Antitrust Quarterly

Issue 10 • Q2 • 06

MAYER BROWN ROWE & MAW

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Editors' note

In Europe, whilst it has been accepted that individuals have the right to recover damages for loss suffered as a result of an infringement of EC competition law, the European Court of Justice has only very recently put this beyond doubt in the *Manfredi* case, which is described in an article. The UK's second instance competition authority, the Competition Commission, has over the last few years clarified the decisional powers and role of the UK's first instance competition authority, the Office of Fair Trading. An article explaining the *MasterCard* decision by the Competition Commission describes another step in this jurisdictional process. Leniency and immunity from fines is increasingly encouraged by the European Commission and national competition authorities. The German competition authority has recently issued its leniency notice, and an article describes this notice and puts it in the context of the EU's recently issued leniency notice. Professor Damien Neven has been appointed by the European Commission as the Chief Economist to its competition department, replacing Professor Lars-Hendrik Roeller whose term has expired. Ms. Nadia Calviño has been appointed Deputy Director-General of the Commission's competition department. She will be responsible for developing and formulating EU/Commission policies in the field of mergers. She succeeds Mr. Götz Drauz. The antitrust and competition practice of Mayer, Brown, Rowe & Maw LLP has strengthened its practice with the hire of Margaret Peristerakis and Daniel Wiedmann, associates in the Brussels and Frankfurt offices respectively. A brief bio of all four is provided in a note.

In the USA, we address whether the Federal Trade Commission and the U.S. Court of Appeals for the District of Columbia Circuit decisions in the Polygram case provide useful guidance regarding the degree to which parties to joint ventures can enter into ancillary agreements to limit their competitive activities. An article also discusses Colgate programs in which a manufacturer attempts unilaterally to impose limits on the resale prices charged by its distributors, and the need for constant vigilance to ensure that, as implemented, these programs do not turn into illegal agreements regarding minimum resale prices. An article by guest authors Lawrence Wu and Alan J. Daskin of National Economic Research Associates (NERA) discusses alternative definitions of the fundamental economic concept of market power and how failure to properly and narrowly define this concept can have serious implications for antitrust enforcement. An article by David Hurtado, a partner in our Mexico City correspondent firm Jauregui, Navarrete y Nader, S.C., provides a summary of recent significant amendments to the Mexican Law on Economic Competition. An article discusses the FTC's recent merger review reforms and whether it is in a party's interest to take advantage of those reforms. We also look at recent legislative and agency activity regarding an issue on the minds of many Americans these days, gasoline prices and alleged "price gouging."

Kiran S. Desai (Brussels) and Scott P. Perlman (Washington, D.C.)

ECJ and European Commission encourage damages actions for breach of EC antitrust rules

It has long been accepted that individuals have the right to recover damages for loss suffered as a result of an infringement of EC competition law. The European Court of Justice ("ECJ") has only very recently put this beyond doubt, however, in the *Manfredi*[1] case. The decision coincides with the Commission's Green Paper on private damages actions, which aims to identify ways of facilitating private enforcement of EC competition law before national courts.[2]

Background: Private enforcement of EC antitrust rules

Article 81 EC prohibits agreements and concerted practices between undertakings that prevent, restrict or distort competition, while Article 82 EC prohibits unilateral conduct that constitutes an abuse of market dominance. Regulation 1/2003 makes it clear that private enforcement of EC competition rules before national courts has an essential role to play, complementing public enforcement roles of the Commission and the national competition authorities.[3] The courts charged with the responsibility of administering these actions are exclusively the national courts of the EU-Member States. There are no courts at EC level competent to hear damage actions brought by private parties for breach of EC antitrust rules.

Possibility of damage claims: The Courage case

Even though restrictions in an agreement that infringe Article 81 EC are void and unenforceable, there is no statutory basis in EC law for damage claims in this respect. It was not until the ECJ's *Courage*[4] decision before it became clear that some form of compensation is to be available to victims of breaches of Article 81 EC. In the *Courage* case, the court held that a party to an anti-competitive agreement could, under certain circumstances, claim damages from the other party. The ECJ based this claim on the principle of effectiveness, which is a general principle of European Community law. Pursuant to the principle of effectiveness ("*effet utile*"), provisions of EC law must be interpreted in a way that does not render their useful meaning ineffective. The court held that the full effectiveness of Article 81 EC would be at risk if it would not be open to "any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition."

The *Manfredi* case

In its *Manfredi* judgment of 13 July 2006, the ECJ reiterates the notion that damages are available for infringements of EC antitrust rules. In this case an Italian citizen and other individuals claimed damages from a number of Italian insurance companies that had been found by the Italian competition authority to have engaged in an unlawful exchange of information with a view to maintaining higher insurance premiums. The ECJ, for the first time, expressly recognizes the right of private litigants to claim compensation for loss suffered as a result of a breach of the EC competition rules. It also offers guidance on the definition of "damages."

Right of any individual to claim compensation

Ruling on a reference from an Italian court, the ECJ has confirmed that it must be open to any individual seeking damages for loss caused by a contract or by conduct liable to restrict or distort competition. Otherwise the effectiveness of Article 81 EC would be put at risk. The court stresses, however, that there must be a causal relationship between the harm and the agreement or practice prohibited by Article 81 EC.

The ECJ also stresses that the principle of effectiveness requires antitrust claimants to be able to seek compensation not only for actual loss but also for loss of profit, plus an award of interest, in accordance with applicable national rules.

Actions for damages are governed by national procedural laws

The ECJ makes it clear, that—in the absence of specific Community rules on the matter—the conditions for exercising the right to claim damages are to be determined by national laws. However, two important conditions apply in this respect: first, national rules on EC antitrust actions must not be less favorable than those governing similar actions under national law (**principle of equivalence**). Furthermore, the court again referred to the **principle of effectiveness** and stated that the national procedural rules must not make the exercise of rights conferred by Community law practically impossible or even excessively difficult. National laws not complying with these principles must be interpreted in accordance with Community law or may even be deemed inapplicable in specific cases.

Possibility of awarding punitive damages if this is foreseen by national laws

The ECJ further discusses whether Article 81 EC requires national courts to award punitive or exemplary damages and how damages for the breach of EC antitrust rules should be measured. It emphasizes that damages actions are subject to national procedural law, but that, again, the principles of equivalence and effectiveness must be observed. Therefore, in accordance with the principle of equivalence, a national court may award **punitive damages** for breach of EC competition law where it has the power to award punitive damages for breach of national competition law. The ECJ also stresses that the principle of effectiveness requires antitrust claimants to be able to seek compensation not only for actual loss but also for **loss of profit**, plus an **award of interest**, in accordance with applicable national rules.

Commission seeks to strengthen private claimants

In December 2005, the Commission published a Green Paper[5] and a more detailed Staff Working Paper[6] with an aim to remove obstacles on damages actions for breach of the EC antitrust rules. These papers are based on a study on the conditions for damages claims for infringement of EC Competition rules across member states.[7] The study found an "astonishing diversity" and "total underdevelopment" in the approach towards private antitrust enforcement across the EU.

Some of the main obstacles for antitrust litigation in the EU identified by the Commission are:

- **Access to evidence**

  Access by claimants to relevant evidence is considered to be one of the key factors for bringing damage claims. Existing national rules in the EC on document discovery favor competition authorities, but not private claimants. The Green Paper discusses several options for improving the access by claimants to documents held by the defendant and to files held by the relevant competition authorities. Furthermore, it outlines options for alleviating the claimant's evidentiary burden of proof.

- **Passing on defence**

  The existence of the "passing on" defence (claimant did not suffer any loss because the overcharge was passed on to its customers) has been identified as an obstacle to claims as it reduces the award paid to the direct purchaser and thereby also decreases his incentive to bring the claim. In addition, this defence may render claims of indirect purchasers practically impossible. The Commission discusses whether there should be rules restricting or even excluding the passing on defence, and whether indirect purchasers should have standing to bring actions.

- **Definition and quantification of damages**

  Defining and quantifying damages has been considered a key difficulty in bringing private actions. The Commission outlines various policy options for improving the availability of damages, including compensatory damages, recovery of illegal gain, and the award of pre-judgment interest.

- **Additional incentives for claimants**

  Besides focusing on remedies and procedures, the Staff Working Paper also reflects on additional incentives for claimants, which include punitive damages, collective actions, and a limitation on cost exposure. Currently, only the national laws of England, Ireland and Cyprus provide for the possibility of awarding **punitive or exemplary damages**. With regard to **collective actions**, the Commission notes that such actions will encourage consumers and purchasers with small claims to bring an action for damages for breach of EC competition law. Therefore the availability of collective actions is not only likely to lead to better protection of consumer interests, but also to save time and money by consolidating many small claims into one action. **Rules on cost recovery** have been identified as another disincentive for bringing an action. In all EC member states the loser has to pay the litigation costs. The Commission gives consideration to a rule that unsuccessful claimants will have to pay costs only if they acted in a manifestly unreasonable manner by bringing the case.

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Manfredi case indirectly supports the initiative of the Commission

The discussion initiated by the Commission may lead to changes in national laws on procedures and remedies available in cases of antitrust infringements. For instance, in 2005, Germany implemented changes in the national antitrust act which improved the availability of damages, for instance, by banning the passing-on defence. The Commission itself is not empowered to implement any reforms to improve private enforcement because the matter falls in the domain of the national legislatives. Nevertheless the *Manfredi* judgment indirectly supports the initiative of the Commission. The ECJ held that the national laws on antitrust actions must observe the principles of effectiveness and equivalence. Accordingly, a national law may be considered inapplicable if it renders it practically impossible to exercise the right to seek compensation for the harm suffered. For instance, in *Manfredi*, the court discussed a provision in Italian law on the limitation period for bringing antitrust damage claims. It held that a national rule under which the limitation period begins to run from the day on which the agreement or concerted practice was adopted could make it practically impossible to exercise the right to seek compensation for the harm caused by that prohibited agreement or practice, particularly if that national rule also imposes a short limitation period which is not capable of being suspended.

