to license is at the far end of the spectrum in terms of the unlikelihood of enforcement. Predatory pricing is close by with a test that is very stringent in order for there to be a successful and viable claim for predatory pricing. At the other end of the spectrum is conduct like exclusive dealing arrangements, tying, etcetera. Even as to those types of conduct, again, like exclusive dealing arrangements, they are routinely used by firms without market power. Yet there is the potential that they can cause harm when engaged in by firms with market power, and there absolutely is an appropriate role for enforcement. At the same time, a highly intrusive rule that forbids all exclusive dealing by a firm with substantial market power would clearly sweep too broadly. There needs to be some set of boundaries. The report attempted to outline a view about an appropriate place for those boundaries to be. There's an appropriate role for debate on that subject. I think DOJ's perspective was we have something to say on the subject, so let's get it out there.

This law is going to continue to develop. Enforcement policy will continue to develop. I would hope the new administration would not simply chuck out the report and pretend it never happened. They might have different views, and they will be entitled to that, but I would be surprised if at bottom their enforcement practices will diverge that much from what's in the report.

MS. TABOR: To supplement what you are saying and to go back to something Sumanth touched upon, one of the concerns is whether this will unwittingly chill innovation. The arena in which this arises is standard setting. A company with absolutely no market power could end up with a great deal of market power depending on what exactly they do. This is a situation in which I think that you need to be sensitive to the different facts or circumstances, because as in the standard setting context, you need to have a balance. Are you extremely aggressive in enforcement like the FTC and consider the effect that that may have upon people's willingness to be forthcoming in a standard-setting organization, which is the entire point of a standard-setting organization, or do you pull back a little bit more, as we believe DOJ does—although that's debatable—in the hope that this will actually foster innovation and create new technologies and hence benefit consumers? That's something else that needs to be considered. If we can move this from the abstract to the specific, can we sort of generally define for this audience the *Rambus* decision by the Federal Trade Commission, appealed to the D.C. Circuit, reversed by the D.C. Circuit, now potentially on appeal to the Supreme Court? Does anyone want to step in and describe to the audience the basic facts around this?

MR. ABBOTT: Okay, the basic facts, and this was a very fact-intensive case, so this is at a very simplified level. But the allegation of the FTC was there was this firm, Rambus—which is not a manufacturer, it is an innovator—started by a couple of Stanford engineers, which had developed patents that read on certain memory chips potentially SDRAM, certain memory technology. This Rambus firm, the FTC believed, had participated in the standard-setting organization, JEDEC, which set widely accepted industry standards for these memory chips. Who are the members of JEDEC? Apart from Rambus, a lot were major manufacturing and technology, such as IBM, Intel, basically all the big technology companies that

are involved and use semiconductor chips for memories. Basically the FTC argued Rambus, inconsistent with a rule or not adhering to an understanding of the standard-setting body, failed to disclose it was developing new patent applications or patent continuations or new claims while a member of the standard-setting body, which could read upon certain standards that might be adopted by JEDEC. In other words, the FTC said basically the purpose of the body was to make it clear, make all the patents and patent claims clear and that Rambus had through a pattern of deception failed to do that. Rambus left the standard-setting-body and then subsequently, after certain standards were developed and widely adopted throughout industry, then Rambus came forth and said, ah ha, we have got key patents that read on key parts of a standard. We demand high licensing fees. That's basically the story. And the FTC said, basically, if you buy the deception story, there is no efficiency associated with deception. David Meyer very well was talking about the spectrum. One end of the spectrum and the FTC has people on cheap exclusion in a staff paper released just a few weeks ago on its Web site associated with single-firm conduct. The notion is if you engage in behavior that has no potential efficiency, then it is tortious behavior, deceptive behavior, and that behavior allows you to obtain market power which you would not have obtained had you not engaged in that sort of behavior, that should be actionable single-firm conduct; and if it gives you monopoly power or the dangerous probability of obtaining market power, that should be actionable.

Basically, apart from the factual complexities I won't get into, the FTC said there were two possible states of the world, had Rambus fully disclosed its patent interest. One, they would not have adopted technology related to the Rambus patents. Rambus would not have had any market power. Instead of having monopoly power with respect to technologies, they would have had zero market power, because JEDEC would have developed a different type of technology. And the D.C. Circuit said that seems to make sense; it is a plausible theory upon competition.

The second leg: however, the FTC said even had they developed a standard that partially read on the Rambus technology, at least if everything had been above board—if Rambus had been above board—there could have been negotiations for fair or reasonable nondiscriminatory licensing fees. And those fees would have been a lot lower than the fees that Rambus demanded. And the D.C. Circuit said that was one of the possibilities out there; that's not an antitrust violation.

Citing the Supreme Court's 10-year-old *DisCon* decision, which held that a firm that already has legal monopoly power, even if it engages in a regulated utility and pattern of deception, that if it already had monopoly power, those deceptive acts are not really monopolizing.

I think the FTC's response would say that's missing the point. Because the allegation isn't that Rambus legally had monopoly power, and by the way, it later engaged in deception; no, the allegation is Rambus didn't have any market power, but deception was the means by which it obtained monopoly power. So that's the debate out there.

MR. COPELAND: So let's take the D.C. Circuit at face value. Let's say we have a situation where the reason why section 2 doesn't technically apply to the conduct of Rambus is that, at least under one factual scenario, Rambus could have ended up in a situation where—if I understood this correctly—it legitimately had monopoly power but had gained unfair economic advantage through deception. Deception being viewed as somehow independent and different from anticompetitive conduct.

I mentioned earlier in my introductions that April Tabor spent some of her time at the FTC working on issues of deception, which has been important to the Federal Trade Commission since its inception and in that regard is different from the Department of Justice. And it leads us to the concept that, if the FTC can't get you under section 2, maybe they can get you under section 5.

April, what is section 5 of the FTC Act?

MS. TABOR: Section 5 of the FTC Act, until recently, was used in the consumer protection context. It declares unlawful any unfair or deceptive trade practices. That is a very broad statement. While, as I said, it has been applied in consumer protection context with respect to deceptive advertising, predatory lending schemes, things of that nature, in the *Rambus* decision and actually in another case, *N-Data*, which very similar to *Rambus*. A company had a patent on which a standard was based. N-Data acquired the patent from that company. And apparently the predecessor had promised to license at set and low, nondiscriminatory licensing terms, but then N-Data refused to honor that and said we are going to license it at the royalty rates we need. The FTC entered into a consent decree with N-Data because they believed this rose to a level of deception and was a very underhanded means for N-Data to circumvent this promise to charge low, non-discriminatory licensing fees.

MR. COPELAND: April, let's see if we have the chronology right. The *Rambus* decision is issued. The case goes up to the D.C. Circuit, and one of the principal arguments is that the conduct, however you view it, is outside the scope of section 2 of the Sherman Act. So am I right that it is at some point after that that the FTC doesn't bring litigation but enters into a consent decree settlement in the *N-Data* case—I think that's right—

MS. TABOR: *N-Data* came out a little before the D.C. Circuit decision.

MR. COPELAND: You're right about that, but while the case was pending in the D.C. Circuit, it was quite apparent that a principal argument on behalf of *Rambus* was going to be whatever you think of what we did, you're improperly stretching the boundaries of section 2 of the Sherman Act to capture it. So just by coincidence, a case

that has significant factual similarities—and differences of course, *N-Data* comes along, and the consent decree is under section 5 of the FTC Act; whereas the *Rambus* decision was pursued through the FTC under a theory of liability section based on section 2 of the Sherman Act. So the FTC is telling us, are they not, if we can't get you under one, we will get you under the other, right?

MS. TABOR: They are suggesting they are going to make an effort to do that. Judging by the *Rambus* digs and *N-Data* consent decree, there seems to be a push or trend to stretch into that boundary where if we can't quite get to section 2, one element may be missing—you are acting deceptively with the intent to acquire this market power. We will make an effort to get you under section 5. Maybe we'll succeed.

We will see what happens under this Obama administration, but the FTC has been looking for a test case out there.

MR. COPELAND: Before we let Alden jump in on this, haven't we been through this before? Wasn't this decided, like, in the '90s or '80s or one of those decades?

MR. ABBOTT: Sure. There were the three in the 1980s, three major Courts of Appeals cases; no Supreme Court, but Courts of Appeals cases.

Official Airline Guides, *Boise Cascade* and *Ethyl*. *Boise Cascade* involved, sort of, delivered pricing; *Ethyl* involved price signaling; *Official Airline Guides*, a refusal to list a certain party that gave monopoly power to the third party.

In all of these cases, you could say the FTC failed, but really it is hard to come up with a consistent theme. Generally, you find language in those decisions saying the FTC hasn't proved a likely anticompetitive impact. It had theories of potential harm to competition, but you needed something more than a theoretical case.

Also, you needed to show, it was argued, that conduct was perhaps oppressive. What is meant by that? Not very clear, but a case like *Ethyl*, which involved oligopoly price signaling, harkens back to an old debate in law reviews that you can use the antitrust laws to go after oligopoly behavior—price signaling—that they may keep prices high. Of course, that general argument was well known, and I think the general case law said conscious parallelism isn't enough; you need some plus factors in order to find an agreement under section 1 of the Sherman Act.

But then, of course, the FTC said there are no private rights of action under section 5. The agreement requirements of section 1 of the Sherman Act don't apply. So maybe you can use it.

So what would the courts say today? It is not clear. The last time the Supreme Court directly spoke about the scope of section 5 as an antitrust action actually was the *Indiana Federation of Dentists* case in 1986, in which it said yes, Sherman Act violations are covered by section 5, but the FTC has the authority to define acts that harm competition that are against public policy but don't violate the letter of the Sherman Act.

MR. COPELAND: Is it fair to read the tea leaves here that what the FTC may be reaching for is that if you're closely within the zone of conduct that you're concerned about but don't quite fit within the zone of illegality defined by section 2—is this an effort to catch that conduct on the perimeter?

MR. ABBOTT: One argument is it is an effort to go after conduct that harms the competitive process and doesn't have any welfare justifications but, for technical reasons, isn't covered under the Sherman Act.

There were a number of FTC consents involving invitations to collude when it was fairly clear that you couldn't make out a reasonable argument that the party that had been invited agreed to the invitation, so no Sherman 1 agreement. However, the FTC said a pattern of invitations to collude, even if not acted upon, may send signals within the industry, a sort of a plus factor that can undermine the sanctity of a competitive process.

Frankly, there is no First Amendment or good efficiency reasons to collude on price. So that doesn't exhaust it, to say the least. But I think there's certainly an effort to focus on practices that harm consumer welfare and that don't have reasonable efficiency justifications.

MR. COPELAND: So my next question is this. We have a situation here where the two agencies are pursuing somewhat different enforcement philosophies, but they are doing it under two different statutes. And only the FTC has the power to enforce section 5 of the FTC Act. Why should the DOJ care, David Meyer?

MR. MEYER: Well, look, I can't speak for the past, present, or future DOJ—particularly the future DOJ—but I do think they have a dog in this hunt, frankly. One of roles we took very seriously during the last eight years, at least during the time I was there, was competition advocacy. Not just domestically in terms of advocating for sensible application of the U.S. antitrust laws or advocating sensible approaches to regulation that consider competition and markets and the like, but also advocating for international competition standards that are sound, accomplish their objectives, but don't meddle in places where markets can function effectively. In that spirit, I think that the DOJ would have been quite concerned about expansive readings of section 5.

You used the analogy from another Supreme Court context phrase "penumbra." An appropriate analogy here is you know it when you see it. The problem with section 5 as I've seen it advocated recently by some is its standardness. It is an approach to applying the antitrust laws, which says if we don't like this—it is not illegal or anything, but we just don't like it—let's find a way to get at it using a statute at our disposal.

I think going down that path would be severely damaging to all of the progress that's been made in the antitrust world, which has moved toward an approach that is more focused on analytics, more focused on clear standards and allows for firms to know what the rules are going to be.

MR. COPELAND: By the way, hypothetically, say, the Supreme Court gets to decide two or three years from now a case which turns on whether section 5 of the FTC Act can be used to address conduct that doesn't technically violate section 1 or 2 of the Sherman Act. Is there the likelihood that the solicitor general is going to be asked to comment on that?

MR. MEYER: The answer is yes. But let's step back and talk about a real case, the *Rambus* case that we've been talking about. I think one of the first real insights that we may see about how the Obama administration and the Justice Department anticipate developing the law in the antitrust field is in the *Rambus* case.

Before the end of the Bush administration, there was a decision about a cert. petition being filed at the Supreme Court in *Rambus*. The FTC ended up filing that cert. petition. Normally, the solicitor general would have filed on behalf of the United States government and the FTC. In this case, the solicitor general passed and did not support a petition for certiorari. The FTC has filed that petition.

There is some likelihood that, in its standard practice, the Supreme Court will ask for the views of the United States, which are provided by the Solicitor General. So the Solicitor General may get a request for views. The question is What will the Obama administration's solicitor general say in response? I think that will be interesting to watch.

But if there is a case under section 5 two or three years from now, whoever is the solicitor general, whoever is the assistant attorney general for antitrust will probably be asked to participate at the Supreme Court level.

MR. COPELAND: Just to clarify, *Rambus* won't tee up the section 5 issue because there was no section 5 claim pressed.

MR. MEYER: That's correct.

MR. COPELAND: So now we have been back and forth about this as a matter of statutory interpretation, FTC v. DOJ.

Dr. Addanki, you have two separate agencies taking fundamentally different views of what is competitive, anticompetitive and illegal. What kind of efficiencies or inefficiencies does that produce?

DR. ADDANKI: Well, it is an inefficiency that I think we have learned to live with. It is not just the FTC and DOJ. There are a number of other statutes—the state antitrust laws out there—there are other agencies that have a finger in the pie. If you've got a communications merger, you know you're not just dealing with one of the antitrust agencies.

But I want to actually tie together the efficiencies question that you just posed, David, with this section 5 discussion. And the point that David had said earlier about the difficulties of counseling about section 2 is actually more of a challenge for conduct under section g5.

One of the things that David was about to say, I think, was that even though there are a lot of practices that are entered into by firms with no market power, such as bundling and tying and exclusive dealing and so on, the potential for anticompetitive harm could arise if those firms have substantial market power and are in danger of enhancing or preserving that market power through that conduct.

Which meant, of course, that if you were going to counsel people about that conduct, as an economist—I suspect the counselors here might be sympathetic to what I'm saying here—you get confronted with this different question: Is there market power? Which means you're asking a fairly fact-specific question which would hinge on questions of market definition and so on. Without cracking that market power nut, you can't really give meaningful advice on some of this conduct that section 2 will challenge.

Let me take a short detour through the Department of Justice section 2 guidelines. One of the things they say, which pleases me as an economist, is that we will not just look at "direct evidence and anticompetitive effect" as proof of market power, monopoly power. We want to go through a market-definition exercise and make sure there is market power and properly defined relevant market.

Why am I talking about this? Because in the last decade or so there has been a huge bandwagon effect in finding direct evidence of anticompetitive effect through looking at prices and regarding prices as being a perfect measure of whether there's been a competitive problem or not.

Economists have been saying for much longer than that that price is just but one thing that happens in the market, and output is perhaps a better measure than price. But even output has problems in how well you can measure output.

The reason I'm getting into this is that the concern that I have going forward is if section 5 does not have very clearly articulated standards as to what constitutes a problem, the way that section 2 does, relative to section 5—and I would be first to agree that section 2 has not been clearly articulated either—the real danger I see is that even in situations where no one has bothered to prove a relevant market to establish that there really was a dangerous probability of acquiring or preserving monopoly power in that market, but some price measure somehow went up, bang, you're there.

That really concerns me. And that would be, to my view, the worst possible outcome with the FTC taking the section 5 instrument and running with it. Not from any bad intentions, but just because I think it is a problem.

MR. COPELAND: Can the FTC answer that concern by conceding that it will have to prove anticompetitive effect in a properly defined relevant market?

DR. ADDANKI: But it seems to me the whole purpose of abandoning section 2 and going to section 5 is that you don't have to do that in section 5. Otherwise, what's the point? In section 2 you do have to do that—

MS. TABOR: I have to interject. I don't think there has been anything in the FTC. While they are trying to push into this section 5, I don't think they have tried to say we are completely abandoning section 2.

DR. ADDANKI: And I am not suggesting they are. My concern though is that if there isn't a clear definition of what constitutes harm to competition in the way that there's 120 years, almost, of jurisprudence on the shelf now, I'm not sure where we go.

MR. MEYER: As a cautionary note, I will observe that in the section 2 arena, in the section 7 arena and perhaps in others, the FTC has—or folks at the FTC (the FTC is not a monolith and that's very important to remember)—but folks at the FTC have been pushing in the direction of dispensing with the rigid or formal market definition exercise and proceeding to condemn conduct, condemn mergers, condemn section 2 conduct and the like without a market definition, without considering market share, but with some form of direct evidence.

If you look, for example, at the discussion in the section 2 working papers, I think you'll see some indications of that. There have been speeches given by some folks, and I think it was our perspective at DOJ that that is very dangerous ground on which to tread for some of the reasons that Sumanth has articulated. And counseling and thinking about how the agencies perceive that issue is going to be very important.