However, the ECJ left it to the national courts to decide on a case-by-case basis whether national laws are in compliance with these principles of Community law. Therefore, national judges have considerable leverage in assessing the conformity of national provision with the principle of effectiveness. In so far it seems at least doubtful that this jurisprudence alone will change the risk/reward balance in favor of bringing actions.

Conclusion

The recent Green Paper initiative of the European Commission and the *Manfredi* judgment back damages actions for antitrust infringements. While it is undisputed that private enforcement plays a vital role in ensuring the effectiveness of the antitrust provisions, there is also a necessity to avoid unintended or undesirable burdens on businesses that may, for instance, result from costly discovery proceedings.

While it is undisputed that private enforcement plays a vital role in ensuring the effectiveness of the antitrust provisions, there is also a necessity to avoid unintended or undesirable burdens on businesses that may, for instance, result from costly discovery proceedings.

In the *Manfredi* judgment, the ECJ establishes a solid foundation for private enforcement of EC antitrust law and lays down the principles of Community law that will govern private damage claims before national courts. Confirmation that such actions are subject to national procedural rules, which vary to a considerable extent between EU-Member States, also increases the likelihood that forum shopping may in the future play an important role in private EC antitrust litigation. Resolving any uncertainties that might have existed about the right of individuals to claim damages for loss suffered as a result of infringements of EC competition law may have opened the door to some interesting future developments.

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Competition Appeal Tribunal sets aside MasterCard decision

This article presents an overview of the recent Competition Appeal Tribunal's ("CAT") judgment in the long running case regarding the investigation and infringement decision by the Office of Fair Trading ("OFT") against MasterCard. The CAT's judgment is significant in a number of ways, particularly because the CAT was bold in asserting what it thinks are its powers when reviewing an OFT decision, in a clear attempt to encourage appellants to challenge the OFT in the future.

However, this judgment does not bring the MasterCard saga to an end, since the OFT has recently announced that it has started a new investigation based on arguments similar to those used in the original decision. It will be interesting to see whether, as is appears likely, the OFT will publish a new infringement decision against MasterCard, and whether the CAT will have to adjudicate on the OFT's decision for a second time.

Background to the order

On 6 September 2005, the OFT announced that it had decided that the collective agreement between members of MasterCard UK Member Forum Limited (MMF[1]) on the multilateral interchange fees (MIF) applicable to UK domestic transactions using MasterCard branded consumer credit and charge cards (between 1 March 2000 and 18 November 2004) infringed the Chapter I prohibition of the Competition Act 1998 and Article 81 of the EC Treaty.[2]

On 10 November 2005, the CAT published notices of appeals lodged by MasterCard UK Members Forum Limited (MMF), MasterCard International Incorporated, and MasterCard Europe Sprl, and by Royal Bank of Scotland Group challenging the decision of the OFT. Visa Europe Limited, Visa UK Limited (Visa), and the British Retail Consortium were given leave to intervene in the MasterCard appeal.

The OFT's defence was lodged on 28 February 2006. It was apparent from the defence—and conceded by the OFT at the subsequent case management conference of 31 March 2006—that in important respects the OFT's defence was substantially different from the OFT's decision.

On 2 February 2006, the OFT announced that it had launched a new investigation into whether MasterCard's new arrangements for setting fallback interchange fees for UK transactions using MasterCard credit and charge cards infringe Article 81 of the EC Treaty and/or the Chapter I prohibition of the Competition Act 1998.[3]

Meanwhile, following the appellants' replies to the OFT's defence, the OFT indicated in its submission to the CAT on 14 June 2006 that it was minded to withdraw the contested decision.

On 19 June 2006, the CAT held a hearing to ascertain a) whether MasterCard's appeal should continue considering the OFT's intention to withdraw the decision and the new OFT investigation, b) if the appeal does not proceed, what order should the Tribunal make to dispose of it, and c) the issue of costs. On the same date, the CAT made an order to the effect that the OFT's decision be set aside and the appellants be given leave to serve an application for costs.

Withdrawal or setting aside of the OFT decision?

The Royal Bank of Scotland and Visa accepted the OFT's argument that if the OFT was to withdraw its decision, then the appeal should not move forward. However, MasterCard argued that in principle it may be possible for the appeal to continue. In the alternative, if the CAT felt that the appeal should not move forward, then the CAT should set aside the OFT's decision. MasterCard argued that it was important for the CAT to adjudicate on the legality of the interchange fees and that the appellant had come to the CAT asking for a declaration to the effect that the OFT's decision was flawed and that there was no infringement of Article 81 or Chapter I of the Competition Act 1998 in this case.

MasterCard argued that the issue of whether the decision could be set aside rather than withdrawn was also important in light of the new investigation the OFT is currently pursuing in relation to the new MasterCard interchange fee scheme.

MasterCard argued that the issue of whether the decision could be set aside rather than withdrawn was also important in light of the new investigation the OFT is currently pursuing in relation to the new MasterCard interchange fee scheme. The OFT indicated when it launched its subsequent investigation that the outcome of the current proceedings was going to have a potentially decisive impact on the new investigation, since the OFT views the old and new arrangements as substantially similar. MasterCard argued that if the CAT was to set aside the decision and to make a declaration as to the legality of the interchange fee scheme, then it would be very unlikely that the OFT would continue with its new investigation and/or use the same arguments it used in the original decision in its subsequent investigation. If the CAT was to allow the OFT to withdraw its decision, this would result in continuing commercial and legal uncertainty and MasterCard would be faced with having to defend itself again once the OFT was to issue a new decision. It would also encourage the OFT to withdraw decisions in the future when it knows it might lose an appeal and embark on a similar investigation without the constraints of abuse of power.

OFT's powers to withdraw a decision after an appeal has began

Moreover, the appellant argued that the OFT has no unilateral power to withdraw its decision once the Appeal has started because there is no such power in statute for them to be able to do so. The CAT recognised that this issue had already been faced by the CAT in the *Association of British Insurers'* case[4] and in the *Association of Convenience Stores'* case[5]. MasterCard noted that those cases were different in that the appellants had received all the relief they had been seeking, therefore it was fair in those circumstances to allow the withdrawal of the contested decision and termination of the appeal. MMF argued instead that as a principle of administrative law, the OFT was entitled to withdraw its decision, although this was susceptible to judicial review. The issue in question was whether the OFT could be considered a public body exercising prerogative powers or a statutory body, whose powers are defined by statute. If the OFT is a statutory body, there is no legal basis for it unilaterally withdrawing its decision after an appeal has been lodged. Visa argued instead that the OFT had a power to withdraw its decisions and referred to European Community law in this area, where the European Commission withdraws its decisions once they have been appealed at the Court of First Instance, as it has done in the recent cases of *IMS Health and Bristol Myers Squibb*[6]. On withdrawal of the contested decision, there is nothing left to appeal against. Visa argued that the CAT could not set aside the decision as this would be outside its powers because the CAT is an appellate tribunal, not a court of trial.

CAT's powers to set aside the contested decision

MasterCard pointed out that since the CAT has exercised its powers in the past to find that there was an infringement[7] and substituted its decision for the OFT's decision, then in principle it is within the CAT's powers to decide that there is no infringement and set aside the OFT's decision. In the *Floe Telecom's* judgment ("Floe")[8], the Court of Appeal recognised that the CAT has such powers when it said that the CAT "*may feel able to decide itself what the current result should have been."* The Court of Appeal in *Floe* recognised that there may be circumstances where the setting aside of a decision does not discard of the appeal entirely so that the CAT could, in addition, come to a view as to whether the conduct of the appellants infringed Article 81 or Chapter I.

MMF pointed out that the CAT should evaluate where its powers lie in light of the *Floe* judgment where the Court discussed in which circumstances an appeal will be stripped of its substance. According to the *Floe* test, if the OFT withdraws its decision, this appears to leave nothing of substance to the appeal and the CAT will not be able to take its own decision. There would no longer be a dispute between the parties and, therefore, the CAT would have no jurisdiction to make a declaration. However, if the CAT was to set aside the decision, this would leave the CAT with some residual power to impose conditions or rule upon the reasons for setting the decision aside.

The OFT argued that the reason why it had to withdraw the decision was that it now had new further evidence about the alleged infringement in relation to the current MasterCard scheme, and since the OFT cannot adduce new evidence to the original decision, the right course is to withdraw the original decision and carry out a new investigation. The OFT referred to *Napp*[9] where it was said that the OFT cannot make a new case once it has further evidence unless it withdraws the original decision. Therefore, there was a procedural obstacle to the OFT continuing with the current proceedings before the CAT.

The OFT also pointed out that the CAT's role is to hear appeals against decisions, not making declarations as to legality of a decision. Only the European Commission can make a declaratory decision of non-infringement under Article 81. In the *Floe* judgment, the Court of Appeal held that the outcome of an appeal at the CAT involves the possibility of "whether the relevant decision is to stand, to be varied or to be set aside." This, according to the OFT, does not involve the CAT making a new decision. However, the OFT said that with regard to whether the decision should be withdrawn or set aside, the OFT saw no real difference in substance between the two courses of action unless the appellants were to indicate that they would bring the case to the Court of Appeal if the decision was withdrawn, in which case it would be better for the decision to be set aside.

The CAT's findings

The CAT did not agree with MasterCard's argument that the appeal should continue and that the CAT should make a declaration to the effect that the OFT's decision was flawed and that there was no infringement of Article 81 or Chapter I of the Competition Act 1998. Instead the CAT found that the appeal should come to an end and the OFT's decision be set aside.

However, the CAT did not accept the OFT's argument that it would not have the power to make a declaration as to the merits of the OFT's decision. The CAT drew attention to Schedule 8, paragraph 3(2)(e) of the 1998 Act which provides that the Tribunal may "make any decision which the OFT could itself have made." Therefore, in theory the CAT could have granted to MasterCard the relief sought in its notice of appeal by making a declaration in relation to the merits of the OFT's decision. However, the CAT noted that in the particular circumstances of this case, whether the decision is withdrawn or set aside, the appellants would have obtained all the relief they seek in these proceeding. For the CAT in those circumstances to go on to adjudicate on the declaration sought by MasterCard would involve a substantial investigation of the merits in the light of the arguments advanced in the defence, and in the light of the replies and any further evidence submitted by the OFT in the rejoinder. The CAT considered that, in the light of the views expressed by VISA and the OFT, it was essential that a case with potentially worldwide implications should proceed on a sound procedural basis. The CAT was not satisfied that the procedural foundation for continuing with the appeal was sufficiently secure to justify the CAT doing so, particularly given the extensive new material, not contained in the decision, upon which the OFT seeks to rely.

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It should be noted that in making its decision the CAT was conscious of the parallel European Commission ("Commission") proceedings into MasterCard's interchange fees and that, following the first Statement of Objections ("SO") sent to MasterCard in 2003, a supplementary SO was now imminent. The CAT felt that if the appeal was allowed to continue, it would run parallel to Commission's proceedings that would touch on similar issues and that may not be desirable. In fact, soon after the hearing, the Commission announced that it had sent a supplementary SO to MasterCard on 23 June 2006. In its SO the Commission takes the preliminary view that MasterCard restricts competition between member banks by pre-determining a minimum price retailers must pay for accepting MasterCard and Maestro branded payment cards. The Commission's preliminary view is that such behaviour is contrary to the Article 81 which bans such restrictive business practices. The CAT felt that although the European proceedings are dealing with international rather than domestic interchange fees, they are likely to bear upon certain points of principle that MasterCard wished to argue in proceedings before the CAT and such overlap would not be helpful.

As to the issue of whether the decision should be withdrawn or set aside, the CAT felt that there was no need to rule on the question of whether the OFT has unlimited power to withdraw a decision once appeal proceedings have started. The CAT was of the view that the OFT had followed the correct procedure by suggesting its intention to withdraw the decision to the CAT, while in fact not withdrawing the decision until the CAT and the parties

"MasterCard decision" continued on page 52

Structuring joint ventures in the wake of PolyGram Holding, Inc.

Antitrust law increasingly has recognized over the past three decades that firms can generate pro-competitive consumer benefits by collaborating to create joint ventures. Joint ventures that create a new product,[1] allow for one-stop shopping,[2] provide more efficient production facilities,[3] allow for better safety and customer service,[4] and provide for cooperative research,[5] have been found to be "not only benign, but pro-competitive."[6] The Department of Justice's Antitrust Division ("DOJ") and the Federal Trade Commission ("FTC") have explicitly recognized this principle, and "have brought relatively few civil cases against competitor collaborations."[7]

In *PolyGram Holding, Inc. v. Federal Trade Commission*,[8] the FTC and the D.C. Circuit condemned restraints associated with a joint venture between two record companies.[9] While *PolyGram* has some doctrinal significance,[10] as a practical matter, *PolyGram* does not provide a shining light to guide joint venture parties. The Commission and the D.C. Circuit gave weight to the fact that the challenged restraints were on non-venture products. However, as the case law demonstrates, what is "inside" the venture and what is "outside" the venture is open to interpretation. The Commission also considered it significant that the restraints were adopted well after the joint venture had started to operate. In other circumstances, the timing has not been considered significant. Finally, the Commission rejected PolyGram's free riding argument, even though it was a theoretically plausible argument that had been accepted in other cases.

The practical lessons of *PolyGram* are that form matters, facts matter and that clients should listen to their lawyers.

The *PolyGram* decision

The *PolyGram* case arose from a joint venture involving three of the world's greatest opera singers. The famed "Three Tenors"—José Carreras, Placido Domingo, and Luciano Pavarotti—were huge soccer fans. In 1990, the night before the World Cup soccer finals in Rome, the Three Tenors performed a concert that was a critical and popular blockbuster. The record album that resulted from the concert ("3T1"), which was produced by PolyGram, became one of the best-selling classical music albums of all times.[11]

In 1994, the World Cup Finals were held in Los Angeles, California, and a similar Three Tenors Concert took place. For a variety of reasons, PolyGram was not selected to distribute the album resulting from the 1994 concert. Instead, Warner Music ("Warner") negotiated to obtain a waiver of Pavarotti's exclusive contract with PolyGram,[12] and Warner distributed the 1994 concert album ("3T2"). Meanwhile, PolyGram took advantage of the publicity from the Los Angeles concert and 3T2, and discounted and advertised 3T1 while 3T2 was being released.[13] Despite the competition from 3T1, 3T2 was a major commercial success and both 3T1 and 3T2 remained on the top-ten classical list throughout 1994, 1995, and 1996.[14]

With the World Cup Finals set for Paris in July 1998 and another Three Tenors Concert planned, Warner again approached PolyGram about obtaining a waiver to the Pavarotti exclusive. PolyGram suggested instead that the two companies become partners on the next album ("3T3").[15] In late 1997, PolyGram and Warner came to an agreement for the distribution of 3T3. The two companies agreed to split the worldwide profits equally, establishing that Warner would distribute 3T3 in the United States, while PolyGram would distribute 3T3 outside the United States. PolyGram and Warner agreed to consult with one another on all "marketing and promotional activities" for 3T3, but each company retained the right to market and distribute 3T1 and 3T2 without limitation.[16]

PolyGram's General Counsel learned of the moratorium agreement. Soon after, PolyGram's Senior Marketing Manager sent a memorandum around the company stating, "Contrary to any previous suggestion, there has been no agreement with [Warner] in relation to the pricing and marketing of the previous Three Tenors albums." Warner then sent a letter to PolyGram repudiating any pricing or advertising moratorium.

Starting in January 1998, PolyGram and Warner marketing personnel began to meet to discuss the marketing of 3T3. At some of the early meetings, the marketing personnel expressed concerns about the effects of marketing 3T1 and 3T2 during the launch of 3T3. Accordingly, the two companies suggested a "moratorium" on discounting and advertising 3T1 and 3T2 during the launch of 3T3. However, the Warner European sales group continued to discount 3T2, and the two sides abandoned the moratorium.[17]

As the concert approached, PolyGram and Warner became more and more concerned that 3T3 would not distinguish itself. Specifically, the concert promoter informed the two companies that the repertoire for the concert would overlap substantially with the songs on 3T1 and 3T2.

Both PolyGram and Warner executives believed that the commercial viability of 3T3 was in jeopardy.

Around the time of the concert, PolyGram and Warner exchanged letters reaffirming their commitment to a moratorium on advertising and discounting 3T1 and 3T2 during the launch of 3T3. About a week later, PolyGram's General Counsel learned of the moratorium agreement. Soon after, PolyGram's Senior Marketing Manager sent a memorandum around the company stating, "Contrary to any previous suggestion, there has been no agreement with [Warner] in relation to the pricing and marketing of the previous Three Tenors albums." Warner then sent a letter to PolyGram repudiating any pricing or advertising moratorium.[18]

About a week after this exchange, the PolyGram and Warner executives spoke on the phone, and repudiated the repudiation. Instead, the executives agreed that there would be a moratorium on advertising and discounting, and behaved consistently with that agreement.[19]

The Federal Trade Commission learned about the moratorium, and investigated. Warner settled with the Commission before trial, but PolyGram did not and the case was heard by an

Administrative Law Judge under the FTC's rules.[20] The parties stipulated that most business documents, and the parties' expert reports, would be admitted. FTC's Complaint Counsel put on its case for about a week (including two experts), closing its case on Friday afternoon. On Monday morning, PolyGram announced that it would rest without putting on any witnesses.[21]

The Administrative Law Judge condemned the restraints. The full Commission affirmed the initial decision. In particular, the Commission held that restraints on price and advertising were "inherently suspect" and would be condemned in the absence of cognizable and plausible efficiency justifications. The Commission specifically rejected PolyGram's argument that any restraint adopted in the context of a joint venture was subject to analysis under the full rule of reason.

The D.C. Circuit affirmed. The Circuit Court held that the Commission did not err in its analysis. The Court endorsed the Commission's *Mass Board* approach, holding that the restrains at issue were inherently suspect, and that PolyGram had failed to proffer valid efficiency justifications. Both the FTC and the D.C. Circuit considered three issues: the legality of restraints on non-venture products; the significance of restraints entered into after the formation of the venture; and the role of free riding in joint venture analysis.

Inside versus outside

In general, restraints on products of the venture (*i.e.*, "inside" the venture) will tend to undergo less antitrust scrutiny than restraints on products that are not part of the venture (*i.e.*, "outside" of the venture).[22] In *PolyGram*, both the Commission and the D.C. Circuit held that it was important that the restraints at issue were on products "outside" of the venture. In its Opinion and Order, the Federal Trade Commission held that the fact that the restraints were on non-venture products is significant:

> Respondents have not cited any cases, nor are we aware of any, in which restraints on the sales of non-joint-venture products have been upheld as ancillary to the production of efficiencies by the joint venture itself. On the contrary, the Commission has long recognized that restraints on activities "outside the ambit of the joint venture" cannot be hidden under its cloak. [Citations omitted].