MR. COPELAND: Before we leave this topic, I want to ask a question to April, focusing on your transition from an attorney in government to an attorney in private practice.

You get a visit, April, from the general counsel of a company with cutting-edge IP. His assistant general counsel is telling him he has to worry about nondisclosure to standard-setting organizations. But his CEO, who went to law school, just read about this *Rambus* decision, and now the assistant general counsel is telling him about the FTC Act, and he's getting a headache. What do you tell him?

MS. TABOR: Take a really large Advil and call me. No, seriously, I would have to sit down with him and tell him, basically, tread carefully. Because *Rambus* is such a fact-specific scenario, and *N-Data* is a fact-specific scenario, it would be difficult to do anything other than to say tread carefully. It is difficult to give a cure-all piece of advice other than to say What standard-setting group are you involved in? What are the disclosure procedures? How does this cutting-edge IP relate to it? What has been promised before, formally or informally?

There are so many facts that would need to be obtained. And I would say if it is a cutting-edge IP that relates to the standard-setting organization's particular standard that's before them and this company is involved, then I would have to sit down and be very, very careful about what the company does, what it represents, what it says in the context of the standard-setting organization.

Frankly, I would probably recommend that if they want to continue to participate in the standard-setting organization and the standard-setting process, to disclose it according to the rules, and they may even want to consider licensing it. But again, that assumes a very specific set of facts. So I would say to anyone who is in that type of situation: you need to get all the facts first.

MR. MEYER: That's undoubtedly good advice. But I just want to note: the fact that such counseling would occur and that a client would be told to tread very carefully about every single thing that's said in the context of a standard-setting organization illustrates the kind of chilling that could occur.

It is not so much that the bad acts alleged in *Rambus* shouldn't be discouraged. Rather, is it an unambiguous, good thing if people are so careful about what they say in the context of a standard-setting organization that either they don't participate at all—

MR. COPELAND: If I could just depart from the question for a second here. What the heck is so wrong about telling a patent holder that he should disclose the existence of his patent to a standard-setting organization? It may embody a technology that his patent covers.

MS. TABOR: I don't think there is anything so wrong about it. Except the reality is that there's a lot of clients out there who don't want to say it.

MR. MEYER: That's a nice black-and-white way of describing the world, but the facts are not so simple. I'm not defending or even talking about the specific facts in *Rambus*. But some standard-setting organizations have objectives that may call for moving quickly, for encouraging participation of everyone, regardless of what they want to say about their intellectual property. And you might put together a list of things that are subject to or somehow related to the standard. What if you miss one by accident?

DR. ADDANKI: Actually, David, I worked on a semiconductor patent antitrust case. The difficulty for these companies is, if you want to say disclose every patent that could conceivably read on any standard JEDEC could

come up with, that's a full-time job for engineers for a hundred years.

MR. COPELAND: I don't disagree with that. My point didn't necessarily cover inadvertence or unintentional disclosure.

Let's move on to this, which is a lesson in antitrust economics. We have had section 2. We have had section 5. So if you add them together, you get section 7.

Okay, Whole Foods wants to buy Wild Oats. So what? I can go next door to Food Emporium and get organic fruit juice. What's going on with this case, and what does it tell us about FTC views?

MR. ABBOTT: First of all, I need to be very careful and limited in what I say because this is still in litigation. I will say there is one piece of news, which an FTC colleague of mine pointed out to me today it was announced that the part 3 administrative proceeding involving *Whole Foods-Wild Oats* has been suspended for five days for settlement negotiations to take place at the request of Whole Foods.

But you're asking me—I can tell you what the market definition that the FTC had in this case was, okay. This was premium natural supermarkets that specialized in the sale of premium natural organic foods and sold some other things as well. But it was sort of a readily identifiable group of players in the market.

As always, the FTC applied the Merger Guidelines. The FTC staff thought it was assiduously applying unilateral effects sections of the Merger Guidelines in coming up with this market definition, which was rejected by a district court judge. But as you may know, upon appeal to the D.C. Circuit, the District Court Judge's decision was rejected on market definition, and his refusal to grant temporary injunction was reversed and was remanded for the district court to weigh equities.

Let me say a little bit about—I don't know if you want me to mention it now, David, the standard?

MR. COPELAND: Let me put that in context for the audience, which is when the Federal Trade Commission goes in for a preliminary injunction, it is governed not necessarily by the generally applicable rules, but there is a specific statute which may or may not reflect a different legal standard for bringing a preliminary injunction. So why don't you explain how that comes up?

MR. ABBOTT: Okay, the FTC goes into district court, and by the way, uses this tactic not just to obtain preliminary relief under section 7, but also under various statutes in addition to 7. But section 53b, 13(b) of the FTC Act says that a district court may grant preliminary relief to the FTC "upon a proper showing that weighing the equities and considering the commission's likelihood of ultimate success, such action would be in the public interest."

Now, is this the traditional four-factors equity weighing you're all familiar with? No. In the FTC *Heinz* case, the D.C. Circuit made clear that the traditional four-part equity test was not appropriate for implementation of the FTC Act's 13(b) authority, and that the FTC need not show any irreparable harm, and that private equities alone cannot override the FTC showing of a likelihood for success.

In addition, most recently in the *Whole Foods* case, the D.C. Circuit majority panel said that the FTC need not settle on a single product or geographic market definition at this stage or theory of harm at the preliminary injunction phase.

What does the FTC have to do under 13(b)? It has to "raise substantial doubts about a transaction. One may have such doubts without knowing exactly what arguments will eventually prevail."

So one commentator has argued, and I'm not saying it, but one said, in effect, the D.C. Circuit determined that a district court must use a sliding scale in balancing the likelihood of FTC's success against the equities. Basically, it found that, in *Whole Foods*, the direct court misapplied the standard by focusing only on the FTC's likelihood of success and failing to consider the equities.

MR. COPELAND: So do we have a situation, David Meyer, where there is a slightly divergent procedural standard as applies to the FTC and DOJ? And what are the implications?

MR. MEYER: Well, I think that answer is it probably depends. It depends on a lot of things. It depends on how *Whole Foods* is interpreted and applied. I think the decision in *Whole Foods* that Alden referenced is, now, only the decision of one judge on the D.C. Circuit. If this case is not settled, there's a question whether that will stand, ultimately. But even if it does, there's a question of its precedential effect and persuasive effect.

But let's take as a given that *Whole Foods* and its discussion 13(b) stands. It certainly reads like a very attractive standard for antitrust enforcers challenging mergers. It reads as if all you have to do is go into court and show some reason to think the merger might be anticompetitive.

I know that when courts—

MR. COPELAND: The FTC would like to have had that burden of proof in *Rambus*, no doubt.

MR. MEYER: Well, when federal courts have looked at merger cases that the agency has brought in recent years, there has been a tendency—and I think it is a tendency that's not altogether a good one—toward the agencies being put to the test of showing that they likely will prove a violation.

At the stage when you're seeking a preliminary injunction, that's a pretty tall order. It requires a lot of proof, es-

pecially in this day and age when the structural presumption of *Philadelphia National Bank* is unlikely to be of much benefit.

Now, that being said, I don't think *Philadelphia National Bank*—and for those of you who aren't familiar with it, *Philadelphia National Bank* is a Supreme Court case from the '60s which essentially stands for the proposition that, if you can show the merger is occurring in a concentrated market and is increasing concentration in the market, the government is entitled to a presumption that the merger violates the law, subject to. And then other courts have said, "subject to a variety of things," including a potential showing that entry is easy, or that there are efficiencies or that changes in the marketplace are such that that presumption ought not be given weight.

I don't think that *Philadelphia National Bank* presumption has totally gone away. I think we are operating within a range where *Whole Foods* is at one end of the range, and for an enforcer it would be attractive. But I don't think the cases that have been decided recently against the government necessarily have given us a clear bottom line on what preliminary injunction standard will be applied at the other end of the range

So yes, there's a difference. Will it make a difference in any individual case? No, of course not, because only one agency looks at any given merger.

Might it make a difference if your client loses a clearance fight by being referred to the FTC instead of DOJ? Frankly, yes, that could matter.

But the way it would matter, I think, principally, is not so much when you get to court, but in the way in which staff and the decision makers within the agency take into account the potential of going into court, and how worried they will be that the court will say this theory is all wet, so we are going to throw out your case.

MR. COPELAND: On the subject of what might be called "procedural differences" or "advantages," as far as the FTC is concerned, Alden, I think you mentioned part 3. Could you tell us all what part 3 is and how it is unique to the FTC as opposed to the DOJ?

MR. ABBOTT: You might say Why is there a looser preliminary injunction standard applied to the FTC? Because, in effect, you're not litigating the merger case there.

The FTC statutory authority has an administrative proceeding whereby issuing a complaint that it has reason to believe that the antitrust law has been violated—being not just section 5 of the FTC Act but also section 7 of the Clayton Act—it may bring an administrative trial before an administrative law judge who is an FTC employee but independent of the commission.

So the commission issues a complaint, and the matter goes before the administrative law judge. Normally—and I'll say, with lots of caveats and exceptions—after it comes before the administrative law judge—and certainly there have been and are exceptions to it. Through rules changes, there was an effort for after the trial, including trial and time to get out an opinion, that the administrative law judge should get the opinion out within the year.

Now, recently, in January, the FTC promulgated an Interim Rule dealing with changes in the part 3 proceedings. By the way, the administrative law judge, applying APA standards, is a finder of fact and may make preliminary determinations of law. But as a matter of statute, the finder of fact for the agency is the commission as a whole.

So if a decision is appealed from the administrative law judge to the commission, the commission can revisit the record, edit the record, and institute new findings of fact and has broad authority to do that in addition, of course, to it being a final finder of law.

Now, a commission decision is appealable to a circuit court of appeals in any circuit in which the respondent does business or in which the activity alleged to be anticompetitive is taking place. So for nationwide corporations, it may give broad ability for respondent to file an appeal in just about any circuit.

MR. COPELAND: So the takeaway here—we are starting to run out of time—is that we spent a lot of time focusing on differences in enforcement views between the agencies—and those are very meaningful and very important—but another piece of the puzzle that always has to be looked at is, depending upon which agency you are being scrutinized by, the tools that are available to those two agencies may be very, very different, and that may affect the way the case turns out.

So, of course, we are going to try to end up with a couple of open-ended questions, but before we go that route, I see we are running out of time. So I want to be able to give anybody in the audience a chance to ask questions.

SPEAKER FROM AUDIENCE: So it is obviously a problem from a business standpoint, whether a merger is going to be reviewed by the FTC or DOJ, if there's a difference or reasonable difference.

Two questions: One, how do you fix that? And two, do you think that Congress realistically is going to get involved in some sort of fix?

MR. COPELAND: I have a third question: Should it be fixed? Anybody?

MS. TABOR: Well, I'm going to interject and call it bias but . . .

Despite the fact that there are these differences, and despite the hurdles that it can sometimes create, in a sense, there are good things to having the differences. Both agencies do change considerably over different administrations, depending on different management, and it would

be false if we were to say that you don't use those differences to your advantage. You definitely use it to your advantage when you're working with one agency over the other.

Also—I'm sure David Meyer will speak to this—I'm sure both agencies know what the other agency is doing and I'm sure, to some extent, it does affect how the agencies enforce or how aggressively they may pursue a particular agenda item over another. How much attention they may pay to a particular issue over another.

To the extent there are differences, I think they can be used to the advantage of businesses. I think I'd be a little bit more concerned if both agencies were identical, because if that were the case, I would be a little bit concerned as to who would be deciding on that identical agenda.

MR. COPELAND: Alden Abbott?

MR. ABBOTT: Yes, let me just comment. I think the fact that there are procedural differences and differences in statutory language regarding injunction, and part 3 shouldn't obscure the fact—in a merger area certainly, both agencies apply the Horizontal Merger Guidelines.

I was involved in 2005 and 2006 in an exercise with the Justice Department where both agencies came out with a commentary on the Horizontal Merger Guidelines. Many of you may have seen it. It is on the agencies' Web sites. It tells you how the guidelines are applied in specific cases.

We found—and I think it is safe to say that staff, in looking at mergers, they apply the guidelines in a harmonious fashion. There is not an FTC interpretation and a DOJ interpretation of the Horizontal Merger Guidelines. Both agencies have large numbers of economists to focus on the debate. There is a great degree of harmony and common understanding and belief that we need to apply the guidelines harmoniously in the same fashion. So let me please calm those who believe there is a different interpretation of substance going on.

MR. MEYER: I think that's absolutely right; that you cannot credibly identify substantive differences in the approach of DOJ and FTC to mergers.

Now, that's not saying that, at the margin where the debate occurs, that different judgments might have been made about particular transactions. But if you take the universe of mergers that are presented and ask Would we have essentially the same enforcement under either agency? I think the answer would be yes, we would.

With regard to procedure, I think DOJ, bringing cases in federal court, has all the tools it needs for effective merger enforcement. I don't think there needs to be an agency that is an administrative agency that sits as a body to adjudicate a merger over the course of six months or a year, on its own, after having decided as a prosecutor it doesn't like that merger.

So I think a credible case could be made—I'm not making that case, mind you—but a credible case could be made for shifting all merger enforcement over to DOJ and having it done in federal court with the very good economists and staff members from DOJ and FTC behaving as law enforcers rather than an adjudicative body.

MR. COPELAND: This is why we have former—

SPEAKER FROM AUDIENCE: I wanted to point out that the AMC report actually recommends harmonizing standards for the preliminary injunction and going, actually, with the DOJ general normal standard for preliminary injunction, basically discontinuing the use of 13(b) and that section.

But my question is about the *Whole Foods* opinion. There was a motion for an appeal, a rehearing en banc in the D.C. Circuit, which was denied. In that denial, the D.C. Circuit stated that one of the reasons why they didn't take it for en banc review was because of the en banc procedure, the opinion would not have force beyond the specific case.

What does that mean for the implications for the value of *Whole Foods* as a precedent going forward? To what extent is the FTC going to rely on it? To what extent does counsel have to take it into account? Is it like a lesser decision or the same force as other decisions?

MR. ABBOTT: Well, I guess I would say the FTC enforcement agency, because merger cases are very fact specific, and particular market definitions are very idiosyncratic and fact specific—those are both unprecedential.

On 13(b), a lot of the language I read to you was quoted from *FTC v. Heinz*, which was a D.C. Circuit opinion from less than 10 years ago, which is why it is quoted and is precedential. So one judge—I won't get into technicalities there—did withdraw from a two-judge minority. Nevertheless, I think the interpretation of 13(b) I outlined is pretty consistent with the D.C. Circuit precedent reflected in *FTC v. Heinz*.

MR. COPELAND: It is always unfair to cut off a conversation, but I have to do it now. I certainly want to thank the panel for their robust expression of views and, I thought, a most enjoyable interaction.

MR. PRAGER: Well, in this instance, you can't set your watch. I let them have a few extra minutes because I thought it was so interesting. We are going to take a break now and reconvene at three o'clock for our final session of the day.

Privilege in the Age of Globalization (Cross-Border Ethics)

MR. PRAGER: We are now in the home stretch. This is our last panel of the day, and I know it is a major cliché to say, but certainly not least. But in some respects, I think that while you might view it as being a somewhat obscure topic, it is actually a fascinating one.

The thing that led to this panel today is that we had a session several months ago at one of the Executive Committee meetings where Scott Martin, who will be introduced to you shortly, spoke to us about cross-border privilege issues. And it engendered one of the liveliest debates and discussions that we have had at any of our Executive Committee meetings. And it just seemed that it was such a natural topic, given the degree of interest that it spawned, to feature on the program today. So I hope that you will find it as interesting and thought provoking as we did.

Of course, we have far more panelists and far more concepts and far more depth that we are going to get into today. But because of the complexity, we had quite a lot of people who were forces behind this particular throne.

Wes Powell, who is going to moderate, was one; but working with him were Jay Himes, Kevin Toner, Steve Edwards and Vernon Vig, all of whom contributed to putting together this panel today. I thank them all for their contributions and their work (not that Wes would not have looked good without them, but I'm sure they are going to make him look even better because of their contributions).

Wes himself is a partner in the competition team of Hunton & Williams here in their New York office. And like all of the panel Chairs that we have had today, he's a very experienced practitioner with great breadth to his practice and brings, on his own, very substantial insights. When coupled with the people that he's about to introduce you to, I know that we are going to learn a lot this afternoon.

So without anything further, Wes, if you would take it away.

MR. POWELL: Thank you, Bruce.

As Bruce said, I'm Wes Powell, and it is my pleasure to chair this panel and to have put together such a terrific group of panelists.

Our goal in planning this program was really to provide an overview that will be useful to all of you on the law of attorney/client privilege, to discuss some of the key privilege-related issues we are facing, both antitrust and other practitioners today, both with respect to private litigation and government enforcement, with a particular focus on globalization's impact on those issues.

Antitrust lawyers more and more are having to consider their clients' legal challenges not just in the U.S. but abroad. And differences in the law of privilege across jurisdictions can really complicate that effort.

That's even more so in complex litigation matters that involve enormous e-discovery productions as well as government investigations. So we'll address those issues today from the perspective of outside counsel; in-house counsel; government counsel; and last but certainly not least, a well-known e-discovery expert. We will focus not just on legal principles, but how these issues come in and can be addressed in daily practice.