The D.C. Circuit affirmed the FTC's conclusion that the agreement between PolyGram and Warner was likely anticompetitive, stating: "An agreement between joint venturers to restrain price cutting and advertising with respect to products not part of the joint venture looks suspiciously like a naked price fixing agreement between competitors, which would ordinarily be condemned as *per se* unlawful."[23]

While the *Polygram* case highlights the risks of restraints on non-venture products, the rule is far from clear. For example, the antitrust agencies' *Collaboration Guidelines* make clear that restraints on non-venture products are not necessarily subject to summary condemnation. In Example 10, the agencies describe a joint venture to produce a new product involving competing software companies. The venture parties agree to restrict research and development on competing non-venture products, and to withdraw potentially competing products from the market. The example also suggests that contemporaneous documents indicate that the venture

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will not go forward without these restraints. Under these circumstances, the agencies suggest that the restraints would be analyzed under the rule of reason and not summarily condemned: "Although the agreement prohibiting outside sales might be challenged as per se illegal if not reasonably necessary for achieving the procompetitive benefits of the integration…the evaluating Agency likely would analyze the agreement under the rule of reason if it could not adequately assess the claim of reasonable necessity through limited factual inquiry."[24]

Simply put, there is no clear rule against restraints on pre-existing products as part of a joint venture. The FTC confirmed this in its appellate brief to the D.C. Circuit, where it wrote: "[T]he Commission acknowledges [that] valuable efficiencies can sometimes be achieved by integrations that entail the restriction or even elimination of pre-existing products. Where, however, the restraint extends beyond the scope of the economic activities the venturers have sought to integrate, it is no longer related to the creation of efficiencies" and is not ancilliary.[25]

Early versus late

The *Collaboration Guidelines* are very clear in stating that a restraint must be reasonably related and reasonably necessary to achieving the procompetitive benefits from an integration.[26] In the initial decision in the *PolyGram* case, the Administrative Law Judge held that the moratorium could not have been reasonably necessary for the creation of 3T3 because it was discussed only after the formation of the venture:

It is clear that there is no black line rule against adopting restraints after the formation of a venture, but that it is better to agree to the restraints as part of the formation.

> The moratorium agreement was not necessary for the creation of 3T3. The negotiators of the 3T3 joint venture did not have it in their minds while creating the joint venture and in fact specifically agreed that they could continue to exploit 3T1 and 3T2 during the sale of the venture product 3T3. The belated moratorium may have been intended to support the introduction of 3T3, but it was created months after the joint venture agreement.
>
> Further, Warner successfully introduced 3T2 in 1994 in the face of serious competition, with discounts and advertising, by PolyGram's 3T1. [citations omitted]. Unless Respondents meet their burden of showing an efficiency justification, the moratorium agreement therefore would not be ancillary to the joint venture.

This ruling does not mean that parties cannot adopt restraints after the formation of the joint venture. For example, in *Polk Bros., Inc. v. Forest City Enterprises, Inc.*,[27] the joint venture partners, both retailers, agreed to construct a building that they would share. Six years after initiating the joint venture, the parties agreed not to sell products at the joint building that the other already was selling. Likewise, in *Rothery Storage and Van Co. v. Atlas Van Lines, Inc.*,[28] a restraint on competition with the joint venture van lines by members of the venture that was adopted after the formation of the venture was found not to be inherently suspect.

Again, it is clear that there is no black line rule against adopting restraints after the formation of a venture, but that it is better to agree to the restraints as part of the formation.

Free riding or spillover

In creating joint ventures, parties often are concerned about whether all partners will commit themselves to making the venture a success. A venture also can create incentives for a party to take advantage of the other members of the venture by allowing them to incur disproportionate costs associated with making the venture a success. This type of activity commonly is described as "free riding."

In *PolyGram*, the Respondent argued that the restraints were necessary to avoid free riding. PolyGram contended that, if there were no restraints on 3T1 and 3T2, the venture partners would draw sales away from 3T3 by aggressively promoting 3T1 and 3T2.

This argument was squarely rejected by the FTC and the D.C. Circuit. The FTC characterized the "free riding" behavior that the Respondents claimed as "an essential process of competition that occurs daily throughout our economy."[29] The Commission analogized the situation to one where an auto company brings a new SUV onto the market, and this increases overall interests in SUVs. While a restraint on advertising or discounting other SUVs may make the new product more profitable, the Commission argued that it cannot be a cognizable efficiency.

The D.C. Circuit agreed with the Commission's analysis. While noting that "[a]t first glance PolyGram's contention has some force," the D.C. Circuit characterized PolyGram's proposed free riding as argument "nothing more than the competition of products that were not part of the joint undertaking:"

> Why not an agreement by which PolyGram and Warner would eliminate advertising and price competition on all their records for a time while they focused exclusively upon promoting the new Three Tenors album? The "procompetitive" justification PolyGram offers is "nothing less than a frontal assault on the basic policy of the Sherman Act."[30]

The Commission analogized the situation to one where an auto company brings a new SUV onto the market, and this increases overall interests in SUVs. While a restraint on advertising or discounting other SUVs may make the new product more profitable, the Commission argued that it cannot be a cognizable efficiency.

Notwithstanding the FTC's and the D.C. Circuit's rejection of the "free riding" claim, free riding remains a legitimate business justification for an ancillary restraint. In *Rothery*, the D.C. Circuit explicitly recognized that free riding "can become a serious problem for a partnership or joint venture because the party that provides capital and services without receiving compensation has a strong incentive to provide less, thus rendering the common enterprise less effective."[31] Likewise, in *Polk Bros.*, the Seventh Circuit recognized that if Polk spent substantial sums in advertising to attract customers to its stores, but another retailer reaped the benefit, "Polk would not continue doing the work while its neighbor took the sales. It would do less demonstrating and promotion, to the detriment of consumers who valued the information." [32] Similarly, in the agencies' *Collaboration Guidelines*, the FTC and DOJ explicitly recognize that a restraint can be reasonably necessary if it "deters individual participants from undertaking free riding or other opportunistic conduct that could reduce significantly the ability of the collaboration to achieve cognizable efficiencies.[33]

The FTC itself in *PolyGram* explicitly endorsed the idea that free riding can have economic consequences. However, the distinction that the FTC and the D.C. Circuit both made—that free riding on extra-venture products is not legally cognizable—is ultimately unsatisfying. Certainly it is true that, if Pepsi-Cola has a successful promotional campaign, it could increase the demand for cola and therefore the sales of its fierce rival Coca-Cola (certainly much to Pepsi-Cola's dismay). No one would ever suggest that Coca-Cola and Pepsi-Cola should be allowed to coordinate their advertising or discounting campaigns.

Nonetheless, there is a harder question, which remains unanswered. Suppose that General Motors and Toyota engaged in a joint venture to create a next generation mini-van. To generate interest, the joint venture spends millions on advertising. It seems wrong to allow GM and Toyota to agree not to discount the Chevrolet Aveo or the Toyota Corolla on the grounds that this is necessary to promote the venture; however, it does not seem unreasonable to ask the parties to discontinue promoting competing mini-vans to ensure the parties are focused on making the venture a success. Both inquiries would turn on whether the failure to have a restraint would deter the parties from engaging in pro-competitive behavior.

In light of this, the rejection of the PolyGram free riding argument and subsequent condemnation of the Three Tenors restraints should be viewed not as a flawed theory, but rather as a failure of proof. By the time the case got to the ALJ, it was clear that the restraints would not have had any impact on the continuation of the venture, or the amount of its promotion. The parties had canceled and reinstated the moratorium no fewer than three times, and there was no evidence presented that showed that the absence or presence of the moratorium had any impact on the promotion of 3T3. In addition, PolyGram rested its case without putting on its economists, leaving only the FTC's live expert testimony and PolyGram's expert reports. The ALJ concluded that PolyGram's expert opinions were not cross-examined and therefore should be accorded little weight. The fact is that the ALJ, the Commission and the D.C. Circuit did not believe free riding was a problem, and therefore had difficulty crediting it as a reason to uphold the legality of the restraint.

***PolyGram* stands for a number of important legal points, but it does not provide a roadmap on how to structure a joint venture and related restraints to avoid antitrust problems.**

Practical advice on avoiding the *PolyGram* problem

PolyGram stands for a number of important legal points, but it does not provide a roadmap on how to structure a joint venture and related restraints to avoid antitrust problems. However, there are a few principles that, if adhered to, will lend valuable guidance.

First, form matters. Had PolyGram and Warner decided to contribute 3T1 and 3T2 to the 3T3 joint venture, then the analysis would have been very different and the FTC would have had a much more difficult case. While this runs contrary to most antitrust lawyers' instinctive response that less integration generally is safer, in this case it would have brought all three albums "inside" the venture.

Second, facts matter. The restraints in this case were condemned in large part because it was impossible for the ALJ, the FTC and the D.C. Circuit to really believe that the restraints that PolyGram and Warner instituted were necessary with respect to any legitimate purpose of the venture. At the end of the trial, the evidence demonstrated that PolyGram and Warner had thought of the restraint as an after-the-fact response to the reality that 3T3 was going to be an artistic and commercial flop. The restraint could not be important to the creation or efficient marketing of the venture, because nothing changed as the moratorium faded in and out of the venture. PolyGram was left in the uncomfortable litigation position of having to rely entirely upon its economists to make theoretical arguments in support of the restraint not based on facts; this may have been why PolyGram decided not to call its experts to the

"PolyGram" continued on page 48

Colgate programs are not "no-brainers"

A "sleeper" among the antitrust cases decided this year was the Fifth Circuit's per curiam opinion in *PSKS, Inc. v. Leegin Creative Leather Products, Inc.*, 2006-1 Trade Cas. (CCH) ¶ 75,166 (5th Cir. 2006), reminding us that although Colgate programs have grown increasingly popular, they are not foolproof and require continuous attention to ensure their success.

You probably know the Colgate saga: The Supreme Court declared resale price maintenance per se unlawful in 1911 in the *Dr. Miles* case, *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), but in 1919, in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), it held that if there is no bilateral agreement on resale prices, a manufacturer or other supplier lawfully may announce a unilateral policy to sell only to dealers that charge no less than a specified price and refuse to deal with those that fail to comply—because the Sherman Act requires a contract, combination or conspiracy. In subsequent years, the Court narrowed this doctrine, culminating in its 1960 *Parke Davis* decision, *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960), so that the *Colgate* approach came to be considered so narrow a channel that it could only be navigated with a program of "Doric simplicity."[1] Lower court decisions reinforced the principle that efforts to persuade a dealer to adhere could easily evidence an illegal bilateral agreement between the manufacturer and the dealer, leaving available only the blunt instrument of refusing to deal. As a consequence, *Colgate* programs fell out of favor as a means of influencing resale prices. In 1981, the Federal Trade Commission tried to overrule *Colgate* completely in its *Russell Stover* decision, *Russell Stover Candies, Inc. v. FTC*, 718 F.2d 256 (8th Cir. 1983), only to be reversed on appeal. Then, in 1984, in the *Monsanto* decision, *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), the Supreme Court reaffirmed *Colgate* and the trend away from *Colgate* programs began to reverse itself. Today, scores of companies have adopted *Colgate* programs, and several lower court cases have upheld them.

Nevertheless, a program must remain scrupulously unilateral to enjoy the protection of the *Colgate* doctrine, and if it morphs into a bilateral agreement between the supplier and the dealer to charge no less than a specified resale price, it can fall out of the *Colgate* safety net and into the fires of per se illegality.

In *PSKS*, a manufacturer of women's accessories instituted a typical *Colgate* program, stating that it would only do business with retailers that charged specified prices when reselling its products. Subsequently, it introduced a store-within-a-store concept by which retailers featured its products in a separate section of their stores. To participate in this program, retailers actually needed to pledge to follow the manufacturer's specified resale prices at all times. When one retailer put the manufacturer's products on sale at discounted prices, the manufacturer suspended all shipments. The retailer's fortunes plummeted and it sued.

The case was tried to a jury, which awarded damages to the retailer, and the Fifth Circuit affirmed. The manufacturer argued that it was improper to apply a rule of per se illegality to its program because recent Supreme Court cases have applied the rule of reason to more and more distribution restrictions, including maximum resale price fixing and agreements to terminate discounters without fixing specific resale prices. The Fifth Circuit pointed out that these cases were inapposite and that per se illegality still applies to vertical minimum price fixing.

This is no surprise, but it provides a wake-up call to anyone inclined to forget that *Colgate* only applies when it is followed consistently. Not every program that begins as a *Colgate* program remains a genuine *Colgate* program. A unilateral *Colgate* policy statement may still provide a potent means of influencing resale prices, but it does not immunize a manufacturer against entering into outright price fixing agreements with its dealers as its business evolves, particularly if its personnel lose sight of what *Colgate* requires. A word to the wise: *Colgate* programs may have become common but they cannot run on auto-pilot. Continuing vigilance is still a must.

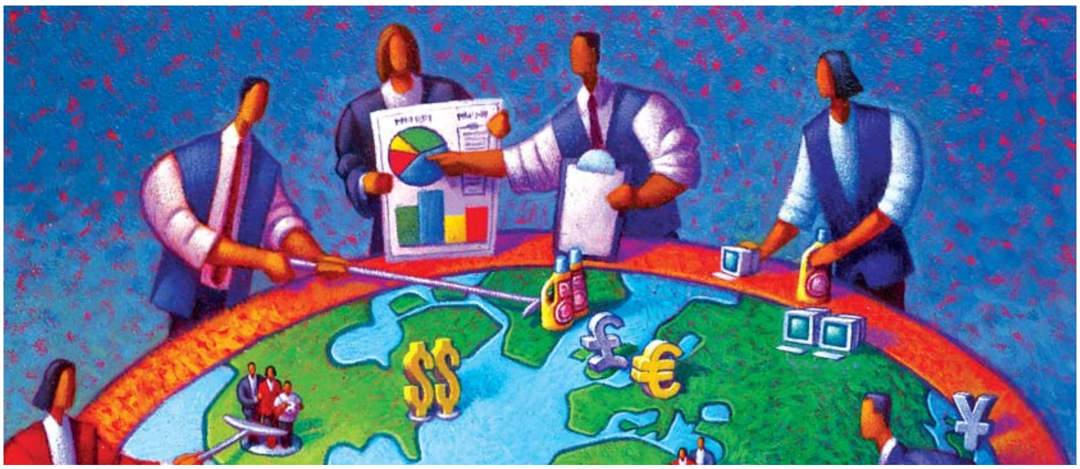
Richard Steuer (New York)

Endnote

1 *Warner & Co. v. Black & Decker Mfg. Co.*, 277 F.2d 787 (2nd Cir. 1960).

Brief observations on the multiple dimensions of market power

Market power is probably the most-often-used term and concept in antitrust and competition policy, yet its meaning is open to much debate and interpretation. Courts, agencies, practitioners, and economists routinely wrestle with issues surrounding market power—whether a merger will enhance market power, whether particular conduct or pricing policies reflect the exercise of market power, and whether market power is synonymous with harm to competition. Although the basic concept stems from textbook economic models of perfect competition and monopoly, the practical implications of the analysis of market power are complex enough to have inspired an entire handbook on the subject.[1]



Indeed, even the definition of the term "market power" is unsettled. Consider, for instance, the following definitions of market power, each of which has very different implications for an antitrust analysis of market power:

Definition 1: the power to control prices or exclude competition.[2]

Definition 2: the ability of a single seller to raise price and restrict output.[3]

Definition 3: the ability to raise prices above the levels that would be charged in a competitive market.[4]

Definition 4: the ability of a firm or group of firms within a market to profitably charge prices above the competitive level for a sustained period of time.[5]

The first definition is the broadest of the four. If all that is required is the power to control prices, then all firms have some market power. After all, firms can set their prices as high or low as they like. Likewise, the ability to exclude competition is overly broad. Many firms can literally exclude "competition." Manufacturers can limit the number of dealers that distribute their products, franchisors do not have to contract with all comers, and retailers can selectively choose which products they want to place on the retail floor and shelves. Yet none of those actions would imply the possession of market power in a meaningful antitrust sense. To be sure, the "power to exclude" is important because without the ability to exclude competition, a firm may not have much market power, if any, in the long term. Nonetheless, the broad wording in the first definition potentially indicts all firms, raising the possibility that there are forms of market power that are not necessarily synonymous with anticompetitive effects or harm to competition.

The second definition (the ability of a single seller to raise price and restrict output) is a refinement: It focuses on price increases and reductions in output, which reduce consumer welfare. All else equal, consumers are worse off if they pay higher prices. However, without a reference point, the definition could encompass a broad range of market events and strategies that do not reflect harm to competition. Without reference to changes in costs or features of the underlying product, for example, a price increase—even if it is entirely justified—might be deemed an exercise of market power under the second definition.

The third definition (the ability to raise prices above the levels that would be charged in a competitive market) is a further refinement, because it adds the concept of a competitive benchmark. However, the definition does not actually specify what might constitute a competitive benchmark.

The fourth definition adds two other conditions: profitability (i.e., the price increase must be consistent with profit-maximizing behavior) and the requirement that a supracompetitive price be sustained for a long period of time. The profitability condition is particularly important because it refers not only to the ability to raise prices but also to the incentive to do so. The ability to sustain a supracompetitive price increase over time is also useful in focusing our attention on markets where new entry and expansion by existing rivals are not likely to be effective or timely sources of competitive discipline.

The concept of market power stems originally from a comparison of the assumptions and implications of the textbook models of perfect competition and monopoly.

The concept of a competitive benchmark, the profitability of pricing above competitive levels, and the ability to set prices above competitive levels over a long period of time are important considerations when evaluating whether market power raises antitrust concerns. In this article, we address the first two of these issues, starting with a discussion of the economic foundations for definitions of market power. While most definitions of market power refer to control that a firm either has or does not have over prices and competitors' entry, analyses of market power should be more nuanced. The focus should be on *the degree to which* prices or profits exceed competitive levels and *how long* they can be sustained. Such analysis requires a clear specification of the competitive benchmark as well as other relevant evidence that can help fact-finders distinguish "market power" that nearly all firms have from the market power that raises antitrust concerns.

The economic foundations for definitions of market power

The concept of market power stems originally from a comparison of the assumptions and implications of the textbook models of perfect competition and monopoly.

Perfect competition

In a market characterized by perfect competition, all firms produce identical products, and each individual firm is so small relative to the market as a whole that the firm's output decisions have a negligible effect on total output or market price. Moreover, there are no impediments to entry by firms that are not currently in the market.

In the textbook model of perfect competition, the prevailing price equals the marginal cost of production.[6] An attempt by the firm to raise price would be futile: Because competitors produce the same product, existing customers of any firm that raises price would defect en masse to competing firms.[7] Thus, in antitrust parlance, firms in a perfectly competitive market do not have "power over price." Firms in a competitive market are instead "price-takers," taking the price dictated by the interplay of market demand and supply. They choose their profit-maximizing output by finding the quantity at which their marginal cost just equals the market price.

Moreover, in the perfectly competitive model, there are no barriers to entry, a feature that is consistent with the first definition above and with most real-world assessments of market power: In a market without barriers to entry, no firm has the power to exclude competition.[8]

The model of perfect competition, therefore, provides one definition of the competitive pricing benchmark that is referred to in definitions 3 and 4 above: In a perfectly competitive market, the prevailing price would be the competitive price, and that price equals the marginal cost.

The ultimate monopoly

The textbook model of monopoly also helps us understand what we mean by "power over price." With no rivals in the marketplace and protected by barriers to entry, a monopolist *does* have a choice regarding the price that it can charge; it is not a price taker. As a result, a monopolist can set its prices at the level that maximizes profits. In contrast, a competitive firm does not set the price; it takes the market price as given, choosing its output so as to maximize its profits at that price.

The textbook model of monopoly also helps us understand what we mean by "power over price." With no rivals in the marketplace and protected by barriers to entry, a monopolist does have a choice regarding the price that it can charge; it is not a price taker. As a result, a monopolist can set its prices at the level that maximizes profits.