So I join Bruce in thanking my fellow planners of this panel, Jay Himes, Steve Edwards, Kevin Toner, and Vernon Vig, and the staff of the State Bar for all they have done to put this together.

With that, now to our panelists. I'll introduce them from nearest to me to farthest away, which also happens to be the order in which they will be speaking to you today.

First, Scott Martin is a partner in the litigation group at the New York office of Weil, Gotshal, and he focuses on antitrust and complex commercial litigation. He has extensive experience in complex litigation and class actions in both bench and jury trials in federal and state courts, and his work has spanned a broad array of industries. His matters often involve complexities of federal multidistrict actions, FTC and DOJ investigations, and even more. He also frequently counsels clients concerning price discrimination, exclusive dealing and other distribution issues. He's a frequent speaker on the issues we are talking about today as well as antitrust and other matters before PLI and other forums. He graduated with distinction from Stanford University and from Stanford Law School, where he was a member of the *Law Review*.

Next in order, we have Larry Newman, who is a partner in the litigation department of the New York office of Baker & McKenzie. Larry's practice focuses on international litigation and arbitration. Since 1982, he has been the author of a column in the New *York Law Journal* called "International Arbitration." He's also the co-author of a treatise for the West Group called "Litigating International Commercial Disputes" and is the editor of a number of other books and publications. He was, until last year, the chairman of the International Commercial Disputes Committee of the New York City Bar Association and is currently the chairman of the Arbitration Committee of the International Institute for the Prevention and Resolution of Conflicts. He's a graduate of Harvard University and Law School.

Next in order is Steve Tugander, who is well known to many of you. He's a trial attorney in the New York field office of the U.S. Department of Justice Antitrust Division. He's a graduate of the State University of New York at Stony Brook and of Hofstra Law School, where he was a member of the *Law Review*. He has been employed with the Antitrust Division since 1989. He's investigated and prosecuted many criminal antitrust cases across a number of industries and jurisdictions throughout the northeast. He has served on the Executive Committee of the New York State Bar Association Antitrust Section since January of 2002 and chaired our Section from 2005 to 2006. He is also an active member of the New York American Inn of Court.

Next in order is Jim Masterson, a good friend and senior business leader at MasterCard Worldwide in Purchase, New York, where he's worked since 2002. In that role, Jim oversees MasterCard's defense in a wide range of litigation and regulatory matters, including widely publicized antitrust litigations in the payment card industry. He manages outside counsel; participates in setting MasterCard's litigation, regulatory and public policy strategy; oversees e-discovery efforts for the company in connection with MasterCard's various litigations. And before joining MasterCard, Jim was an antitrust litigator at Clifford Chance where he handled antitrust matters in the financial services industry and across other industries. He is a graduate of Georgetown and NYU Law School.

Finally, Adam Cohen is a senior managing director at FTI's technology practice based here in New York. He has assisted some of the largest investment companies with their electronic discovery and electronic information management compliance. His practice focuses on proactive implementations of systems, policies, and procedures to reduce the risk and cost of managing electronic information. Adam is experienced in this area from a different perspective since he, too, was a litigation partner at Weil Gotshal, where he represented corporate clients in complex litigation involving computer and Internet-related issues. He is the co-author of a treatise on electronic discovery and has recently published a book called *ESI Handbook: Sources, Technology and Progress*. He teaches electronic discovery at Rutgers Law School and similar courses at Georgetown. He's a graduate of Wesleyan University and Duke University School of Law.

And with those introductions, I'm going to hand things off to Scott Martin, who is going to begin our discussion today.

MR. MARTIN: Thanks, Wes.

No matter what Bruce says, I know what really stands between you and the cocktail hour. So I have, for once, departed from my usual practice and actually written out my remarks and timed them in order to keep them to the appropriate length. We'll see if it works. I don't know if any of my associates would tell you I'm incapable of sticking to a deposition outline.

I'm charged this afternoon with briefly discussing U.S. privilege law. That is, I suppose, before we do one final indignity to the Monroe Doctrine and talk about privilege in the age of globalization. In some sense, I say that really only half tongue-in-cheek because most of us here at these sorts of events—and I say that with some regret because it is a less diverse and interesting crowd—are operating, most of the time, on the defense side.

Bob and Steve, thank you for holding your nose and coming today.

The privilege protection is, for us, if some of you remember the movie *Ghostbusters*, the EPA official there—a much more colorful name in the movie that I won't use here—shuts down the power grid, a big containment system. All the bogeymen get out into Manhattan, totally unrealistic because there would be no surprise by all these strange characters on the streets. But nevertheless, you get the point. All the bad stuff is out there for everyone to see.

So let me start by trying to put into a backyard perspective some of the things that my really terrific colleagues here—and I say that in all sincerity—will discuss. Because in some cases, the results are going to be quite foreign or counterintuitive or counterproductive, and in many instances they are. And that's a shame, owing to the distinct importance of privilege in the context of antitrust law and litigation.

The circumstances can involve cross-border privilege issues and document seizures in international cartel cases and dawn raids—as Larry will address.

We have seen more evidence, frankly, of "globalization" on a practical level. U.S. plaintiffs' firms—Mike Hausfeld and others—are beginning to operate overseas, raising very interesting issues of access by their lawyers to documents in different jurisdictions and under different regimes

- Where effective in-house investigations are critical and, in fact, often performed for compliance purposes that ought to be lauded by regulatory authorities and should be encouraged—as Jim can attest. And remember, the seminal Upjohn case arose out of an internal FCPA investigation;
- Where huge masses of documents, particularly e-docs, are involved, sought, and reviewed, Adam, my former law partner, literally wrote the book on that issue, which is impacting some of the very procedural rules under which we litigate and which we will discuss today;

- Where potential criminal liability intersects with civil discovery and potential exposure, the most important decisions are made, as Steve knows first-hand.

Now, the good news, as you'll hear, is that there is some reason coming and maybe even some harmonization, albeit slowly. And there is some practical advice I think we will hear today to maximize the value of privilege in this brave new world.

And no one in this room should doubt the significance of that, at least in American jurisprudence. *Hickman v. Taylor* is ingrained in all of our memories of work product privilege, but if you go back and look at Justice Jackson's concurring opinion there, it is one of those that have these very practical sentiments that you have to love because they actually make the law make sense.

He wrote, "Discovery was hardly intended to enable a learned profession to perform its functions on wits borrowed from the adversary."

That seems right. It's an adversarial system; we ought to make it adversarial. The denigration of that principle is exactly what is at issue when U.S. privilege law is diminished.

The Court's opinion itself is also instructive, noting that if discovery of the work product material at issue there were permitted, much of what now is put down in writing would remain unwritten. Inefficiency, unfairness and sharp practices would inevitably develop, and the interests of clients and the cause of justice would be poorly served.

So think about that: It is a 60-plus-year-old precedent, as the panel proceeds, because I think some of those principles will be heard from again.

Some reminders of key blackletter concepts in our own parochial law of privilege before we talk about global perspectives. And, New York being the center of the universe, we'll stick with those courts.

Start with the attorney/client privilege, just to get everything back in one's head, because a lot of these things are going to sound again. It is pretty well articulated in the Second Circuit in simple bite-sized points:

- The legal advice is sought;
- From a professional legal adviser in his or her capacity as such;
- The communications relate to that purpose or predominantly to that purpose (we will come back to that);
- They are made in confidence with the client at the client's instance and are permanently protected from disclosure by the client or the legal advisor, except if the protection is waived; again, another point we will return to.

A number of these threads will re-emerge as my colleagues speak.

In the U.S., the attorney/client privilege extends only to communications; it does not protect underlying facts, which was made crystal clear by the Supreme Court in *Upjohn*.

The attorney must be acting in his or her capacity as an attorney. That is, actively providing legal advice. And in the U.S., for a corporation, which, after all, can only communicate with some sort of carbon-based life form, namely its agents, we extend the privilege on the client side to members of the control group or those employees who make the communications at the directions of superiors and that can bind the company.

Now, in the U.S., of course, we recognize that an in-house counselor could do that in a privilege context, which makes absolute sense when that counselor is authorized by a manager to evaluate, for example, whether an employee's conduct would bind the corporation, what are the legal consequences of such conduct, or the appropriate legal response as to actions of others taken with respect to such conduct.

Then, there's a work product privilege, a qualified one that can be overcome for documents and materials prepared in anticipation of litigation by or for a party or its representative, including those working at the attorney's direction. The Second Circuit has made clear that that includes documents prepared because of the prospect of litigation.

But as we know, the privilege does not extend to documents prepared in the ordinary course of business or basically those that would have been prepared in the same or an essentially similar form regardless of the litigation, a point that I think you need to keep in mind as Larry speaks.

Again, important to keep in mind, building upon *Hickman* and *Upjohn,* Rule 26 is intended to protect an attorney's mental process. Rule 501 anticipates, essentially, a flexible—here in the U.S—case-by-case analysis of privilege issues.

As I said, work product is subject to a qualified privilege, which may be overcome with respect to production of the factual material underlying the mental impressions, where a substantial need and inability to obtain the information without undue hardship can be shown.

That, I don't dispute, Steve, is a fair consideration in the government's investigatory role.

We have extended these privileges through concepts of "common interest" and "joint defense," important in

section 1 cases, cartel cases, and the like. I won't dwell on that except to note that the concept does call for some care except for considering when to enter into a written JDA—which will be the subject of discovery requests (it happens in litigation, as we all know)—and discretion on what to share.

If you've not seen it, Crowell & Moring, just this month, found itself disqualified as counsel for plaintiffs in the *DRAM* cases in the Northern District of California on the grounds that a new lateral partner had previously represented an employee of a defendant in a related litigation under JDA. The Court did so notwithstanding an advance waiver provision of the JDA and also rejected an ethical screen as insufficient.

Everything is not always clear with U.S. privilege law, either, but we are making strides. And let me point to some recent developments that you'll hear more about; first, with respect to inadvertent production of privilege documents.

The general approaches in the federal courts are like Goldilocks and the three bears: once in a while strict—that is, the production can be a waiver as to the subject matter of the document; once in a while lenient, requiring an actual, knowing waiver. More often than not, probably, a balanced approach turning on whether reasonable steps were taken to prevent disclosure.

In New York courts, the factors generally considered have been the reasonableness of the precautions taken to avoid such disclosures. And in the federal courts, the proportionate volumes of the production and the erroneous disclosure, the prompt rectification by the producing party, and the fairness and prejudice involved.

That portends the new Federal Rule of Evidence 502. Before turning to that, however, I'd also like to point out that Federal Rule of Civil Procedure 26(b)(5) places obligations on a party notified of an inadvertent disclosure to return—or at least sequester—such material and not use or disclose the information until the claim is resolved and, frankly, implicitly seems to contemplate the use of clawback agreements among parties to a litigation, which, as Adam could address much better than I, are common now in the age of e-discovery, where the alternatives may be substantial motion practice or "quick peek" productions before privilege and responsiveness reviews.

If you'd like an illustration of just how much can go wrong when these issues are contested rather than anticipated by agreement, take a look at the *Knitting Fever* case from the Eastern District of New York, 2005, in which the plaintiff ultimately was ordered to appear at the courthouse with all of his computer hardware so the defendant could conduct a forensic search for its privileged documents.

Now we have the new Federal Rule of Evidence 502, which is reprinted along with the judiciary report in the materials. The purpose of the revision was to provide a "predictable and consistent standard to govern the waiver of privileged information" as well as to improve the efficiency of the discovery process, recognizing that literally billions of dollars are spent in litigation annually to avoid inadvertent disclosures.

So, the new rule provides that a disclosure made in a federal proceeding or to a federal office or agency does not operate as a waiver in a federal or state proceeding if (1) The disclosure is inadvertent; (2) Reasonable steps were taken by the holder of the privilege to prevent disclosure; (3) Reasonable steps were taken promptly to rectify the error, including notification under Rule 26(b)(5), if applicable.

The same is true of a disclosure in a state proceeding. It does not operate as a waiver on the federal level if it would not have been a waiver under the rule or was not a waiver under the law of the state.

Under Rule 502(f), the rule applies to state proceedings as well as federal court-annexed and federal court-mandated arbitration proceedings, even if state law provides the rule of decision.

Now, the really interesting provisions are found in sections (d) and (e). Under 502(d), a federal court may order the privilege is not waived by disclosure connected with the litigation pending before the Court, in which event, it is also not a waiver in any other federal or state proceeding.

Under 502(e), an agreement on the effect of disclosure in a federal proceeding is binding only on the parties of the agreement unless it is incorporated into a court order, in which case, it becomes subject to 502(d), which tends to suggest that the "so ordered" line is going to become very commonplace now.

One last point on waivers at this stage: for years, there have been differing views and treatments of productions of privileged material in the U.S. made under compulsion or by voluntary submissions to the government.

To summarize very briefly, courts have held that a submission under compulsion does not waive an otherwise applicable privilege, but they have also employed a very narrow reading of "compulsion." Essentially, any privilege must be asserted and the disclosure must be made in response to a court order or subpoena or the demand of a governmental authority backed by sanctions for non-compliance.

For example, in the *Vitamins* litigation, relying on well-established D.C. Circuit law, it was found that the benefit from a failure to receive leniency did not meet the standard.

If one puts that in the position of a voluntary disclosure, then the issue of whether there can be a selected waiver—for example, of work product only with respect to a governmental entity from which one seeks leniency or non-prosecution—becomes very important.

Here, the courts have fallen into three camps: most finding "no limited waiver," and the Fourth Circuit extending that to the subject matter; some—the Eighth Circuit in *Diversified Industries v. Meredith* being the poster child and orphan circuit court case—finding, okay, limited waiver can apply to these submissions to government entities; and some open to the compromise position that "limited waiver is permissible only when the government agrees to a confidentiality agreement or otherwise provides for nondisclosure."

Keep that in mind as Steve addresses the DOJ position, as it's been expressed from the Holder and McNulty Memoranda through the Filip Letter and so forth concerning the department's position on what's necessary and what's least intrusive in terms of waiver in order to qualify for and provide cooperation.

I think I would also bear in mind a few other things:

1. The significant core work product that was likely prepared in advance of seeking leniency or even a marker;
2. The weight of the decision to cooperate rather than face criminal charges, which can sound a death knell;
3. The enormous potential civil exposure—albeit, potentially tempered by limitations to single damages and freedom from—for a cooperator;
4. The extensive tool box that the DOJ has for obtaining evidence, including abroad, MLATs, cooperative arrangements with other countries, and letters rogatory.

Those points—as well as the core factor that protecting attorney/client privileged communications from compelled disclosure, likely increases corporate compliance programs' effectiveness—may well have been on Arlen Specter's mind as, in the past two session of Congress, even after issuance of the revised DOJ Guidelines, he's proposed an Attorney/Client Privilege Protection Act that would prohibit requesting or considering privilege waivers as part of the prosecution and cooperation calculus.

So with some comfort—at least here in the U.S—as prelude, Larry is probably going to spook anyone unfamiliar with *AM&S* and *Akzo* decisions in Europe.

MR. POWELL: Thank you, Scott.

Larry is going to give us an overview of those decisions in Europe. In an effort to make this a bit more interactive, we are sort of keeping our panelists' initial discussions brief, and then Scott and Larry will have some interaction after that to talk about some of the practical implications of the differences in the two bodies of law. So, Larry.

MR. NEWMAN: I'm going to focus on the differences in the ways we consider confidential communications in Europe through the *Akzo* case.

The *Akzo* case was decided in 2007 by the Court of First Instance of the European Union. It is in volume 2 of your materials, starting at 655. And there is also an article by my partner, David Zaslowsky, and me at 691, which talks not only about the *Akzo* decision but about generally the ways in which in-house counsel get the benefit of attorney/client privilege with respect to their communications to and from them.

Just to set the stage, there was what was called in England and elsewhere a "dawn raid" by the European Union regulators. A dawn raid—I've learned, to my disappointment—doesn't really occur at dawn, but more like about nine thirty. Because there have to be people there to comply with the EU rules about guidance and disclosure and responding to questions, which is another way where privileged issues and disclosures do come up.

When they made their dawn raid, they found a two-page, typewritten memorandum from a general manager to one of his superiors. And according to *Akzo*, it contained information gathered by the general manager in the course of internal discussions with other employees, and it was gathered for the purpose of obtaining outside legal advice.

It was the second copy of the same document, according to Category A or Set A, and there was Set B. There was another issue before the Court. Those were two e-mails sent by in-house counsel, who was actually an admitted member of the Bar in the Netherlands, and they contained discussions or advice concerning certain matters that the regulators found interesting.

So what does the upshot show? As you can see from what we have up there, communications between in-house counsel and the internal client are not governed. These are the headline points. And the legal professional privilege—that's what LPP stands for here—covers documents prepared exclusively for the purpose of seeking legal advice.

That "exclusivity" is taken very, very seriously. It cannot be circulated, for example, to members of the board. And, of course, filing has a great deal to do with how this kind of protection is accomplished. It also clarifies procedures that provide for protection in light of what they say with respect to Set A.

Akzo reflects the national rules on the legal professional protection. Most countries in Europe, especially France,

do not provide for in-house counsel—protection of communications with in-house counsel.