Moreover, a monopolist's profit-maximizing price will exceed its marginal cost. That is because profit-maximizing firms choose the quantity at which marginal revenue equals marginal cost (MR = MC).[9] For the monopoly, however, the MR = MC condition, combined with the fact that the firm faces a downward-sloping demand curve, implies that the monopoly's profit-maximizing price *exceeds* its marginal cost at the firm's profit-maximizing quantity.[10] In other words, a monopolist has the ability to profitably set price above marginal cost.

Supracompetitive pricing: A closer look at the competitive benchmark

As already noted, definitions of market power often refer to pricing above competitive levels (e.g., definitions 3 and 4 above). Based largely on the standard model of perfect competition, some definitions of market power refer to a firm's ability to set price above marginal cost.[11] Many practitioners also assess market power using the price-cost margin, which is defined as the percentage markup of price over marginal cost.[12] In many cases, however, firms may charge a price that exceeds their marginal cost without having "power" in a sense that does—or should—offend the antitrust laws, in which case the marginal cost would not be an appropriate proxy for the competitive price.

Three examples of pricing above marginal cost: Is marginal cost the right benchmark?

In many markets, for example, prices are determined by the cost of the "marginal seller." For instance, consider the markets for many natural resources. There are many competing suppliers with different levels of efficiency. Because firms face capacity constraints, however, price will exceed marginal cost for all but the least efficient firm in the market. In fact, prices are determined by that "marginal seller," whose marginal cost, while higher than other firms' costs, is just equal to price. In these markets, the efficient but capacity-constrained sellers are able to price above their marginal cost, yet the prevailing market price and the process by which prices are determined are generally considered competitive.

For another example, consider a so-called "monopolistically competitive" market. Such a market differs from a perfectly competitive market in one important respect: Because firms' products are slightly differentiated from each other—as is true in virtually all actual markets—individual firms face demand curves that slope downward. Unlike firms in a perfectly competitive market, sellers in a monopolistically competitive market can raise price without losing *all* of their customers to other firms. Because of free entry, however, firms in a monopolistically competitive industry lack the ability to exclude competition. Consequently, they cannot earn supracompetitive profits in the long run. From an antitrust perspective, therefore, it makes little sense to say that they have meaningful "power" over price. Free entry in this type of market guarantees that prices will fall to the point at which firms no longer earn abnormal profits.

Inferring the anticompetitive exercise of market power from prices above marginal cost may also be inappropriate because of the cost structure of the industry. In some cases, the technology of production or the nature of costs precludes sustainable pricing at marginal cost. That is, although the firm *could* set the price equal to marginal cost, it would lose money by doing so. To understand why, suppose, for example, that the firm incurs marginal costs that are constant—i.e., the marginal cost per unit neither increases nor decreases as output increases—as well as fixed costs each period that are independent of the level of output. In that case, if the firm sets price equal to marginal cost, it will cover *only* its marginal costs each period; its need to incur each period's fixed costs guarantees that the firm will operate at a loss.

Inferring the anticompetitive exercise of market power from prices above marginal cost may also be inappropriate because of the cost structure of the industry. In some cases, the technology of production or the nature of costs precludes sustainable pricing at marginal cost.

More generally, it is likely that such analysis applies to many firms that have low or negligible marginal costs but substantial and recurring fixed or sunk costs. Pharmaceutical manufacturers, for example, expend substantial sums on research and development for new products, but the marginal cost of actually producing each pill or unit of the product is typically small. Similarly, software firms spend considerable time and money on development of new or updated software, but the marginal cost of producing a diskette or compact disc with the new code is trivial. In fact, some commentators claim that such cost structures are quite typical:

> The industries that are the hallmark of the "new economy" are characterized by a special cost structure. From software to semiconductors, digital entertainment to biotechnology, and in innovative fields more generally, the standard cost pattern entails sunk outlays that are large and must be incurred over and over again, but the marginal cost—the cost of serving an additional customer—is virtually negligible.[13]

Under such cost conditions, a firm may set its price above marginal cost to recover its fixed or sunk costs. Such cost structures also may force firms to adopt discriminatory pricing to remain viable. If a firm charges different prices to different customers, then it must be setting at least some of its prices above marginal cost. But it is hard to argue, in general, that antitrust should condemn such firms for exercising "market power" simply because they must set prices above marginal cost to avoid sustaining continuing losses.

All of these examples suggest the need to revisit some of antitrust's conventional thinking about market power, particularly inferences of market power simply from the observation that price exceeds marginal cost or, equivalently, that the firm faces a downward-sloping demand curve.

Rethinking the competitive benchmark

One possible approach is to continue to use marginal cost as the competitive benchmark when defining and assessing market power but recognize that possession of market power does not necessarily imply any anticompetitive effects. The fact-finder could then consider other relevant evidence (e.g., rivalry among competitors and entry conditions) to judge whether the possession of, exercise of, or increase in market power warrants an inference of anticompetitive effects or consumer harm.[14]

An alternative approach would be to develop other measures or definitions of market power instead of, or in addition to, those that focus on the relationship between price and marginal cost. Consider, for instance, the approach suggested by William Baumol and Daniel Swanson, who question the inference of market power from the observation that price exceeds marginal cost:

Whether we choose to focus on prices or profits, neither economic theory nor the law provides guidance on how high they must be before they constitute antitrust market power or imply anticompetitive effects.

> [B]ecause discriminatory pricing is common in markets that are subject to intense competitive pressures, neither the presence of discriminatory pricing, nor the negative slope of a demand curve, nor the existence of prices that exceed marginal costs, can be deemed by itself to establish a presumption of market power.
>
> …
>
> We believe that a firm's profit record can be very helpful as one defensible indicator of market power, although it is hardly the one most commonly used.
>
> …
>
> The logic of our approach suggests that monopoly power can appropriately be defined as the ability to obtain monopoly *earnings*, rather than as the power to charge monopoly *prices* (or as the power to exclude competition).[15, 16]

Whether we choose to focus on prices or profits, neither economic theory nor the law provides guidance on how high they must be before they constitute antitrust market power or imply anticompetitive effects. Analyses that focus on these measures, therefore, should also include other relevant evidence that helps determine whether prices or profits reflect competition or the exercise of market power in the antitrust sense. Such evidence might include the degree of product differentiation in the marketplace, the structure of costs, and the firm's efficiency relative to its rivals.

Conclusion

Some market power definitions emphasize power over price, while others emphasize the ability to exclude competition. Without some further specificity, such definitions are not very useful for identifying the kind or form of market power that is likely to raise antitrust concerns. Antitrust market power must be more narrowly and carefully defined. The competitive

"Market Power" continued on page 46

Summary of changes to The Mexican Law on Economic Competition

Major reforms to the Mexican Federal Law on Economic Competition ("the Law") were published in the Official Gazette of the Federation (*Diario Oficial de la Federación*) on June 28, 2006 and became effective on June 29, 2006. This is the first major reform to the Law since its enactment in December 1992.

The reforms significantly modify the Law as regards the investigation and determination of alleged monopolistic practices, and the approval or denial of mergers, acquisitions or related transactions.

The following summary deals only with certain highlights to the reformed Law. This brief summary, along with any explanations or comments herein, should not be taken as a legal opinion or as legal advice.

Monopolistic practices

Clarification of legal bases for CFC rulings[1]

A number of decisions by the Federal Competition Commission ("CFC", or "Commission") have been challenged successfully as violating constitutional due process because they were based upon analytical principles that, while common, were not laid out specifically in the original Law, but only in the regulations of the Law.[2, 3] In response, the amended Law explicitly recognizes the Commission's authority to base its rulings on factual/legal findings such as:

- Predatory pricing;
- Price discrimination;
- Exclusivity discounts;
- Cross-subsidies; and
- Increasing a competitor's costs, obstructing its productive process or diminishing the demand of competitors.

On the other hand, the reform specifically directs the Commission to take into account, in order to determine if a "relative" monopolistic practice (as defined herein below) violates the Law, the degree to which market gains achieved by the alleged violators may be the result of improvements in economic efficiency from new production techniques, integration of activities, economies of scale, creation of new products, technological advancement, quality improvements and the like.

Leniency petitions[4]

The **first** participant in an "absolute" monopolistic practice[5] to inform the Commission of such practice—and who terminates its involvement in the scheme, cooperates fully and provides convincing evidence to the Commission—shall be subject only to "a minimum fine". Neither judicial nor administrative action shall be taken against such entity or individual.

Those other participants who admit their involvement and cooperate fully with the CFC's investigation may obtain reductions in their fines, of between 20 and 50 percent, depending on their alacrity and the quality of their cooperation. This alternative codifies in law the Commission's recent practice of considering leniency petitions.

Tougher sanctions[6]

Fines increase substantially under the reformed Law. An "absolute" monopolistic practice is sanctionable by up to 1.5 million times the daily minimum wage for the Federal District (approximately MXP $73 million, the rough equivalent of US $6.3 million, and subject to increase as the minimum wage is raised from time to time). A "relative" monopolistic practice[7] may be fined at up to 900,000 times the daily minimum wage (approximately MXP $44 million, the rough equivalent of US $3.8 million). In addition, any entity or individual aiding or abetting, participating in, instigating or inducing a monopolistic practice is subject to a fine of upwards of 28,000 times the daily minimum wage (approximately MXP $1.4 million, the rough equivalent of US $122,000).

With the enactment of the modifications, it is expected that many fewer mergers, acquisitions or similar transactions will have to be submitted to the CFC for review.

In addition, repeat offenders are subject to sanctions in double the amount of the above-mentioned maximums or equivalent to 10 percent of their assets, whichever is greater. In the alternative, the Commission may obtain either the involuntary dissolution of the repeat offender or the divestiture of its assets, shares, rights, etc., sufficient to ensure that such entity no longer has substantial power in the relevant market. Dissolution or divestiture may only occur upon court order.

Mergers and acquisitions

Fewer transactions subject to automatic review[8]

With the enactment of the modifications, it is expected that many fewer mergers, acquisitions or similar transactions will have to be submitted to the CFC for review. It is important to note that any merger, acquisition or related transaction filed with the CFC after June 28, 2006, will be subject to the reformed law, regardless of when the underlying agreement between the parties may have been reached.