Now, this is a flow chart titled "In-House Lawyers: Is Your Advice Protected?" By the way, all of these charts are in the materials, outside, not in the book, but outside. You can see that there's a low risk in the common-law jurisdictions, but high risk as far as EC competition law is concerned, and as far as many of the other non-common-law jurisdictions of concern.

Now as to the Set A documents that I mentioned and then the Set B documents, this is an interesting case because there were a number of amici curiae who came in, including the International Bar Association, the Netherlands Association of Lawyers—a lot of in-house counsel associations who felt there was no reason for treating in-house counsel any differently from lawyers outside.

They argued that EC competition should be modernized and in deference to national law, which, in many instances, England and the Netherlands, for example, in-house lawyers are permitted to or afforded the privilege as well. But independence was the key, and the prior case, AM&S, does not provide for independence for in-house lawyers, even if they are members of the Bar or law society.

So in-house lawyer communications are not covered. That obviously has a great many implications. The advice that is suggested here is that in-house advice should be given carefully or given orally, not that that's a really practical way of practicing it, certainly because they're marked "privileged and confidential."

And filings are important. They should be filed separately in what is considered to be a protected, privileged communication because the EC regulators tend to regard filing as an important possibility of a waiver; that is, if a filer puts something in the wrong place, that can constitute a waiver.

Involving external lawyers, written advice is needed. You can see, under the "Exercise of Caution" there, be careful about non-EEA lawyers. Those include the 27 member states plus Finland, Lichtenstein and one other country.

It's okay if the person from Ireland is advising on EC competition law in France, but not for a U.S. lawyer to do so or another non-EEA lawyer. You can see there is a mention here that the British authorities often assist the commission, those include both criminal and civil authorities.

Internal preparatory documents are the key to how there should be protection afforded that attracts attorney/client privilege. They have to be, as I said here, provided exclusively for the purpose of seeking external legal advice. And that means, as the Commission has said, unambiguous and clear.

So the implications and lessons are that the legal professional privilege can now cover internal preparatory documents, as has been clarified by the *Akzo* decision; that is to say, working documents in summary, providing that they are prepared exclusively with the purpose of seeking external legal advice.

The burden is on the company and may be difficult to prove. So it's important to mark them as documents exclusively for the purpose of obtaining external legal advice.

It's important to note also that dominant purpose is not enough, and you can't transform preexisting documents into documents that are protected by simply incorporating them into a document that is going to be sent to outside counsel.

So there are disputes that can occur with the commission. There is an obligation under the law for company employees to actively assist, and failure to do that is taken very seriously and may itself be the basis for action taken by the EC authorities.

One of the approaches that were taken, as alluded to here, was a cursory examination. That is, the EC authority or investigator looks at it quickly and tries to get some sense if it was for outside counsel or not. If there's an argument about it, they put them in a sealed envelope and study them later, but that's not until there has been a decision internally and before allowing the subject of a search to apply for interim relief.

So if you're involved in a dawn raid, what does *Akzo* mean? There should be preparation. Obviously, be prepared to explain why LPP applies. There is—resist even the cursory glance that this would reveal the context, but explain why. And all documents protected by the privilege should be labeled clearly and ideally stored separately.

There is a suggestion here that in-house counsel can be consulted by phone, and that in-house advice drafted in a noncompromising way or given orally and having recourse for an external lawyer.

Labeling is very important; filing is very important; storing is very important. There really is an emphasis in this whole process for how sensitive internal legal documents are to be created. So if anything internal is to be created for the purpose of obtaining legal advice, it has to be done with care and needs to be unambiguous and clear. There is also a suggestion that there be avoidance of annotations on protected documents, keeping the circulation to those who need to know.

Be careful with summaries of advice. And if so, if they summarize external legal advice, mark them privileged and confidential. And avoid legal advice in presentations.

That is the *Akzo* situation in a nutshell.

As far as U.S. counsel is concerned, there has to be some caution exercised by U.S. counsel writing European clients about EU law, because if there is a dawn raid, that document is not going to be protected.

Also, one should be aware that in France, Italy, and Spain and many other countries, as we say in our article, communications involving in-house lawyers are not protected. So that in a U.S. lawsuit, it could well be that internal communications with, say, a French in-house lawyer will not be protected. So there are a lot of things to think about if one is involved in competition law matters—or other matters for that matter—involving countries outside the United States, particularly Europe.

MR. POWELL: Thank you, Larry.

So Scott, as somebody who knows this area well and counsels clients on both sides of the Atlantic, what are the most troubling aspects of the differences between the EU and U.S. law, and what can you do about it when you're representing a client who may have issues in both jurisdictions?

MR. MARTIN: I don't know how many Europeans we have in the audience, so I'll put it felicitously. The whole regime is frightening to me. I mean, it is, to me, an elevation, a supreme elevation, of form over substance.

U.S. privilege law under 501, under the seminal cases, is evaluated on a case-by-case basis. I candidly have been very fortunate, I think, in my career—although I've had disputes over thousand of documents—privilege disputes and logs and whatnot—and never had a sanction motion against me. Knock on wood. And I've only brought one.

By and large, when people practice in good faith with respect to privilege, and it's not material, that, frankly, ought to be subject to disclosure. I think it really impugns the entire attorney/client relationship and the entire nature of the adversary process—which, of course, is not the regime that some of our confreres across the pond grew up in—to elevate form over substance to the point that a document that is misfiled or not exclusively—in a pristine, virginal sense of the word—prepared for purposes of the litigation, or for that matter, to have people in-house who are performing the same functions, that advice ought to be protected. For it to not be protected is frightening.

In the first sense, it is unfortunate; number one, the very first thing you do is you hire outside counsel in the EU, and you funnel communications through that outside counsel.

MR. POWELL: That's good for outside lawyer business.

MR. MARTIN: It is. And you do communications orally. You think about how things can become compartmentalized as work product here in the U.S., and something that is not going to be protectable elsewhere. But boy, it doesn't make Jim's job any easier.

MR. NEWMAN: I thought that one of the interesting points of this, to me, was that a commission official took the view, not necessarily acted on this, that if otherwise privileged documents are filed in places not confidential, that they will consider that the filer had not intended the documents to be confidential, notwithstanding the fact that they are confidential.

MR. MARTIN: I think the other thing I would say—and Jim may touch on this later—probably the first thing I would do is, under that sort of regime—and it is going to have an enormous chilling effect—embargo all communications. I don't want you talking to anybody. I don't want you writing anything, because I don't have any certainty whether it is protectable.

And if it is not protectable over there, understanding the kind of cross-border discovery in civil litigation, those documents may wind up here in the U.S. So it is chilling.

MR. POWELL: What about the differences in handling inadvertent production?

Larry, you touched on that, but is there a corollary to the new Rule 502 and rule of evidence or the recognition of the ability to claw back inadvertently produced privileged documents?

MR. NEWMAN: The viewpoint of the EC, as I understand it, is when there are documents produced on discovery, it will be considered prima facie as a waiver of the privilege. But if the recipient should have been well aware that a mistake was made and that no waiver was intended, then the Court can order the document to be returned and not used. Somewhat similar to our situation, but we may have a more robust view of what constitutes clawback.

MR. POWELL: We covered the U.S. and EU, but what about other jurisdictions around the world? Is one trend or the other catching hold?

MR. NEWMAN: Well, as you probably know, there's no discovery in most of these other countries, or there is no issue around this. As far as EC, I was reporting on what the EC was talking about, but I really can't comment on inadvertent disclosure in civil law countries.

MR. POWELL: Or what about more substantive privilege issues, the differences between them?

MR. NEWMAN: Self-incrimination.

MR. MARTIN: I can give you one. It may be dated.

Is there anybody here that's familiar with Korean law? Don't hold me to it if it has now been changed. But that is a jurisdiction we have seen, of late, taking an interest in antitrust enforcement.

They did have, at least as of a few years ago, a very peculiar sort of treatment of privilege in terms of immunizing an attorney from having to testify as to communications, including facts transmitted to him or her by the client, but at the same time not recognizing any work product privilege and not recognizing any privilege or immunity in the opposite direction. Which is to say, that the legal advice and the facts and so forth and information conveyed by the attorney to the client can be discovered. So whether that peculiar regime still exists there, I don't know.

MR. POWELL: Well, thank you.

Why don't we move on to Steve Tugander and see how this plays out in federal enforcement.

MR. TUGANDER: Welcome, everybody. Another disclaimer: The views expressed today are my own and do not necessarily represent those of the Antitrust Division or the Department of Justice. I feel confident there are not going to be any more government disclaimers today.

Today I will discuss hypothetical division approaches to privilege issues. Any privilege issue that comes up in the future, obviously, will have to be discussed on a case-by-case basis.

Some of the topics I'm going to cover today, and I will do so quickly: privilege in the context of a grand jury subpoena, in the context of a search warrant, and what happens with inadvertent disclosure in criminal cases. I'll try to touch upon electronic discovery throughout the presentation and, briefly, a note about *Stein* and the Filip revisions.

Guiding everything that we do at the division is that we are very mindful of the attorney/client privilege. We realize it is essential to our system. We have no desire to intrude or violate the privilege, and our interest is in discovering facts. You're going to see that we take a lot of steps to protect the privilege, and we give a lot of thought to it.

Our division schedules: we like to think that we draft them as tight as possible, but some people argue they are fairly broad. By necessity, we do require a lot of documents, and as anybody knows, in most of our cases we are talking about boxes and boxes of documents—sometimes terabytes worth of e-docs.

Where does privilege come up? Usually, it is in the e-mails. E-mails, I think, right now, are the most likely areas of privilege concerns. Typically, we subpoena numerous e-mail custodians, any employee with pricing authority and a whole bunch of others. Sometimes in particular industries, this is a problem because some of these people that we are interested in may be in frequent communication with counsel just because of the nature of the industry. But obviously in the subpoena situation, counsel has some control over the production before it gets to us. They have the ability to withhold privilege, and we are going to assume that they screen it before it does get to us.

If counsel does withhold, we have privilege log instructions with our usual subpoena schedules, and we have some information that we require. But really, the purpose is to describe the nature of the document in such a way that we can assess the applicability of the privilege claim, real short: just provide us with enough information so that we can have a discussion about it. Electronic discovery, obviously, adds a whole new dimension. When we have a lot of volume, we prefer an electronic log. Usually, we are going to resolve these disputes. It is usually not a problem. But if it is, we may decide to bring a challenge, depending upon whether it is worth it to us. But we go on with the knowledge that the burden is on the withholding party to show that a document is privileged.

Switching quickly to search warrants, as most of you know, they are becoming much more common in the Division. There are a number of reasons. One is the leniency program.

But in the search context, we have a law enforcement team, usually FBI agents, IRS agents or some other law enforcement authority which goes in and actually seizes those documents. Again, the results of those searches are pretty big, both in terms of paper and e-docs. In this situation, obviously, counsel is not screening these before they come into our possession. And that's a mixed bag for us.

You say Why? On the one hand, we are going in there and we are grabbing what we think is relevant to the investigation. But on the other hand, we have a burden now to protect that privilege. And sometimes those privilege issues in the context of a search warrant can be much more time-consuming, in my experience, than a subpoena situation.

So what do we do to protect the privilege in a search warrant environment? Well, first, the law enforcement team that's going in is going to have case agents actually doing the search and seizure, and they're typically going to have some taint agents that will also be there. When a privilege issue comes up, the case agent will see a document that could potentially be privileged and then pass it off to the taint agent, who will take a look at it and try to resolve that issue.

We then have some options when those documents come back to our office. We will set up a taint team of attorneys to protect the privilege. That's a staff of attorneys separate from the investigative staff so it is shielded from our investigation, and their job is just to protect the privilege.

One option is to have the taint team themselves just conduct the privilege review. And there are various pros and cons to that option, which I won't get into.

But there is another option, which is the more likely scenario that you'll see today. We will actually provide counsel with paper copies and electronic images of documents that have been seized. And then we give counsel the opportunity to do a privilege review. In that situation, it becomes very similar, again, to the subpoena situation. If privilege issues arise, counsel will be able to talk to our taint team attorneys.

Some of the e-discovery issues arise in a search warrant context. Again, it tends to be a voluminous amount of material. In some cases, we have e-mails, e-docs, sometimes audio files. We are seizing hard drives, servers, disks, backup tapes, all kinds of media.

What we sometimes do with counsel, if they are actually doing the review, is we will establish certain types of priorities. So we may say we are interested in e-mails of Mr. Powell and Mr. Martin. We want to look at them first. So can you go through them first, screen them for privilege, release them and we will get working on those. So the idea is to protect the privilege but speed the process of our investigation.

A couple words on inadvertent disclosure: with the large volume of e-documents, it is not uncommon in division investigations. In some situations, we may allow a clawback. We are generally not interested in playing gotcha.

Different inadvertent disclosure situations: the first is if a document is not read by us before notice is given by counsel. What do we do in that situation? Typically, we are likely to return it. In fairness, we'll return it, and we ask that counsel put it—add it to the privilege log, so again we can have a discussion about it—whether or not there are privilege issues we need to talk about. We are basically following the same procedures as if it was originally withheld for privilege.

In a situation where a document has been read before we get notice from counsel, we are typically going to remove the document from the files and secure it. So we are going to segregate it out. If it is an e-doc, we will separate it out of our database to a separate database that the investigative staff can access. We might have taint staff access it, but the investigative staff can't access. It won't be read or used again until it is either resolved by agreement, or we have court approval to do so.

There are some situations where we come across a document and we didn't get any notice of inadvertent disclosure, but it appears, on its face, there could be an issue. We are going to assume that if counsel had the opportunity to screen, any disclosure was intentional. But if something looks clearly confidential and privileged, we may set it aside and question counsel about their intent to disclose it.

We do sometimes enter into an inadvertent disclosure agreement. Since this is going to arise when the production volume is very large, counsel needs a lot of time to adequately screen. We may reach an agreement in that situation: produce it with minimal screening, and in exchange, we will provide clawback.

Just real quick, on *U.S. v. Stein* (I'm sure most people are familiar with it). The Second Circuit affirmed the dismissal of the indictment on tax charges against 13 former KPMG employees. This resulted from KPMG's decision to condition, cap and ultimately stop advancing legal fees to 13 defendants. The Court held that KPMG's policy was a direct consequence of the government's influence on KPMG's desire to cooperate with the government.

Right around the time of *Stein* came the Filip revisions to the corporate charging guidelines. This was announced by the then-deputy attorney general Mark Filip last August.

Credit for cooperation depends on the disclosure of facts and not on waiver of privilege or work product. There's a prohibition generally against requests for privileged communications and work product such as legal advice. There's a prohibition against considering whether a corporation advanced attorney's fees—the problem in *Stein*—to defend employees, officers and directors. There's also a prohibition against the DOJ considering whether a corporation has entered into a joint defense agreement; and, finally, a prohibition against considering whether or not the corporation disciplined or terminated its employees. These are all considerations in charging the corporation and giving credit for cooperation.

So how does this affect Antitrust Division investigations? Stay tuned, and we'll talk about it later.

MR. POWELL: Thanks, Steve. Why don't we discuss that issue now?

From your perspective, did the Filip memo reflect a change, at least, in how Antitrust Division conducts its investigations?

MR. TUGANDER: In my experience, actually, no. Because in my experience, the division has never really been focused on waivers of privilege, whether or not a company pays for attorney fees for its employees; whether or not it entered into a joint defense agreement. I mean, all these things outlined in the Filip memo, the division, for the most part, has been following that practice up to this point, and obviously we are going to continue to comply with that.

MR. POWELL: What about the—we have talked a bit about the new Federal Rule of Evidence 502. From your

perspective, how is that going to affect Antitrust Division investigations and how inadvertence is handled?

MR. TUGANDER: I think our approach to handling inadvertently disclosed materials is not going to change. We are going to employ the same procedures that I went through before.

It may have an impact on a decision to challenge a particular claim, because in some jurisdictions where the waiver standards traditionally have been less favorable to producing parties, we will have to consider that now. But because the Court, because the rule kind of adopted the majority view, I don't really see that either having much impact.

MR. POWELL: And one other question, which is I assume that the Antitrust Division, the DOJ, takes care in handling privilege issues because it believes in the principle behind it. But are there other practical reasons why in running an investigation it is particularly important to take all of these steps with to respect the privilege?

MR. TUGANDER: Right, we are obviously very concerned about fairness and concerned about ethics. But also from a practical point of view, we are concerned that if we mishandle a particular document, a relevant piece of evidence could be excluded from a trial. More broadly, we are worried that if we improperly handle something, we are going to have a problem with the entire investigation.

So again, another reason why we employ taint teams is to prevent that from happening. So I think our system sets up a lot of safeguards to protect that privilege.

MR. NEWMAN: How does a taint team get the problematic documents from the search warrant executions?

MR. TUGANDER: Well, what will happen is there are two options. We could have the taint team—once we get possession of the documents from law enforcement—we can have the taint team go through them for privilege. If something is privileged, it will be removed and segregated, and they can talk to counsel about it.

The second option is more likely these days: We provide copies of all the CDs to defense counsel to have them review them for privilege. If some issue arises, they then discuss it with the taint team.

MR. NEWMAN: When you send it to defense counsel, then you know what's in it, and they know you know what's in it.

MR. TUGANDER: No, we have not looked at that. We have not looked at the documents. The investigative staff has not yet looked at it. So before we look at it, we are going to have that taint team review it or give defense counsel an opportunity to review it.

MR. NEWMAN: So the taint team sends the message?

MR. TUGANDER: Right.

MR. POWELL: Do you have a reaction to that, Scott?

MR. MARTIN: No, I would be sanguine if all enforcement officials were as clearheaded and reasonable as Steve. But there's some reason to support a—

MR. TUGANDER: Again, I'm talking about possible approaches. I'm not saying this happens in every way in every case, but a likely scenario is the one I've just described.

MR. MARTIN: I think there are very good procedures in place at present, but they are not perfect, and they are not necessarily permanent.

MR. TUGANDER: I think it is hard to be perfect. Having good faith is really the best you can do.

MR. POWELL: Thanks, Steve.

Why don't we move on to Adam Cohen, who is going to talk about handling privilege in the context of massive e-discovery productions and how to deal with inadvertence and all the other issues we have been talking about.

MR. COHEN: Thanks.

Well, privilege review has been an e-discovery issue since the beginning of e-discovery, and the reason simply is the volume of information that has to be reviewed. So the risk of inadvertent disclosures is higher, because of the volume, and also to some degree, because of the nature of the electronic information.

The difficulty of making judgments about e-mails is the fact that the same content of an e-mail may be reviewed by different reviewers who will come to different judgments about whether the document is privileged or not. And of course there's also the issue of electronic information that's hidden when you look at the printed version of the document.

So, for example, the comments in a Word document that would be incredibly difficult and expensive and time-consuming to review for privilege—so that's the other issue, the cost issue. And it's that cost issue and the likelihood of making inadvertent productions of privileged information that led to some of the considerations that led to 502. If you look at the legislative history and the comments to that rule, you'll see that's the case.

So the question that the electronic discovery industry and lawyers have been struggling with is How do you deal with filtering for privileged documents in a way that will protect you against waiver and also will make sense economically?

There have been some interesting methods that have developed. They're not widespread yet, but they are beginning to emerge in some of the cases, including a recent case interpreting 502. And they're really borne out of

some research that was done on the effectiveness of keyword searching.

This research was done years ago. There is some research done by NIST and also by the Sedona Conference Work Group on Electronic Discovery. In a nutshell, using keywords to filter for privilege or any other research really is incredibly ineffective.

The numbers would shock most lawyers, I think, who are not aware of them. The degree to which productions that were originated through keyword searches are over-inclusive in some respects—and that means wasted money for the client—and under-inclusive in others is very substantial.

So if you are a client, you are concerned that there are lawyers reviewing documents that are irrelevant, and that's just increasing the burden on them to identify the privileged documents. And if you're a lawyer who is receiving a production, you're concerned that you may be missing some important documents.

So what do you do if you can't just apply a keyword search in order to save yourself incredible expense of doing the privilege review? And if the keyword search is not going to be considered adequate in terms of reasonable measures to prevent the disclosure of privileged information?

There actually are a few cases. If you're an e-discovery maven, you'll know about these cases. If not, you may not have heard about them yet. They are opinions that were written by magistrate judges who are well known in the e-discovery field and who look for opportunities to move the law in this area forward.

One case is by a magistrate judge in the District of Maryland, Judge Grimm. He also wrote the seminal opinion on admissibility of electronic evidence. And the case is called *Victor Stanley v. Creative Pipe*. That's a case where a party who refused to enter into a clawback agreement used keyword filtering to filter for privileged information and then tried to claim inadvertent production and no waiver. Judge Grimm found that they had not taken reasonable measures to prevent the disclosure, and he ordered that there was a waiver.

In the District of Columbia, you have magistrate judge John Facciola; he's the Judge in the White House e-mail case that has been in the news. He has raised the issue of whether, in this age of technology and the need to use sophisticated search technology to do electronic discovery, including privilege filtering, whether we need expert witnesses to validate the technology and the methods that are used. I know this has caused a lot of concern for clients who are worried that now there is going to have to be a hearing with expert testimony every time one of these methods is questioned.

So what do you do? Well, I'm going to just describe, very briefly, some of the ideas that are coming out, and then maybe we'll have some questions about it.

Basically, what people are doing is employing new methods and new technology. One of the methods that is being used widely is sampling. So rather than just coming up with a keyword search that everybody agrees on or seems to be pretty good, they are testing on different samples of data—different ways of doing the keyword searching. Through the use of statistical methods, you can get to a pretty reasonable measure of certainty.

But at that point, there is new technology that can be used based on some of the data that's been collected that has been determined to be privileged or relevant or whatever else you're trying to identify for it, that will actually find similar documents with similar content that don't use the keywords. So it is getting at that underinclusive prong. And that information is then used to refine the keyword search further.

I'm sure you have all had cases where you had discussions with the other side about a list of keywords, but it's still not very common for that list of keywords to be the product of real testing and sampling and using the benefit of the technology that's available.

I think you will see that more and more because, with these decisions coming out, you know, there's a lot more questioning and looking under the hood and trying to make that whole process transparent.

There's a quote, actually, from the recent case I mentioned, the recent 502 case. This is *Rhoades Industries v. Building Materials Corp. of America*, where they say, "Proper quality assurance testing is a factor in determining whether reasonable steps were taken under 502 to prevent inadvertent waiver."

So I think the message is that you will have to have a process for identifying privileged documents that involves something more than an attorney doing a review and making a judgment. And that is a process that you're likely going to have to defend at some point. It may involve sampling; it may involve the use of the technology I mentioned; it may involve use of multiple levels of reviewers. But whatever it is, the way that we have come to view privilege reviews in the past and the way that we are familiar with doing them as lawyers is really undergoing quite a significant change.

MR. POWELL: Adam, there were one or two cases that you cited where judges who were sophisticated enough in e-discovery issues recognized that these types of electronic search methods may qualify as "reasonable steps" under inadvertent production waiver law. But I don't know to what extent judges around the country share that same level of familiarity. What is being done to educate the judiciary on these issues? Is that part of what your firm is doing?

MR. COHEN: Yes, that's a question that comes up a lot.

On the federal level, there is this Federal Judiciary Center. One of the key writers and thinkers in the federal field came from the Federal Judiciary Center. Before he left, I think that gave us all a lot of hope that there was some very good education going on.

I'm not sure what kinds of programs are in place now. Although I do know that Judge Facciola, who is one of the judges that I mentioned, is one of the editors of the *Federal Courts Law Review*, and they frequently publish articles on this topic. This is the law review that goes out to all the federal judges.

The state level is a little more difficult. But it is up to organizations like the New York State Bar Association to do that kind of education. And there are Committees and Sections that are doing that.

I co-chair the E-Discovery Committee for the Commercial and Federal Litigation Section. We have had several programs where we have actually taught judges at Pace's Center for Judicial Education. So there are efforts being made, but these things are going to take place over time.

MR. POWELL: Well, thanks, Adam.

Why don't we move onto Jim Masterson, because so many of these issues concern communications between in-house lawyers at companies facing inadvertent production issues. So it would be great to hear from an in-house lawyer who deals with this problem.

MR. MASTERSON: Sure. Thanks, Wes.

As Wes indicated, the focus of my talk today will be on providing a perspective of an in-house counsel on the practical implications that multinational corporations face concerning privilege and discovery issues that have been discussed here today.

As the prior presentations delved into the substantive difference in the law as well as how to address these issues potentially in the e-discovery context, my focus is going to be on how these substantive differences impact the way that an in-house counsel provides legal advice to our clients as well as potential impact on U.S. litigations.

But before delving into those issues, I thought I'd provide you with a brief background about my role in MasterCard and MasterCard itself, since I think it presents a good example of problems that a multinational corporation may encounter.

As noted by Wes, I've been with MasterCard since 2002, with the majority of my time spent on managing our U.S. litigation. But I'm often called upon to provide antitrust and litigation advice on matters that have global import to our company.

Our law department is based in Purchase, New York, right near White Plains; but we have offices in over 40 countries around the world, with regional counsel having responsibility for certain countries or a number of countries, and all those regional counsel report in to one counsel in New York, who has responsibility for global matters.

In my prior work as outside counsel, I did not face the problems that may be encountered because of the differences in the substantive privilege laws between Europe or the United States, for example. And surprisingly, for some of you, nor had MasterCard really faced these issues, since prior to 2002, MasterCard, while a global player in the payment stakes, had generally participated and gotten acceptance of our cards in other regions through joint ventures or partnerships. Thus, for example, in Europe, we had partnered with EuroPay, who had their own separate law department. So MasterCard didn't face issues of providing legal advice on European issues.

In 2002, however, we went through a restructuring where all these global and regional players came under the single MasterCard organization structure. Our law department was then faced with addressing the differences in substantive issues. I can tell you that a number of my U.S. colleagues, including myself, were quite concerned when, shortly after our reorganization, we had outside counsel present on privilege issues that might occur related to European issues. And we were all concerned that the scope of the privilege and the scope of our legal advice might not be defined by U.S. law but other laws.

I can tell you that, shortly after that meeting, it was one of the few times as an in-house counsel that I actually did some Westlaw research—not that I doubted the firm which had a global presence—and then, subsequently, we did increase our budget for European counsel.

So after the integration of our regions, the reality that we faced at MasterCard was that we were providing and frequently being responsible for providing legal advice on global matters, such as advising on contracts with import across multiple countries; overseeing global compliance initiatives; or heading up investigations which might require the collection of data from not only the United States offices but from abroad, as well as litigation requests and discovery for documents concerning our European or other foreign offices.

The main concern, and I think the one that Scott had articulated earlier today, that I found was a concern that the scope of privilege would not be—even if it was potentially in U.S. courts—would not be defined by U.S. privilege law but by the lowest common denominator of the country where we might be doing business.

Another problem that I have encountered because of the limited privilege is that it impinges on the role that I

view as one of the primary value-adds of in-house counsel, which is to serve as the intermediary between outside counsel advice and our senior management.

Thus, rather than being able to, on European legal issues, work with outside counsel and then distill that outside counsel advice, using my knowledge of the MasterCard business and distilling it into a succinct form for our management, there needs to be on privilege-sensitive matters where that advice goes directly, it is purely from outside counsel, not with any changes from me.

Also, probably the largest problem that I faced is on managing our U.S. litigations, since we have often encountered the need to collect information from foreign countries.

For example, in many of our U.S. litigations, lawyers seek documents concerning regulatory investigations of MasterCard abroad. Although we might disagree as to the relevance of these materials, given the different market structures and substantive antitrust laws, the literal discovery rules permit their disclosure. So we typically, obviously, try to narrow the scope of the potential document rolls. But then we are faced with the problem of while European privilege law is so restrictive and so limited, their data privacy laws are extensive.

So what we are faced with then is trying to manage and weigh the needs and the requirements to produce documents relating to foreign materials in U.S. litigation but also observing the foreign laws in the countries where we're pulling that data.

How we go about doing that depends, first of all, on the circumstances. I think preparation is certainly a key, where we try to research the laws of the different countries—and particularly the data privacy laws—to determine what is the scope of our obligations.

In some instances, you may be required to hire local counsel to give that advice. And then subsequently, you may, at a minimum, need to provide notice to your employees abroad of the document roll as well as, potentially, in certain countries the workers councils that oversee those employees.

I found that a practical problem is, fortunately or unfortunately, our U.S. employees are very familiar with discovery and the discovery process. So when an e-mail goes out, it is a pretty smooth process to pull relevant data from employees.

Dealing with foreign places is a very different matter. The discovery process is completely foreign to them, and you really do need to spend extensive time walking through the process with them.

Often, I think a useful way we go about doing that is through, hopefully, negotiating relevant search terms with the opposing counsel. That way, you can provide those search terms to the foreign employees so they can understand the scope of the documents that will be pulled.

Obviously, working with e-discovery vendors is critical in these instances because certain countries' laws require such heightened restriction on the ability to pull documents, process documents, where they need to be processed, whether abroad or in the United States, and certainly encryption methods.

In light of these problems, I have some suggestions on ways to attempt to minimize the practical impact. I'm going to focus on two areas. One is providing just general legal counsel on sensitive areas on European issues; and the second is, when required, to produce foreign information in U.S. litigations.

Certain safeguards that I would recommend putting in place concerning just general counseling advice to clients concerning global issues or legal issues are

- Preparation is the key. So if you do have global responsibilities, in-house counsel is essential to understanding the purpose of laws that apply to the advice that you may be given.
- Secondly, you need to assess and determine the level of the sensitivity of whatever project that you might be advising on. If necessary, you should involve outside counsel and have all communications on that issue go through outside counsel.
- Finally, I think it's important on these projects—and it's more with the view of potential need to produce them down the road in a litigation—is that they be carefully labeled. "Privileged and Confidential" is always one way, although I prefer and I've found the use of project terms on a particularly sensitive project is even a better way. That way, your e-discovery vendor can segregate all of those documents with a unique word outside the scope, and they can be reviewed separately with additional safeguards in place.

Some suggestions for addressing issues when foreign materials are needed to be produced in a U.S. litigation. The first is communication with your clients—with your business clients. You've got to recognize that, especially when needing to communicate or deal with clients abroad, they are not familiar with the U.S. discovery process, and they have very different views of who should have access to their work e-mails. Thus you should explain the scope of the case, rather than sending an e-mail saying we are going to be pulling your documents. Have a conversation; do a phone call; provide, hopefully, search terms so they can better understand the breadth of the document pull.

It also is imperative to ensure that the data is handled properly and consistent with local law, and both—your

outside counsel and your e-discovery vendor—can be a great resource.

Finally, I think if you really do face substantial problems with data privacy laws in countries, you can try to attempt to create alternative or creative ways to satisfy your discovery obligations in the United States while at the same time attempting to satisfy the local data-protection laws; for example, the *In re Vitamins* antitrust litigation, where the Court limited foreign discovery by allowing the defendant to file a privacy log of documents protected by discovery by Swiss and German data privacy laws. The plaintiffs were then given the opportunity to review that log and challenge based upon the need for the document first, and the Court would make a judgment as to the burden of whether or not that would have violated the local privacy laws.

Finally, I think it is critical to work in partner with your outside counsel and e-discovery vendors. It is important to coordinate early with outside counsel as well as your e-discovery vendor. As part of any early case assessment we do at MasterCard, we try to determine the scope of the potential electronic discovery in the case because that may very well inform your strategy for moving forward.

Unfortunately, given the breadth of some of the discovery at times, the cost of pulling the documents and reviewing the documents might exceed the exposure of the company. It's also really important, I think, to have a preferred e-discovery vendor with preferred pricing established before a case or litigation arises.

Thus, do your homework and make an assessment of the vendors and have multiple vendors rather than a single vendor. At times, you'll face instances of e-discovery issues where certain vendors have better specialties, whether it be in addressing foreign language searches or being able to cull documents.

I think you have to try to utilize technology in order to gain the efficiencies and save costs in the discovery process, and at the same time, using that technology to help protect the privilege.

That's it for now.

MR. POWELL: Great. Thanks, James.

You talked about efforts to segregate privileged documents or counsel clients to segregate them. Can you talk about the burden of an in-house lawyer having to deal with production and what, in your perspective, can be done when that comes up in litigation?

MR. MASTERSON: Sure.

First, you make sure outside counsel knows you have zero tolerance for such production.

I think, at MasterCard, we have produced, in a number of litigations, tens of millions of documents. Inadvertent productions do occur. I think, again, in-house counsel's role is to help inform both your e-discovery vendor and your outside counsel and help them be able to segregate documents.

So I know that particularly sensitive projects are going on within MasterCard and the terms that might need to be used. So, obviously attorney names and lists but also project names are very important. It is a good way to try to at least capture a majority of the potentially privileged documents.

And then, also, I think in any case with large discovery you need a protective order that permits the return of inadvertently produced documents. With the revisions to the Federal Rules, I think that's just good advice.

MR. POWELL: Well, Adam, you've been both a partner at a law firm dealing with e-discovery and doing e-discovery now. What is it that you know now that you wish you knew when you were a practicing partner?

MR. COHEN: I think there's been a lot of focus in e-discovery on the spoliation issue. That's sort of what everyone is worried about. But there have been some cases with sanctions, and it really is a much bigger issue in terms of other parts of the process, like this kind of search and filtering that we are talking about. I think that lawyers have a tendency to assume that certain aspects of that process are generic.

So, for example, I need to hire someone to go look at hard drives or I need to hire someone to process data, and they don't really understand what that means. It sounds to them like photocopying: I'm going to take the documents to Kinko's or take the documents to Staples.

Really, all of these phases of the process are much more complex than that and involve the use of lots of different kinds of technology but also the application of expertise. Lawyers who don't understand how that's impacting what they are producing or not producing, they are going to have problems.

There is an ethical duty on the part of the lawyer to supervise people who are working under the lawyer, and that includes technology vendors. There is no way you can do that effectively if you don't have some basic understanding of what the technology vendor is doing. So that's something to think about, from my perspective on the other side of the fence.

MR. POWELL: Scott, you're still outside counsel. Do you have a reaction to that?

MR. MARTIN: No, I call Adam.

MR. NEWMAN: I have a question. You say that key words are not a good way or that you've got to combine them with sampling. I've heard there is some "concept" type of search? What does this all mean in practical terms? Because the logic seems to say you just find the keywords.