The new provisions establish that only transactions for over a certain amount of money need to be filed with the CFC. They establish three categories of transaction that must be filed for review prior to becoming effective:

- When the value of the Mexican portion of the transaction,[9] regardless of where it occurs, is greater than 18 million times the daily minimum wage for the Federal District (approximately MXP $876 million, the rough equivalent of USD $76.2 million).
- When the transaction will involve the acquisition of 35 percent or more of the shares or assets of a business whose annual sales or assets originating in Mexico is greater than 18 million times the daily minimum wage for the Federal District (approximately MXP $876 million, the rough equivalent of USD $76.2 million).
- When the transaction will result in the acquisition in Mexico of assets or stated capital higher than 8.4 million times the minimum wage for the Federal District (approximately MXP $409 million, the rough equivalent of USD $35.5 million), and the merger or acquisition involves two or more companies whose assets or annual sales volume, taken separately or together, is greater than 48 million times the minimum wage for the Federal District (approximately MXP $2.3 billion, the rough equivalent of USD $201.5 million).

Waiting period[10]

A new paragraph was added to Article 20 whereby a waiting period may be imposed for mergers and acquisitions, at the CFC's discretion. In these instances, within 10 business days from the date that notice of such transaction is filed, the Commission may order the parties to not follow through with the execution of the transaction until the Commission issues a ruling on the legality of the proposed transaction. If no such order is made within 10 business days from the date of the filing, the parties may execute the transaction, although if they do so, they are still subject to having it rejected by the Commission, within a total time limit of 35 business days from the date of the filing. Until a favorable ruling is rendered, or until the 35-day term from the filing has elapsed, without any decision by the Commission, the parties may not register the transaction in the Public Commercial Registry, which is necessary to put third parties on notice that the transaction has taken place.

A prohibited merger, acquisition or other consolidation also could bring a sanction of up to 900,000 times the daily minimum wage (MXP $43.8 million, the rough equivalent of USD $3.8 million).

Fast track approvals[11]

Upon filing, the parties to the merger or acquisition may present an economic analysis and related proof to show that the transaction clearly will not "lessen," "harm," or "impede" competition and the free flow of commerce. In such instances, the Commission must make its determination within 15 business days, rather than 35. If this 15-day deadline passes without a CFC determination, "it shall be understood that there is no objection to the achievement of the economic concentration." If within this 15-day deadline the CFC rules that the analysis and proof offered by the parties is not sufficient to show the clear absence of anti-competition effects, on the date of such ruling it will, for effects of the normal, 35-day deadline, re-receive the filing.

Tougher sanctions[12]

- A prohibited merger, acquisition or other consolidation also could bring a sanction of up to 900,000 times the daily minimum wage (MXP $43.8 million, the rough equivalent of USD $3.8 million).

- Failure to inform the CFC of a merger, acquisition or other consolidation that meets the criteria for automatic review by the Commission could result in a fine of 400,000 times the daily minimum wage (approximately MXP $19.5 million, the rough equivalent of USD $1.7 million).
- A false declaration or presentation of false information may be fined by upwards of 35,000 times the minimum wage for the Federal District (approximately MXP $1.7 million, a rough equivalent of USD $148,000).
- In the event that a merger, acquisition or other consolidation is approved upon the basis of false information, or a condition subsequent with which the business in question fails to comply, the Commission may impose a fine of up to 900,000 times the daily minimum wage (MXP $43.8 million, the rough equivalent of USD $3.8 million).
- Individuals involved in a prohibited consolidation may face sanctions upwards of 30,000 times the daily minimum wage (approximately MXP $1.5 million, a rough equivalent of USD $130,000).
- Any entity or individual shown to be involved as an instigator, inducer, supporter, abettor or participant in the commission of a prohibited consolidation may be fined upwards of 28,000 times the daily minimum wage (MXP $1.3 million, a rough equivalent of USD $113,000).

Repeat offenders are subject to sanctions in double the amount of the above-mentioned maximums or equivalent to 10 percent of their assets, whichever is greater.

In addition, repeat offenders are subject to sanctions in double the amount of the above-mentioned maximums or equivalent to 10 percent of their assets, whichever is greater. In the alternative, the Commission may obtain either the involuntary dissolution of the repeat offender or the divestiture of its assets, shares, rights, etc., sufficient to ensure that such entity no longer has substantial power in the relevant market. Dissolution or divestiture may only occur upon court order.

Reforms to the Commission

Enhanced investigatory powers[13]

The modified Law gives the Commission somewhat broader investigatory tools, such as the right to obtain a court order to make an inspection of the offices of a target and to require the production of documents and data during such visits. The entity subject to the inspection visit shall receive prior notice of same, which notice shall specify the place, time, object and scope of the inspection visit, as well as the legal basis for the visit. The Commission may not seize, embargo or otherwise take any of the information or documents shown to it during the inspection, but may request copies. The target may make comments and clarifications to the inspectors, and these must be duly recorded as part of the official record pertaining to the inspection, which record shall be provided to the target. Every inspection visit shall be done in the presence of two witnesses chosen by the target.

In a related change, the CFC now may order production of documents and information that it believes are relevant and pertinent to its investigations, as opposed to the objective-relevance standard in the previous law. This change is apparently deliberate, and it may make

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FTC reforms merger review process

On February 16, 2006, the Federal Trade Commission ("FTC" or "Commission") announced new guidelines and procedures intended to "streamline the merger review process." The reforms are designed to ease the burden and expense associated with compliance with requests for additional information ("Second Requests") by formalizing best practices typically employed by merging parties and the agencies.[1] By holding FTC staff, merging parties, and outside counsel more accountable for deviations from best practices, the reforms are designed to facilitate "rapid identification of the relevant issues, preparation of more focused Second Requests, and the use of consistent investigation timetables." The reforms took effect for all Hart-Scott-Rodino ("HSR") filings submitted on or after February 17, 2006. While the Department of Justice ("DOJ") has indicated that it is also considering streamlining its Second Request process, the reforms announced in February apply only to Second Requests issued by the FTC.

The FTC reforms are not mandatory—rather, a party to a transaction may elect whether to take advantage of the "streamlined" process. However, in order to do so, the FTC requires the party to agree to a number of provisions that could significantly disadvantage the party's position during the Second Request review process as well as subsequent litigation. Antitrust counsel and in-house lawyers should carefully consider the benefits of each reform, as well as the potential consequences, before agreeing to the revised procedures. In many instances, it may be in a party's best interest to continue to separately negotiate limitations to Second Request specifications both at the outset of the investigation, as well as during the various phases of the production as the parties and counsel uncover additional information that allows more informed decisions.

The primary benefits of the reforms, discussed in more detail below, are as follows:

- Limit the number of employees required to provide information in response to a Second Request to 35;
- Reduce the time period for which parties must provide documents in response to a Second Request to two years;
- Allow parties to preserve fewer backup tapes and produce documents on those tapes only when responsive documents are not available through more accessible sources; and
- Reduce the amount of information that parties must produce regarding privileged documents.

Background

The HSR Act requires parties to certain mergers and acquisitions to file notifications with the FTC and DOJ, and to wait statutorily prescribed periods, prior to consummation of the transactions. The law is designed to allow the agencies to review and challenge under Section 7 of the Clayton Act acquisitions likely to harm competition.

Each year the FTC and the DOJ clear approximately 95% of the HSR-reportable transactions during the initial statutory 30-day waiting period and issue a Second Request for the remaining 5%. A Second Request generally requires parties to mergers and acquisitions to produce documents relevant to the transaction and respond to a number of interrogatory requests designed to solicit information relevant to the agency's analysis of the likely effect of the transaction on competition.

As noted by former FTC Bureau of Competition Director, Susan Creighton, an employee "who maintained four boxes of documents in 1998 would be likely to maintain roughly 140 boxes of documents today."

Since the HSR Act took effect in the late 1970s, Second Request compliance has become increasingly burdensome and expensive, primarily as a result of fundamental changes in antitrust analysis as well as advances in technology.[2] Today, a Second Request can cost merging parties millions of dollars and delay consummation of a transaction by several months. Electronic transmission of documents as well as storage and retention in e-mail files, hard drives, portable computers, and mini-computers have tremendously increased the volume of information retained by companies. This results in greater burdens on parties responding to Second Requests as well as the agency staff that must review and analyze the information received. As noted by former FTC Bureau of Competition Director, Susan Creighton, an employee "who maintained four boxes of documents in 1998 would be likely to maintain roughly 140 boxes of documents today."[3] Reforms designed to streamline the Second Request process are therefore welcomed by antitrust counsel as well as private parties contemplating mergers or acquisitions.[4] However, as discussed below, a number of the reforms recently announced by the FTC are unlikely to relieve the burden associated with responding to a Second Request, and also have the potential to create a disadvantage for the parties to a merger or acquisition.

FTC reforms to the merger review process

Custodian presumption

The reforms create the presumption that the FTC will not require a party to a transaction to search the files of more than 35 employees in response to a Second Request, provided that the party complies with the following requirements:

- provide staff with organization charts to assist in identification of relevant employees;
- make employees available, in person, to discuss employee responsibilities and the company's electronic databases;[5]
- provide, if requested, brief written descriptions of the responsibilities of a limited number of employees;
- produce materials responsive to the Second Request 30 days before formally certifying substantial compliance with the Second Request or agree to a mutually acceptable "rolling" production or other form of timing agreement; and

- agree to propose to the court jointly with the FTC a scheduling order that contains at least a 60-day discovery period, if the FTC challenges the transaction in an adjudicative forum.

The number of employees whose files must be searched and produced during a Second Request is one of the most important determinants of the total cost of most Second Request productions. The FTC set the presumption at *no more than 35 employees* because, as Chairman Majoras explained, a search group of 35 employees is generally sufficient for the FTC to analyze the potential competitive effects of a transaction.