MR. COHEN: The reality and what the studies have shown is the way that people use language is much more complex than can be captured by keyword searches. The words that I might use to describe something or the words that you might use to describe something may be completely different. There may be all kinds of words that you haven't thought of that somebody might use in connection with something that's the subject of litigation.

So it's not that keyword searching is good or bad, it is that a poorly constructed keyword search, by itself, is not going to be enough in most cases. That if you rely purely on a keyword search, you will inevitably be missing substantial numbers of responsive or privileged documents, and you're also going to be taking in lots of documents that have nothing to do with the case.

So the concept—I didn't actually use the term "concept searching," and it means something different depending on who you talk to—but the idea is almost like artificial intelligence. Through the application of linguistics to software, the computer applications are able to find documents with similar content to relevant documents found by the keyword searches but that don't contain those keywords. So that you can then develop a better keyword search and eventually come to a statistical level where you have some assurance that you've found whatever the level is everybody decides is okay—99 percent of the responsive or privileged documents.

Now, that's going to be what's going to be tested in the courts in the cases coming up, and your adversaries are going to have to realize that the reality is they are not going to get every single responsive document.

MR. MARTIN: I mean, it may not have happened with us personally, but we have all been in the situation where the document is there and you are slapping your forehead and saying, How on earth did we not find it? Or, How on earth did we wind up producing the document?

The fact is it is not that simple. Whether something is as straightforward as a misspelling or whatever, you can go through the simple search term technology and figure out instantly why it made it through the filter or it didn't.

So I just really have to underscore what Adam is saying with the 502 out there. The simple search, at the end of the day, is not one that I would feel comfortable standing up in a court and defending before a judge as reasonable.

MR. NEWMAN: The big cost is the human beings reviewing for privilege.

MR. COHEN: Absolutely.

MR. NEWMAN: Have you been able to devise ways of shortcutting that?

MR. COHEN: Well, yes. What the technology can do to help you there is group documents together that are similar. So for example, there is a technology that's described as "near deduplication." Let's say you have a privileged document, you have it in a Word format, a PDF format, you have it in a TIF format.

When you do regular deduplication, those are not going to come out as duplicates because they are different formats. If you use the technology of near deduplication, you will group those documents together. So the same reviewer who is making a decision about whether the document is privileged or not will have those in front of him.

A lot of the privilege issues and certainly the litigation that I saw in my career came because of inconsistent designations by different reviewers. And when you have the documents grouped together like that, you can make much more efficient and quick determinations once you've seen the first document. So that's just an example. I mean, this is an area that is really burgeoning right now.

MR. POWELL: Thanks, Adam.

We have pledged to save some time for audience questions. I think we have less than two minutes left. So, Yes?

SPEAKER FROM AUDIENCE: I understand that the letter or expressed opinion that we write from our New York office might not be privleged in the EU based on your earlier observations. Would that loss of privilege apply or the flip side? Would there likely be a privilege if, for example, we are writing to a client in Italy and the letter was signed by or in addition by one of our colleagues in our office in London, for example, or in Brussels? Is it just a foreign non-EU? What is the extent of the loss of privilege based on non-local counsel writing a letter to a European client?

MR. NEWMAN: I can give you my own reaction. It would seem to me that, if there is a team of lawyers, one of them includes a qualified EU lawyer; that should be sufficient. It would seem to me taking form way over substance, to say otherwise, but that's just my own reaction. I don't know the answer. I don't know whether anybody knows the answer.

MR. MARTIN: Is the lawyer opining on U.S. law?

SPEAKER FROM AUDIENCE: You tell me.

MR. MARTIN: I hope not. I don't know the answer to that question.

SPEAKER FROM AUDIENCE: I did the *Akzo* case, firstly. I happen to know a bit about it. It is correct: no EU lawyer registered with the EU Bar has official privilege for correspondence.

However, there's a deal with each government, documents signed by a U.S. lawyer, for example. There is rule of the game that they will not use the documents. But that's the rule of the game. If the document is interesting, I don't know whether the rule of the game will prevail.

And on perhaps another issue, we filed an opinion against the decision. So the issue of whether in-house counsel can have privilege is still open for debate. Many member states intervened, so we will have a hearing, I suppose, somewhere in the spring and the judgment. As of yet, we are getting a lot of support from member states, from all sorts of associations, as was mentioned. So we still have hope to overturn that judgment.

SPEAKER FROM AUDIENCE: But it sounds like you're appealing only to the issue of internal counsel, not the issue of United States counsel.

SPEAKER FROM AUDIENCE: No, frankly, it didn't strike my mind because I'm a European lawyer. But there is also the reciprocity issue mentioned, as well. If we write something in EU law, it would probably not be privileged in the United States. So the system works both ways.

And perhaps the last issue, form over substance, is correct; but I think the judgment is huge progress because now all documents which had been prepared internally for the purpose of seeking advice or reporting external advice inside the organization are now covered as well. And that was still an issue which was not so clear before *Akzo*. So in that sense, it is a significant step forward.

MR. POWELL: Well, we hope you win your appeal. It will make Jim's life much easier, if nothing else.

SPEAKER FROM AUDIENCE: Let's say you have a communication from in-house counsel in Europe to in-house counsel in the U.S. Let's say that communication is privileged under U.S. law but not privileged under EU law. Then let's say there is private litigation here in the U.S. Do you list that document on your privilege log?

MR. MARTIN: I guess I'd list it. I'd list it on the privilege log, as far as I'm concerned. The choice of law issue, that is one I'd have to think about, but I would definitely list it on the privilege log.

I struggle with the same issue sometimes, in particular, for example, with Japan where you have—people may not function as legal directors with the companies and so forth. Candidly, I think what's sauce for the goose is sauce for the gander.

I have not seen somebody challenge that sort of designation in the past. I've never thought long and hard about the conflict of law question there vis-à-vis in-house counsel. Maybe Jim has had to.

MR. MASTERSON: No, I would certainly hope that that would be privileged. That would be our view.

MR. MARTIN: And candidly, I think, if nothing else, one could certainly compartmentalize it as work product for the U.S. in-house counsel under which it would unquestionably be privileged, from my perspective, because the choice of law there has to be the jurisdiction.

MR. POWELL: Do we have time for another comment?

SPEAKER FROM AUDIENCE: As part of the concept search, would you do more than one concept search? And can you give us an example of how you go about creating a concept search?

MR. COHEN: As I said, "concept search" is not a term that has a universal meaning, so I'm not sure what you mean when you say "concept search." I didn't use the term on purpose to begin with. And every company that is selling a technology that they call "concept search" does it a different way.

In answer to the question, well, Would you do one or more than one? Those kinds of search protocols are exactly the kinds of things that, ideally, you would negotiate with the other side. And I think that's what's contemplated by the new—not new anymore, I guess a couple years old—in the Federal Rules of Civil Procedure, when they say you're supposed to discuss electronic discovery issues at the meet-and-confer—this is the kind of thing you might want to discuss so that you don't have problems later on down the road and you don't have to redo the search.

If this is an internal investigation or situation where you're not conferring with another party, then the way to determine how many searches or what different kinds of searches is really by the sampling method that I talked about earlier. I mean, it is very easy to test the population of data to see what the right searches are.

SPEAKER FROM AUDIENCE: Stacey?

MS. MAHONEY: Just to follow up on that, now, if you're in a situation where you're negotiating, my feeling is, still in this day and age, if I have a defensible position—in other words, I've conducted a search that I know I'm going to feel comfortable standing up in court with—I may not want to actually share all the details at the outset with my adversary. Because once it is done, the court is far less likely to order me to redo it.

If I'm arguing in the front end, then I don't have any subcosts, so to speak, and then I might have to get into a negotiation and have to spend more money with folks

like you to do more than I would have had to do. What makes you say negotiate up front?

MR. COHEN: You should always spend more money on folks like myself. More importantly, I think that this is the way that we are used to doing things. We are used to having most of the discovery process occur behind closed doors, in private. We decide how we are going to search for things. And we don't tell anybody about it unless we absolutely have to. But what is changing as a result of the change in the Federal Rules is that courts are expecting you to discuss these issues with your adversary, and there are plenty of cases that have come out since those rules were put into effect where the court has said this is something you should have discussed at the meet-and-confer. So, well, I didn't want to discuss it then, and I already did the search, so don't order me to do it again.

That's not going to fly. The whole point of those amendments was to add transparency to the discovery process and make it more efficient by avoiding disputes later on about things that could have been resolved in the beginning of the case. So that may be a viable strategy, depending on who your judge is and what they think of these rules. But I think that that's exactly the kind of shift in discovery practice that the Federal Rules are bringing about.

MR. PRAGER: Thanks very much.

MR. PRAGER: If nothing else, perhaps we have learned how little we understand the issues that relate to cross-border privilege questions.

I thank all of you for coming today. I want to thank all of the panelists; the Chairs of the panels; the organizers of the panels; Stacey Mahoney, the outgoing Chair of the Section, about whom I will say more at the dinner tonight; the New York State Bar Association staff, who have helped to make this day run so smoothly; and my colleague and associate, Doreen Burdeau, who helped me to organize myself and to organize the programs for you.

A reminder: The dinner tonight is at the University Club. It is not here in the hotel. If you come here, you will miss cocktails or leave hungry. Again, our featured speaker this evening is Commissioner Tom Rosch of the Federal Trade Commission.

And if you're thinking this far ahead, the meeting next year will not be here at the Marquis, it will be at the New York Hilton. So again, if one year from today, you show up on the fifth floor of the Marquis, you will be in the wrong place, and who knows what kind of horrendous programs you might be subjected to.

So again, thank you all for coming. And thank everyone who was involved.

The 2009 Antitrust Law Section Dinner

MS. MAHONEY: Good evening. Welcome to the 2009 New York State Bar Association Antitrust Section Annual Dinner.

I almost wasn't able to give you any of my comments tonight because I threw out my notes. But here we are.

As you know, all of you who were able to attend today, we had a fabulous meeting. The attendance was tremendous. We had almost not a free seat in the house. And thank you so much for all of you who were able to come to the meeting today. It is members like you that make this association as strong as it is.

And once again, a huge thanks must go out to Ilene Gotts and Michael Weiner, our dinner Co-Chairs, for so perfectly coordinating everything with the folks here at this beautiful venue, and to the University Club for making us always feel so comfortable.

I want to also thank Joshua Richmond and Julliard Jazz who provided our musical accompaniment during the cocktail hour.

Now, as Chair Emeritus, as I am already, there are a number of additional thank-yous it is my privilege to offer tonight.

First and foremost, Lori Nicoll from the New York State Bar Association, who comes down from Albany to New York City every year for this event. Without her we would not have had our meeting today, and we would not have our dinner here tonight. So I don't know if Lori is still with us this evening, but if she is, and even if she's not, thank you very much to Lori.

And, I suspect, if we want to get through this, you might want to let me do the thank-yous, and then we will all clap together.

We are the beneficiaries this year again of a wonderful group of sponsors, and I will I introduce and thank our Platinum Sponsors first. Actually, this year we have a really fortunate to announce each of the Platinum Sponsors is returning to us: Garden City Group, LexisNexis and NERA Economic Consulting.

Our appreciation also goes to our Gold Sponsor, who is likewise a repeat supporter, and that is Analysis Group.

And this year we have thanks to give to our expanded group of Silver Sponsors: Complete Claim Solutions, CRA International, FTI/Compass Lexecon, LECG Corporation and Lexolution.

You make have representatives of these sponsors sitting with you at your tables, or you may have had an opportunity to meet with them during the cocktail hour. If you do, please again extend a warm thanks to them. They not only support us throughout the year in our professional endeavors, but they have made a very special endeavor to support us here this evening.

In addition—and I am jumping the gun to the end of the evening, when we are continuing our tradition of our delectable dessert buffet. And I would like to extend a thank you to Kaye Scholer; Latham & Watkins; McDermott; Will & Emery; Proskauer Rose and to my partners at Gibson, Dunn & Crutcher.

We are fortunate to have a full dais this year, and I would like to introduce these folks to you, although I think almost everybody up here is well known to all of us here tonight. So I'm going to start to my far left, and starting there we have Leonard Gordon, the Regional Director of the Northeast Region for the Federal Trade Commission; Ralph Giordano, Chief of the New York Field Office of the Antitrust Division for the United States Department of Justice; Ilene Knable Gotts, the Section Dinner Co-Chair and former Chair of the Section; the Honorable J. Thomas Rosch, Commissioner of the Federal Trade Commission and our keynote speaker here tonight. Thank you, Commissioner, for joining us this evening.

To my immediate left is my successor, Bruce Prager, our newly elected Chair of the Section and Chair of today's marvelous program. Thank you again for the program today.

To my right, Robert L. Hubbard—Bob, I've never called you Robert—Director of Litigation in the Antitrust Bureau of the New York Office of the Attorney General, Chair of the Multistate Antitrust Task Force of the National Association of Attorneys General, former Chair of this Section and our honoree tonight. Just to further date you, Bob, I actually interned for you in the Antitrust Bureau way back when.

Michael Weiner, the Section's new Co-Chair and also one of our earlier presenters today; Stephen Madsen, the Section's newly elected Vice-Chair; Eric Stock, the Section's Finance Officer; and April Tabor, the Section's newly elected Secretary, who has agreed to don the Secretary hat on top of her hat already as Section Head of our Membership Committee.

Now I would like to turn the microphone over to Bruce, who again not only did a super job with today's program but has been an immense help to me throughout this year, generously and graciously filling in and supporting me in numerous and non-obvious ways, given my demanding trial and travel schedule.

MR. PRAGER: Thanks very much, Stacey. And I would like to add my welcome to all of you and thanks for your being here tonight.

I want to thank all of the moderators and panelists who made today's program such a terrific success. I'm not sure, but I think that if people had been unhappy, they would have let me know. And I've heard nothing but praise for each and every one of the panels we had today. So I thank all of the participants. And just briefly, let me tell those of you who weren't here what you missed, and maybe you'll make an even stronger effort to attend the next program. We started the day with Molly Boast and Irv Scher presenting the Annual Review, which as I explained to people, allows those who had no opportunity to track the events and developments of the year to catch up on everything in slightly more than an hour, which was a real treat.

We had a panel moderated by Bill Rooney on Pharmaceuticals, Healthcare and Antitrust, focusing in particular on the issue of reverse payments and the *Schering-Plough* case. That was followed by a panel on Antitrust in the Media and Advertising industries; a particularly topical and fascinating panel that was moderated by Kevin Hart. A Roundtable Preview, as Dave Copeland, the moderator, liked to call it, the "McLaughlin Report" on Antitrust in the Obama Administration, and a focus on some of the disparities between FTC and DOJ enforcement and where we might expect to see those divergences go in the near future. And then we ended the day with a panel hosted by Wes Powell on attorney/client privilege in cross-border matters, which for those of you—and I guess most of you are lawyers—had the special added benefit of two ethics credits. So this was definitely a worthwhile afternoon and activity.

So for those of you who wasted the afternoon playing solitaire in your office, now you know what you missed.

Turning to more serious matters, one of the real honors and privileges of becoming the Chair of this Section, beyond having the honor and privilege of serving all of you for the year that is yet to come, is the opportunity to thank and tell you a little bit about our outgoing chair. And speaking highly and fondly of Stacey Mahoney is very easy to do. It has been an absolute pleasure to work with her this year and in the preceding years. And I hope that she will be available and willing to continue to work with us in the coming year. For those of you who can't see Stacey, she said, "No way." I don't believe it for a second. She's too generous a person to actually abandon us.

For those of you who don't know her at all, Stacey is a partner with Gibson, Dunn, and her fan club is sitting here in front to cheer her on. She joined them only recently, after a number of years at the Constantine Cannon firm. And yes, she's had a busy schedule. She wasn't joking when she said there were occasions where somebody needed to fill in a little bit. But it is incredible how much she has been able to contribute while preparing for and, in the last several weeks, having been in trial seems like eight or nine days a week in Washington on a merger case against the Federal Trade Commission.

She has been very dedicated to the New York State Bar Association for many years, working her way up through the ranks. Having served on the Executive Committee as Secretary of the Section, as Vice Chair, and now having culminated a marvelous year as Chair of the Section.

But the New York State Bar is not her only extracurricular activity. She has been a dedicated participant in a wide range of organizations, and in particular she has been focused on helping, mentoring and assisting women in the Bar and has been involved with the New York Women Antitrust Lawyers Network, as well as the Antitrust and Trade Regulation Committee of the New York City Bar. I can go on and read you her biography, but then we would never get to dessert, let alone anything else.

So with that, I would ask Stacey to please come up and allow me to give you a great present. It is a pleasure and a privilege to be able to present you with this beautiful blue box. We said we had to save in the budget, but I can get a big one next year. On behalf of the Section and all of its members, particularly the Executive Committee, we thank you so very much for your leadership, your guidance and most of all your friendship, which we know will remain for many years to come. Thank you so much.

You can have the microphone now.

MS. MAHONEY: Thank you very much, Bruce. That was really great. Thank you.

This has been a tremendously fun job for me, and I expect it will be even more fun watching Bruce do it. But I know that you'll have all the support that you need from Steve and April and Eric. But I guess I should put you on notice, because there seems to be a trend—Ilene, Saul, myself—we had ridiculously crazy, busy years during the year that we were Chair, so you should probably get ready now.

My goal this year was really to try to create additional service offerings to the membership of the Section and thereby hopefully support the Association's effort to grab membership, not only for the Association but for the Section. I think today's program was a perfect example of our goal and our abilities to do things. Bruce managed to fit an extra program into today that we were never able to do before. So we were able to give five substantive programs today. And I just think that given the attendance that we had, it demonstrated how valuable the membership really considered our program to be.

So again, I can't thank you enough. Today was just a spectacular day.

We were successful in other efforts too, in expanding membership as well. We are continuing to do the things we do well. We have our Summer Associate Program which, has been run for years now by April Tabor, and we have participated and are dedicated to the Diversity Program of the Association. And both of those efforts really go to deepening the strength of the membership and creating a new strength from younger members, which is really, I think, how we build the association into a strong community tomorrow to continue on what we are doing today.

We also expanded the services that our Section was able to offer. In addition to the monthly meetings that we always do, which explored very topical and somewhat often controversial issues in antitrust, we were able to begin our program offering brown bag teleconferences headed by Bill Rooney. I think he's in the room. Thank you, Bill, for really helping to focus and address issues that are more of interest to the younger members of the Section. The enthusiastic attendance of those programs demonstrates to me they are really filling a gap.

We continue to do our CLE, not only today but also throughout the year. Thanks to the continuing initiatives and the tremendous contributions of the Executive Committee members and members-at-large, our membership numbers have increased, and active participation of our members-at-large has increased as well. I think that's really going to be critical to the continued success of the association in the future.

Of course, as a Section we can be proud of these successes, but we continue to look for ways to serve each of you. I encourage you to look to the Executive Committee as a tool that you can use to get what you want out of this Section. We are really here for you. We encourage you to have your colleagues join and participate and to let us know what, in addition, you want from us, so we can continue to fill in those gaps.

As I was thinking about tonight, I realized there have been several mentors in my career who have been chairs of this Section. And it is a testament again to the leadership that the Section provides to its various members. I'm hoping that if we continue to do this right as a Section, some years from now there will be somebody else standing up here saying that they found the leadership of the Section was also inspirational to them in their career. And that's a good way to know that we are doing the right thing as lawyers, as people and as members of this sensational association.

So thank you all very much. It has been a fabulous year, and you are in wonderful hands.

I would like to ask Stephen Houck to come up now. Steve is a longtime friend and colleague of Bob Hubbard, and Steve has volunteered to present the Section's Public Service Award tonight to Bob.

Thank you, Steve.

MR. HOUCK: I have the honor of presenting the Section's Annual Service Award this year to Bob Hubbard. And it truly is an honor, because there is no one who better exemplifies the attributes the award is intended to acknowledge and encourage: dedicated public service, able lawyering, a positive impact in development of antitrust law and leadership not only in the New York State Antitrust Bar but in the antitrust community generally.

I first got to know Bob well in the late 1990s when I was Chief of the New York State Antitrust Bureau. Bob, of course, has been a long-term and indispensable member of that office, which he joined in 1987. Although Bob is a native Midwesterner, it is New York's good fortune he decided to stay here after he finished Fordham Law School, where he was a member of the *Law Review*.

In preparation for my remarks this evening, I did some due diligence and spoke to several of Bob's former and present colleagues. So the observations about Bob and his stellar career I am about to share with you are not just my own but represent a consensus view of his many, many admirers.

Bob has a singular record of accomplishment in several different areas. First and foremost, those of us who know Bob think of him as a prosecutor and zealous advocate on behalf of New York State consumers. Bob, as I mentioned, has been a key member of the New York State Antitrust Bureau for the past 21 years, and he currently serves as its Director of Litigation. That office has a very tough job: enforcing the antitrust laws with limited resources and underpaid staff against major corporate defendants with vast resources represented by the best defense counsel in the country—you all sitting here this evening.

You deserve the applause, because you're tough adversaries.

The Antitrust Bureau has been fortunate over the years to have some very able chiefs, including prominent members of this Section, like Lloyd Constantine, Harry First and Jay Himes. But what stands out to me is the uniformly high quality of the bureau's advocacy and work product, regardless of who the chief has been. That's no accident. It is due to the uniformly high quality of the professional staff, lawyers and others, and their hard work and dedication. And I can attest from personal experience that there has been no harder working or more dedicated member of the Antitrust Bureau than Bob. In fact, my powers of description are woefully inadequate to describe how invaluable Bob has been and how prodigious his work output has been. I don't think anyone who knows Bob will disagree with that.

During my time at the bureau, Bob was invariably the first person to arrive in the morning and one of the last

to leave at night. Bob's persistence and hard work paid off. He's gotten extraordinary results for his clients, the citizens of New York, across a broad swath of industries and substantive antitrust issues. In deference of time, I'll cite only a few examples. One of Bob's early victories as a trial lawyer was securing an injunction to prohibit an anti-competitive merger upstate. I'm sure it will come as no surprise to our distinguished speaker tonight, Commissioner Rosch, that one of Bob's co-counsel was Pamela Jones Harbour, then Bob's colleague and now one of Commissioner Rosch's fellow commissioners at the FTC.

While I was Bureau Chief we enjoined a so-called virtual hospital merger in Poughkeepsie, after the USDOJ had declined to prosecute. That case, *St. Francis/Vassar Brothers*, in which Bob worked as lead counsel, represents a rare if, indeed, the only successful government enforcement action, federal or state, against a hospital consolidation in at least the past 15 years. And Bob got this result by summary judgment. Summary judgment for antitrust plaintiff in this day and age is an almost unheard-of accomplishment.

Also, while I was Bureau Chief we commenced the disposable contact lens case, a multistate action in which New York was the lead player involved. Bob was one of the lead trial counsels, and the case resulted in a multimillion dollar recovery for consumers.

And Bob has gotten equally exceptional results recently in the important pharmaceutical case *In re Cardizem*. These accomplishments are all the more remarkable since they come in an increasingly difficult environment for antitrust plaintiffs.

Among Bob's outstanding character traits are his unflinching determination, his tenaciousness and optimism, whatever the odds, all fueled by his passion and commitment to antitrust enforcement. Someone with less energy than Bob might be content with the extraordinary success he has achieved as a public servant, prosecutor and litigator, but not Bob.

Despite long hours at the Antitrust Bureau working on behalf of the state's consumers, Bob has contributed significantly in many other ways. I don't want to prolong this homage to Bob unduly, but I think I would be remiss if I didn't mention Bob's other contributions to the antitrust communities. First, as regards this Section, Bob served as the Chair and continues to serve as both an active member of the Executive Committee and the Nominating Committee. Bob is equally active in the ABA Antitrust Section, where he served as Chair of the State Enforcement Committee and currently serves as a state representative on its council. Indeed, Bob has only recently returned from a very arduous journey to attend an ABA council meeting in Hawaii and has had the difficult task of reacclimating himself to the New York winter.

Through his Bar Association activities, Bob has already nurtured antitrust scholarship. He has worked as Editor-in-Chief of the *ABA State Enforcement Handbook* and of this Section's volume, *Antitrust Law in New York State*.

I've yet to mention the role Bob plays that he may be best known for: Chair of the Multistate Antitrust Task Force of the National Association of Attorneys General. That is practically a full-time job, in addition to Bob's day job at the Antitrust Bureau, and one that Bob has held since May of 2005. Bob's selection to this prestigious position is a reflection of the enormous regard with which he is held by the state antitrust enforcement community throughout the country. As the Multistate Task Force Chair, Bob shares the stage at the ABA spring meeting with the chief enforcement officials from the USDOJ, the FTC and European Commission. Bob has used his position as Multistate Task Force Chair to cement a reputation as "Mr. Vertical Restraints," and he organized the states' *amicus* settlements in *Leegin*. Bob also helped organize the states' response to the Antitrust Modernization Committee, successfully persuaded the commission members to keep their hands off state antitrust enforcement, a very significant accomplishment.

Bob cannot, obviously, have accomplished all that he has accomplished without a lot of support, and I'm referring to his wife Meredith, who is sitting at my table. Given the long hours that I know Bob puts in on the job, including frequent travel to many destinations less glamorous than Hawaii, I am equally in awe of what Meredith has accomplished. She and Bob raised two fine sons, one of whom is here tonight. Rob, it is interesting to note, is a graduate of the alma mater of our new Attorney General, Stuyvesant. And Luke is a student at the alma mater of your new Solicitor General, Hunter College High School. Bob, you have achieved a lot, and I know you will achieve much more. It is therefore with great pleasure that I present you with this well-deserved award.

MR. HUBBARD: Thank you. I'm honored and quite pleased to join the group of attorneys who have received this award. Steve, I thank you for your kind remarks. I thank you for your guidance and counsel over the years, including your leadership as a Bureau Chief.

I thank my family, Meredith, Rob and Luke, for loving me and joining me here. I learn from them all the time. I learned from Luke today that you can't wear jeans into the University Club.

I thank all my AG colleagues that have been very helpful through the years, for the camaraderie, for the opportunity to learn and grow with them.

And, of course, I thank all my friends and colleagues in the Section throughout the years. I remember that I first joined the Section because Lloyd Constantine, with his vigor, decided that it was time for public enforcers to

take over the Section. He thought there weren't enough plaintiffs on the Executive Committee, and it was time to sort of take that over. I don't think we have managed to accomplish that goal, but I think we have done all right.

I do remember my first public presentation was at one of the annual meetings of the state bar. It was a health care panel talking about antitrust, and I met a health care advocate on the panel. I introduced myself as an antitrust lawyer, and in all earnestness she looked at me and she said, "How can you be against trust?" So like so many things, I found that the State Bar activities that I've done over the years have really broadened my perspective. I've come to understand through my colleagues on the Bar the experience of others. I think that they have tempered my enthusiasm when it was appropriate to do so, and I appreciate that they have willingly and gladly allowed me to subject them to the same sort of tempering. Thank you very much.

MR. PRAGER: Now we are going to eat. After dinner we are going to hear from Commissioner Rosch. Enjoy and bon appétit!

(Dinner served)

MR. PRAGER: Ladies and gentlemen, I know that many of you are still eating, and I want you to continue to enjoy your meal. But since our guest and speaker tonight is a former cabaret performer, he said he can handle giving his speech over you still clanging on some forks and enjoying your wine.

I would like to recognize Kitty Rosch, Tom's lifelong mate and wonderful friend, one of the most charming women I've ever had the pleasure of knowing. Kitty, I'm so glad you came up with Tom and gave us the opportunity to see you again.

Every introduction of a dinner speaker begins with something like it is a great pleasure. . . . I'm thrilled. But that phrase or something like it is so genuine and heartfelt for Tom. He was my partner for more than a decade, has been a friend, an advisor, and everything that one could want in a mentor for several decades. Having the opportunity, by happenstance, to introduce him tonight really does fill me with great pride. And I have to say, in the style of all the disclaimers that we hear from our government colleagues, that I wasn't even at the Executive Committee meeting that decided to invite Tom to speak tonight. But when I heard that he was our selection and that he had accepted, I immediately stepped up and said I'm going to exercise the Chair's prerogative and ask him to do something, because Tom had held such a special place for me.

I am truly amazed and commented to him just a short while ago that he knows so many of you, despite the fact that he has never lived in New York and has never practiced in New York. For those of you who don't know, he's a California boy and has lived out in San Francisco for most, if not all, of his life.

In any event, Tom was, as I said, my partner at Latham & Watkins for over a decade. He was the managing partner of our San Francisco office for a number of years. He was the chair of our antitrust practice until he graciously persuaded me to take that position over, having not fully disclosed all of the pitfalls of doing so. But I don't hold that against him.

About three years ago, almost to the day, having decided that he was ready to retire from the practice of law, and I think much to Kitty's chagrin, Tom decided to accept an appointment to the Federal Trade Commission. If you don't know that he has been outspoken—I think you know that he has been outspoken. He has been stimulating. He has made us think, which he promises to do again tonight, and has put a new spin on old issues across a panoply of antitrust concerns.

Earlier I enumerated to you the panels that we had on our program today. I can tell you that Tom has made contributions on every single one of those issues, perhaps save one until tonight. In the past he has given speeches; he has spoken. He has participated in programs, panels; led the FTC as a thought leader and as an inspiration. And tonight he's going to take that next issue, which is—he wouldn't frame it as FTC and antitrust in the Obama Administration, but I think Tom is going to talk to us about the impact of the financial meltdown on the FTC and its mission, which kind of moves in that direction.

So I promised him that I would keep this brief, and I will. It is with great pleasure and supreme pride that I introduce Commissioner Tom Rosch. Thank you.

HON. J. THOMAS ROSCH, Commissioner, FTC: Well, thank you very much, Bruce. I appreciate that.

I want to, first of all, congratulate Bob Hubbard, who is a very deserving honoree tonight. It was mentioned that I knew a lot of you, and that is certainly true. I want to thank you, first of all, for the opportunity to speak to you here tonight. This is a very distinguished group of people, and I do know a lot of you. I know a lot of you as a result of the Antitrust Section, Irv, Ilene, Barry, many, many people—too many really to mention. I know a lot of you through the *Brand Name Prescription Drug* case in Chicago; a lot of you are veterans of that case. We labored together on it. I knew a lot of you through cases in San Francisco—the cosmetics case. I see Bruce over there, where we cut I think probably the best settlement in the history of class actions. I knew a lot of you through NERA. And I appreciate all of the hospitality that we have enjoyed over the years in Santa Fe.

So I thank you very much for the opportunity to speak to you this evening. You are indeed my friends, and it is without question the most distinguished audience

that I've had the pleasure of speaking to in my three-plus years at the FTC.

I would like to share with you tonight my thoughts about what the implications are of the ongoing financial crisis on the FTC's mission. The financial crisis is the most pressing issue facing the Nation, not only domestically, but arguably internationally because it has rapidly spread worldwide. But it is also an extremely important issue at the FTC. The FTC's mission, as you know, is to protect markets from anti-competitive, fraudulent or deceptive conduct that prevents those markets from functioning properly. What happens when a market-based economy fails, or comes dangerously close to failing? What does that mean for the FTC's mission? I have been giving this a lot of thought over the last several months, and these are my tentative views, and I express them with great humility. In voicing them, what I would really like to do is to stimulate thought in each of you, whose opinions I truly prize. And I would like to know what you think about my ideas, as well. I know that some of you will disagree with me and with what I have to say. David Meyer, who is sitting over here on my left, I know that we will disagree on a lot of what I have to say tonight. But my MO is to stimulate thought and debate, and that is what I am going to do tonight.

First, I will discuss the economic theory that has predominantly influenced antitrust for the last four-plus decades, and what has happened to it. Then I will discuss some of the views about how antitrust may be applied that have been circulating since the crisis exploded on the scene last Fall. I will explain why I would suggest that antitrust enforcement is part of the solution to the economic crisis, rather than the problem, and provide some specific examples as to how antitrust might apply to mergers, single-firm conduct and cartels.

Finally, I will also discuss how the consumer protection aspect of our mission may be impacted by the financial crisis.

Let me start with the economic theory. One thing is clear to me, and that is the orthodox and unvarnished Chicago school of economic theory is on life support, if not dead. Antitrust enforcement principles over the last forty-plus years have been heavily influenced by this school of economic thought, which has its origins in, among others, Friedrich von Hayek's and Milton Friedman's views. Underlying the Chicago school theory is the principle that markets essentially take care of themselves without the need for extensive regulation. Thus, if not perfect, markets will quickly correct themselves, and recognizing this, rational business people will not engage in predation. Now, that stands in contrast to John Maynard Keynes's economic theory that there can be situations where it is necessary for governments to stimulate economic growth and improve stability in the private sector. Keynesian economics holds that markets do not always take care of themselves—that some conduct may lead to aggregate macroeconomic outcomes in which output and growth are not optimal.

Robert Bork's *The Antitrust Paradox* applied Chicago school theory to antitrust law and is extremely influential. He asserted that many of the then-current cases applying the antitrust laws were irrational and actually hurt consumers. He also argued that consumers were often beneficiaries of corporate mergers. Chicago school theory was first fully embraced by the Supreme Court in the 1977 *Sylvania* opinion, where the Supreme Court abandoned reliance on the rule of per se illegality for non-price vertical restraints and instead opted for the rule of reason.

Evidence of the Chicago school economics is still evident in the FTC's Web site, where there are repeated references to "faith in the market." For example, comments the FTC made to the OECD roundtable on the interface of competition and consumer policies in 2003 stated that "our faith in the market is firmly grounded in the principle that free enterprise and competition best guarantee commercial freedom, economic efficiency, and consumer welfare." Chicago school economic theory is also evident in the Supreme Court's *Trinko* decision, where the second part of the decision suggests that monopolies are beneficial because they will spur innovation. It is also the basis for the Department of Justice Antitrust Division's Section 2 report, where the dangers of overenforcement of the antitrust laws (called Type I error) were emphasized.

The antitrust agencies have tried to export this theory, particularly when counseling the Chinese with respect to the development of their anti-monopoly laws. Although the counseling to the Chinese was done orally, the theory is evident in speeches. For example, in a speech before a standard-setting conference in Beijing, former counsel to the assistant attorney general of the Antitrust Division, Hill Wellford, declared that "as we consider the challenges and proposed solutions within standard setting, we should keep in mind the power of markets to self-correct." And in a Beijing speech, former assistant attorney general Hew Pate declared," . . . the American intellectual property system rests on two fundamental foundations: first, protecting and enforcing private intellectual property rights; and second, a trust in markets, which means a belief that private solutions are usually more efficient than government solutions."

In light of the events of the last year—that continue today—the positions I have just discussed have been called into question—some would even say that Chicago school is "out" and the Keynesian economics is "in." Alan Greenspan and former secretary of the treasury Henry Paulson both fully subscribed to the Chicago school theory before the crisis. But in his testimony before Congress last October Alan Greenspan recanted his faith in the market and the rationality of business people; he testified that more government regulation of the financial

sector was both necessary and proper. Although Secretary Paulson was not so specific about market imperfections and irrational behavior, he has intervened repeatedly to try to deal with perceived imperfections in the market. Now, this is not to say that one size fits all when it came to his interventions. Secretary Paulson intervened in different ways at different times. For example, he intervened when he felt that some institutions were "too big to fail"—e.g., Bear Stearns, Fannie Mae, Freddie Mac and Citicorp—but did not do so when other institutions failed—e.g., Lehman Brothers. Also, initially he intervened by purchasing (or standing behind) the distressed assets of financial institutions, and he initially considered using TARP funds to do that exclusively. But he ultimately intervened instead by buying equity in major financial institutions that were considered "too big to fail."

In short, two of my fellow Republicans—and I stress that I am a Republican—whose opinions I respect a great deal have declared emphatically by their words and by their deeds that in the real world—as opposed to worlds of political and economic theory—markets are not perfect, that imperfect markets do not always correct themselves immediately and that business people (who, let's face it, are part of this crisis) do not always behave rationally.

So what does all this mean for antitrust enforcement? There have been a lot of recent ruminations about the financial crisis slowing or stopping antitrust enforcement. One of those expressing that view has been David Boies, who I suspect is probably a member of this organization. Two months ago he speculated that the antitrust agencies would not proceed to block any transactions in the face of the financial crisis. He speculated that politicians wouldn't be able to afford to worry about anticompetitive mergers and other practices as much as they would worry about saving jobs. If an anticompetitive merger would at the same time save jobs, Mr. Boies declared that it would not be politically palatable to kill the deal.

Now, this is not the first time that Mr. Boies has made predictions of easy antitrust clearance. He predicted that antitrust clearance would be a slam dunk when President Bush was President and, more specifically, when Charles James was assistant attorney general in charge of the Antitrust Division. Mr. Boies was wrong about that. The Antitrust Division, under Charles James, you will recall, blocked the acquisition of Direct TV by Echostar, which Mr. Boies represented, and Echostar ended up paying Direct TV a huge breakup fee.

Another commentator has articulated a more nuanced approach. In a December article, Randy Smith of Crowell and Moring opined that current merger analysis undertaken by the agencies must account for economic realities affecting a particular industry. He pointed to the forward-looking analysis the agencies currently utilize. In this analysis the key issue is whether past market shares accurately reflect the future competitive significance of the merging parties.

Although the article doesn't cite *General Dynamics*, the most recent Supreme Court merger case, that is what it is based on. There of course the Supreme Court allowed the acquisition of a coal company despite the fact that the transaction resulted in very high market shares. It held that high market shares did not reflect the true nature of the acquired firm's future competitiveness, because the firm's coal reserves were either depleted or committed under long-term contracts. This undermined the government's prima facie case. Mr. Smith argued that this analysis allows parties to argue that current high market shares are not always good indicators of what future competition will look like. That is correct. But the impact of a financial crisis on antitrust enforcement can work both ways—it is by no means clear that it will result in less enforcement.

Contrary to Mr. Boies, I would suggest to you that antitrust laxity during an economic recession can result in a deepening of economic contraction. Competition spurs innovation, productivity, growth and cost-effectiveness. Increased prices are almost always (if not always) accompanied by reduced output. So reduced antitrust enforcement could result in increased prices and reduced output, and in turn, more unemployment. Put differently, if anticompetitive mergers and other business practices are permitted during an economic crisis, it is likely to cause reduced innovation and output, and consumers will lose the benefit of lower prices. So I would suggest that competition laws need to be implemented at least as strictly during a time of economic crisis as they are otherwise.

At a minimum, we need to be more humble. We can't make orthodox and unvarnished Chicago school of economic claims with the same authority. Now, this does not necessarily mean that antitrust based on Chicago school economics is dead wrong. But the message needs to be much more fine-tuned. In terms of economic theory, we may need to move more towards what has been called "behavioral economics," based on the facts about how individuals are behaving rather than on how Chicago school of economic theory would predict they will behave. This would require some adjustments in how we apply the antitrust laws—particularly in the section 2 area, which I will briefly discuss in a moment.

But at the same time, antitrust enforcement agencies should arguably be cautious in embracing market innovation, lest market innovation result in unforeseen consequences. After all, I recall the problem that occurred when certain nations sought to manage their iron and steel industries. That led to severe protectionism and undermined free trade, to the detriment, I would suggest, of all, including themselves. In sum, there may be circumstances in which intervention is not well advised in a financial crisis. But that doesn't necessarily mean that antitrust is less important, but what it does mean is the financial crisis creates certain discrete failures in the market and intervention in other respects may not be advisable.

Now, let me turn to merger policy. Let me please provide some examples to illustrate how merger law enforcement may be affected by the financial crisis. To begin with, mergers may arguably be examined with an eye toward whether they are creating a merged entity that is "too big to fail." If so, the transaction may violate section 7 (or section 1). Now, I acknowledge this is a controversial point; and many may argue that the antitrust laws—specifically the Clayton Act—does not reach this type of concern and that legislation amending the Clayton Act to include this concern is appropriate. But I personally doubt that an amendment is necessary. The Clayton Act is inherently prospective and the current standard prevents anticompetitive harm in its incipiency. So if a merger creates a firm whose failure is likely to have a catastrophic effect on the market as a whole because it is so integral to the market, the end result may be a substantial lessening of competition. It would arguably be better to avoid the creation of such firms in the first place through merger instead of having the Treasury Department bail them out.

Conversely, as my predecessor, former FTC commissioner Tom Leary has suggested, a merger involving two firms who do not compete in the same relevant market may violate section 7 or section 5 if because of the resulting financial weakness of the merged entity, the merged entity may not constrain the exercise of monopoly or near-monopoly power by a powerful competitor as much as that market power is likely to be constrained prior to the merger. In other words, in his view, such a merger arguably could have just as pernicious an effect on competition as a merger of two powerful rivals.

There may also be situations where a merger of two weak and financially struggling firms (though not necessarily on the brink of failure) could result in a stronger single competitor and enhance competition. Or there may be situations where a merger will create unique synergies that enhance efficiency, so the transaction results in a stronger competitor and thus enhances competition. These possibilities have always been taken into consideration in merger analysis, even without a financial crisis, but the financial crisis may make them even more important, because preserving competition in this environment becomes all the more valuable.

Entry conditions may also be impacted by the financial crisis. One of the assumptions of federal merger policy, based in large measure on orthodox Chicago school thinking, has been the entry is frictionless. In large measure, that assumption is in turn based on the assumption that capital is readily available. Those assumptions undergird a number of attitudes about mergers: that entry is likely, that efficiencies will occur and that "fixes" can be achieved. During the recent crisis, capital has been entirely or partially frozen. These assumptions must be re-examined in light of that experience. Short- and medium-term tightening of capital markets may make entry less likely. This may arguably make it more difficult for the antitrust agencies to find suitable buyers for our divestiture orders, making it harder to craft an appropriate remedy. If so, the lack of an effective fix may in turn lead to more aggressive action by the enforcement agencies—for example, an action to block the merger instead of trying to fix the problem.

Are we going to see more failing firm arguments? The answer is probably yes, and the FTC's analysis will probably be the same as it has always been. The 1992 merger guidelines describe the conditions the agencies look for to see if a failing firm defense should apply. In fact, the commission has already been faced with not just a failing firm argument but an actual failing firm in one industry in the last month and a half. The most the agency could do was to explain to the bankruptcy court which of two bidders for the failed firm's assets appeared to be the least anticompetitive (though I would say that both seemed to be anticompetitive). As almost always happens in these situations, the more anticompetitive firm offered more money for the assets to the bankruptcy court, and the court approved that buyer. And the result will probably be reduced output, higher prices, less innovation and fewer jobs. But there's nothing antitrust enforcement agencies can do about it. This is not a good result, and it underscores the need to closely analyze the financial conditions of all firms involved when we review mergers—the resulting merged entity as well as the remaining competitors.

On a very granular micro level, the financial crisis has resulted in far fewer filings of the Hard-Scott-Rodino Act, which means that HSR fees for the enforcement agencies have been dramatically reduced. It is possible that over the next four to six months the FTC's merger shops will have more resources freed up. Now, that may not be a bad thing, not only for those of you who represent respondents in those cases, but because the resources that are freed up can be used to conduct some much-needed retrospective analysis of our merger and non-merger remedies. This is something that Chairman Kovacic has often advocated. We need to examine whether the relief that we order is working. Too often in the last three years in my tenure at the FTC, I have wondered whether a merger remedy was so complicated it was doomed to failure. For example, when a remedy requires licensing, sharing of manufacturing plants, supply agreements or other ongoing entanglements between firms, I have wondered whether it would be better to just say no to the transaction in some situations. And I am not the first commissioner, past or present, to have such thoughts. Conducting retrospective analysis of some of the agencies' more complex remedies will help us understand whether in some circumstances it is better to just say no.

Review of consummated mergers could also be stepped up with freed-up resources resulting from a decline in HSR filings. In the current crisis there may be more last-minute mergers that should have been blocked. I don't know. As you know, however, the FTC and the

Justice Department can always challenge the transaction after the fact.

And finally, Mr. Boies may be right that there may be an increase in political or societal pressure to either block or allow a merger because it will prevent job losses or plant closures, good or bad. In other countries, the government has been more willing to step in and override the relevant antitrust authority. For example, very recently, in the face of the current financial crisis, the UK altered its regulatory framework as applied to the financial sector to enable public interest concerns to trump competition review. In September 2008, the UK secretary of state issued an intervention notice under the Enterprise Act of 2002 on the Lloyds TBS/HBOS merger, thereby eliminating the authority of the Office of Fair Trade to review the transaction and placing it entirely in the hands of the secretary of state. Our antitrust laws in the U.S. do not incorporate this type of analysis. I hope the administration here resists the temptation to emulate the UK in that respect. I think it will: if the antitrust agencies take into consideration the financial condition of the merged entity and those remaining in the market, that is likely to help solve the current financial crisis, in my judgment.

Now, let me make a few comments about how nonmerger antitrust law enforcement may be affected by the financial crisis.

As I have said, one of the corollaries of the orthodox Chicago school of thought has been that firms are rational, and predation is rarely rational (because imperfect markets correct themselves). Now that theory has been questioned by various what have been called "post-Chicago" school economists like Salop and Lande and Whinston and others (like Susan Creighton) who have suggested that predation may be rational (and may work) in a number of instances. Recent events should further fuel that intellectual ferment, particularly when there is direct evidence that predation was intended. Indeed, the commission and the Antitrust Division should be willing to challenge any course of conduct whose purpose and effect may be to eliminate or cripple rivals whose competition could operate to constrain a firm with monopoly power from exercising that power. In those circumstances, the rival is arguably "too important to fail."

As for cartel activity, an uptick in cartel activity may occur because firms may be especially tempted to conspire with competitors in order to prop up their prices, margins and stock prices during a recession or depression. So extra vigilance is in order to protect consumers from other competitors from that kind of conduct.

Now, I would like to finish tonight by talking briefly about the impact of the financial crisis on the American consumer and, consequently, how this will inform the consumer protection aspect of our mission at the FTC. As you are probably all well aware, the current economic situation is extremely grim for many consumers: delinquencies on auto loans and home equity lines of credit have reached their highest level since record-keeping began in 1980; a record 1 in 10 American homeowners with a mortgage were either at least a month behind on their payments or in foreclosure at the end of September; increasing numbers of Americans are struggling to pay off medical debt; and in December the unemployment rate rose from 6.8 percent to 7.2 percent, the highest rate since January 1993. And judging from recent layoff reports, the January figure may well be higher than the December figure.

Clearly, consumers are struggling with personal financial difficulties. Now, whether these difficulties are caused by a general downturn in the economy, a loss of employment, or the burden of a ballooning mortgage payment, many consumers will need some sort of assistance. Unfortunately, unscrupulous actors will use this time of crisis to take advantage of vulnerable consumers who are trying to solve their financial problems.

For example, we have already started to see the tip of this iceberg with respect to mortgage foreclosure scams. In the past year, the commission has filed several law enforcement actions against business entities and individuals that were targeting consumers faced with foreclosures. Generally speaking, those types of scams usually involve claims that if a consumer pays an upfront fee—often in the range of $500 to $1200—the defendant will save consumer's home from foreclosure by negotiating better terms with a mortgage lender. However, in most cases the foreclosure is not prevented by the scam artists. In addition to losing their homes, affected consumers may be left in worse shape because they followed instructions not to contact their mortgage lender and may have further damaged their credit history. And, of course, consumers are rarely to get those upfront fees refunded as promised.

Personal financial difficulties may also make consumers vulnerable to other scams or deceptive practices involving debt settlement offers, credit repair counseling, debt collection efforts and the extension of credit, including subprime lending. We at the FTC are engaging in comprehensive law enforcement and regulatory efforts—or at least trying to—in order to protect consumers from those practices.

Along the same lines, the commission has been aggressively investigating some of the practices that may have contributed to putting consumers into precarious financial situations in the first place. Now, to be sure, that's not always the case. Sometimes the problems are of the consumer's own making, but sometimes they are not. For example, the commission has challenged mortgage advertising that has promised low rates or low payment amounts but that has failed to disclose the short time period for those rates, or advertising that has failed to disclose that the loan is "negatively amortizing." The commission also recently settled an enforcement action

that alleged the defendants engaged in deceptive conduct while marketing Visa and MasterCard credit cards to consumers in the subprime market.

In addition to bringing law enforcement actions, the commission continues to foster efforts to educate consumers about the potential harms related to mortgage foreclosure rescue, debt settlement, credit repair, debt collection and a variety of other potentially deceptive and illegal practices.

I heard on the radio the other day that at least one consumer organization was counseling that all school children be obliged to take a course in financial counseling. And I thought to myself, maybe that's a good idea because, particularly in this environment, we have a lot of naive people. Nobody in this room perhaps, but that is the fact of the matter.

At the same time there is a recognition that more must be done to protect consumers and to help them in getting the disclosures and information they need before the harm has occurred. One respected commentator has proposed the creation of a single federal regulator that would be put in charge of consumer credit products. And I am referring to Elizabeth Warren now, in her University of Pennsylvania article. The hallmarks of that framework would include providing the administrative agency with a broad mandate rather than using piecemeal legislation. In addition, the authority over consumer credit products would be vested in a single federal regulator, so that the same regulation applies to all similar products, regardless of the identity of the lender. Another proposal for reform was issued by Secretary Paulson, who presented a conceptual model for a new financial regulatory structure, focused on functions rather than type of entity, to cover not only consumer credit, but also banking, insurance and securities industries.

While the framework for ensuring greater consumer protection and financial services has yet to be decided (that's now before the Congress), I think that the FTC should play an important role, not in ensuring the safety and soundness of financial institutions—we don't really, frankly, have much background or expertise in that, and the financial regulatory agencies do—but in protecting consumers in this area. Consumer protection has been the central mission of the FTC for many decades, and the agency has extensive experience not only in the enforcement of many consumer credit laws, but also in regulating advertising and consumer disclosures across a wide swath of industries and products. We have been recognized also as a leader in developing and distributing consumer and business education materials on a wide range of topics. And in this time of economic belt-tightening—which I think we ought to be doing—it arguably makes sense to reduce government spending by vesting consumer protection leadership in an existing agency, rather than in multiple agencies.

Let me conclude by emphasizing that I have done a lot of crystal ball gazing tonight. These are uncertain times, and many of the predictions I made are very uncertain. But one thing is certain, and it is that the FTC has much to learn from the financial crisis. And, if we don't learn from it, we are foolish. Thank you very much.

MR. PRAGER: Thank you so much for those thought-provoking remarks. Commissioner Rosch has graciously agreed that he would take a few questions, to my surprise, but he's always been willing to suffer those things. So if there is a question or two, we will take him up on his offer. We couldn't stop you from asking questions earlier today. Nobody has a question?

AUDIENCE MEMBER: [Inaudible]

COMMISSIONER ROSCH: Well, I suppose I could answer that question, because that merger will not come before us; it will come before Justice.

But as I have indicated, that may be a merger, depending on who the merger B side was or who the A side was, that would result in an entity that's too big to be effective. So I would take a very close look at it if I were an agency and had responsibility for that transaction.

MR. PRAGER: All right, I guess we are at the time of the evening where instead of belt-tightening, a belt-loosening is in order. It is time to adjourn for dessert.

As Stacey mentioned earlier, this is sponsored by a number of law firms, including each of our firms, who were gracious enough to do so.

Thank you for joining us tonight. The formal program is concluded. Enjoy.