In order to qualify for the custodian presumption, the company must agree to provide certain assistance that is customarily provided to the agencies in response to a Second Request. For example, the company must provide the FTC with organization charts as well as an employee that can inform staff about others in the company that have relevant information regarding the transaction. The company must also make available an employee that understands the company's software and databases.

The presumption also requires the company to agree to several conditions that parties generally seek to avoid. For example, the HSR Act requires the FTC to decide whether to "clear" a transaction or bring suit to block it within 30 days of a party's substantial compliance with the Second Request. The condition that a party produce all responsive material <u>30 days before</u> certification of substantial compliance extends the statutorily prescribed period to <u>60 days</u>, effectively eliminating the leverage provided by substantial compliance and, at the least, delaying consummation of the transaction by an additional 30 days. The company must also agree to a scheduling order that contains at least a 60-day discovery period if the FTC challenges the transaction.

Further, parties often are not in a position during the early stages of a Second Request to make well informed decisions regarding a number of the reform conditions, namely, decisions concerning "rolling" productions, timing agreements, and discovery periods—parties often simply do not have sufficient information regarding the volume or substantive significance of the potentially responsive information contained in the files of its employees during the initial phases of a Second Request.

Even if the company agrees to the custodian presumption requirements, the FTC staff can ask the Director of the Bureau of Competition to authorize a larger search group when staff believes it necessary to evaluate the potential competitive effects of the transaction.[6] Although the reform requires staff to notify the party, when "reasonably feasible," of the identities of the additional individuals to be included in the larger group, the presumption does not specify the number of days within which 1) staff must designate the additional employees, or 2) the Bureau Director must decide whether to authorize a larger search group. The absence of such timing provisions means parties may agree to the reform conditions, and plan their response to the Second Request accordingly, only to learn later that they did not need to do so.

The number of employees whose files must be searched and produced during a Second Request is one of the most important determinants of the total cost of most Second Request productions. The FTC set the presumption at no more than 35 employees because, as Chairman Majoras explained, a search group of 35 employees is generally sufficient for the FTC to analyze the potential competitive effects of a transaction.

In addition, the limitation on the number of employees in a party's search group does not apply to requests for information contained in "corporate" or "central" files, such as central databases, budgets, contracts, and financial reports—often a source of a significant volume of data.

While limiting the size of the search group to no more than 35 employees may significantly reduce the scope of the model Second Request, experienced counsel may be able to obtain a similar limitation through negotiation with the FTC during the early phases of the investigation. As several of the conditions to which a party must agree in order to obtain the limitation by way of the custodian presumption can weigh heavily against a party, it may be better for counsel to continue to separately negotiate the size of the search group with the FTC rather than to agree to these conditions.

The reforms create a presumption that that the "relevant time period" for which a party must produce documents in response to a Second Request will be from two years prior to the date on which the FTC issues the Second Request until 45 days prior to the date on which the party certifies substantial compliance with the Second Request.

Two-year relevant time period

The reforms create a presumption that that the "relevant time period" for which a party must produce documents in response to a Second Request will be from two years prior to the date on which the FTC issues the Second Request until 45 days prior to the date on which the party certifies substantial compliance with the Second Request. When the custodian presumption 30-day advance production period applies, the presumptive relevant time period will be from two years prior to the date on which the FTC issues the second request until 45 days prior to the date on which the party *produces* the materials responsive to the second request. A party will be required to produce all responsive documents that it generated or obtained during the relevant time period. Also, the FTC staff may enlarge the time period when it is "reasonably likely" that a "longer relevant time period" would be necessary for the FTC to analyze the transaction's competitive effects.

The model Second Request requires a party to produce all relevant documents from three years prior to the date on which the FTC issues the Second Request. The FTC's review of recent Second Request responses revealed that approximately 25% of the documents produced were more than two years old. However, the FTC staff is often reluctant to agree to limit the "relevant time period" for fear that they might miss critical evidence. Therefore, elimination of one year from the search period will significantly reduce a complying party's cost and burden by eliminating many older and redundant documents that the party otherwise would be required to produce.

The model Second Request also requires parties to produce relevant documents until <u>30 days</u> prior to the party's certification of substantial compliance, and Specifications 7 and 15 (which request all documents relating to competition as well as transaction related documents, respectively) require production of documents produced or obtained up to 14 days before the party certifies substantial compliance. Because employees of merging firms typically continue to receive and create responsive documents after issuance of a Second Request, these short "cut-off" dates (the most recent date for which a party is required to produce documents) typically require responding parties to search the files of many employees multiple times prior to certification of substantial compliance. The <u>45 day</u> "cut off" date afforded by the two-year presumption will eliminate most "second sweeps" and, in many instances, significantly alleviate some of the cost and burden imposed by Second Request productions.

Unfortunately, as with the custodian presumption, the two-year relevant time period presumption does not apply to requests for data, which also generally cover a three-year time period, but often cover five years or longer.

Empirical data

This reform instructs staff to inform the parties about the competitive effects theories under consideration and the types of empirical analyses that may prove useful to the agency's investigation. The reform encourages parties to assist staff (through written descriptions and employee interviews) with understanding how the party collects, maintains, and uses data, and to propose limitations to the staff's data request. The party will be entitled to confer with a Director or a Deputy Director from the Bureaus of Competition and Economics if the party believes staff has not sufficiently limited the data requests.

The increased transparency intended by this reform has been the focus of prior agency initiatives over the past several years intended to streamline the review process.[7] Indeed, insight into the agencies' competitive effects theories early on in the investigation would allow parties to promptly initiate the factual and economic analysis required to address agency concerns. Unfortunately, the agencies are often not certain regarding the theories of harm that they intend to pursue until months into an investigation. "As [an agency] learns more about the merging firms and the market environments in which they compete, staff rejects or refines its hypotheses of probable relevant markets and competitive effects."[8] Without a clear explanation of agency concerns, parties have difficulty providing the relevant econometric data necessary to address those concerns. Nonetheless, the renewed focus on transparency and the right to meet with a Director or Deputy Director regarding overly broad data requests should encourage open discussion regarding staff thoughts relating to the likelihood of anticompetitive effects, as well as the data necessary to alleviate staff concerns.

The cost to retrieve and produce the information on backup tapes can be tremendous—often, backup tapes contain information from legacy systems that companies have long since abandoned.

Preservation of backup tapes

This reform establishes a presumption that (1) a party may elect to preserve backup tapes for only two calendar days identified by staff, and (2) the FTC will require a party to produce documents contained on backup tapes only when responsive documents are not available through other more accessible sources. If a party's document storage system does not permit designation of backup tapes for two specific calendar days, staff will work with the party to designate a comparable set of backup tapes that the party must preserve.

Most document retention policies limit the amount of e-mail and other electronic files kept on servers, and save older data on back-up tapes. Backup tapes are typically preserved for disaster recovery, not review purposes, and generally the information preserved is difficult to access. The cost to retrieve and produce the information on backup tapes can be tremendous—often, backup tapes contain information from legacy systems that companies have long since abandoned.

Nonetheless, the model Second Request requires that all relevant information contained on backup tapes be produced. Because backup tapes contain older data, the information needed by the agencies to evaluate the potential competitive effects of a transaction is generally available from other sources. Thus, experienced counsel generally is successful in deferring the production of information from backup tapes, and negotiating the preservation of only a day or two of information. This reform therefore is unlikely to result in significant cost savings, but will eliminate the need for counsel to negotiate limitations regarding the production of backup tapes.

Partial privilege log

The reforms provide that, in lieu of providing a complete privilege log for all custodians in the search group, a party may elect to provide a partial privilege log ("Partial Log") for all of the custodians in the search group, and a complete privilege log ("Complete Log") for the greater of five individuals or ten percent of all of the custodians in the search group. The Complete Log will contain the information specified in the Second Request, including, for each document withheld, identification regarding authors, addresses, recipients, date, and a description of the document. The Partial Log will identify the total number of documents withheld from the files of each custodian. The FTC staff retains the right to require a Complete Log in "appropriate cases."

Today, it is not uncommon for parties to have terabytes of data stored on e-mail servers, network drives, and personal and portable computers. Every potentially responsive document, whether paper or electronic, must be reviewed by an attorney for privileged information.

For a party to exercise the option to produce a Partial Log, the party must provide a signed statement in which the party acknowledges that, in consideration for being permitted to submit a Partial Log:

- the FTC retains the right to serve discovery requests regarding documents withheld on grounds of privilege in the event the FTC votes to seek relief through judicial or administrative proceedings;
- the party will produce a Complete Log for all custodians in the search group no later than 15 calendar days after a discovery request is served, which will occur promptly after the filing of the FTC's complaint; and
- the party waives its objections to such discovery, including the production of a Complete Log for all custodians in the search group, except for any objections based strictly on privilege.

Depending on the volume of responsive materials, a privilege log can take several weeks to prepare, and often contains thousands of detailed entries. Today, it is not uncommon for parties to have terabytes of data stored on e-mail servers, network drives, and personal and portable computers. Every potentially responsive document, whether paper or electronic, must be reviewed by an attorney for privileged information. For each document containing privileged information, an attorney must prepare a description of the document in a manner that, though not revealing the privileged information, provides sufficiently detailed information to enable the reviewing agency to assess the applicability of the privilege claimed.[9] There are no clear guidelines regarding the level of detail required, and staff attorneys differ with respect to the amount of detail deemed sufficient. Law firm and in-house counsel have long contended that the rules surrounding the preparation and submission of privilege logs should be relaxed.

Nonetheless, the benefits of submitting a "Partial Log" can be outweighed easily by the conditions to which the parties must agree, especially considering that a party must waive all objections to the FTC's discovery requests in the event the FTC seeks to oppose the transaction. In addition, preparation of a privilege log can easily take longer than the 15 calendar day period which the reforms require if the FTC seeks relief through judicial or administrative proceedings. Finally, while the reforms provide the FTC with the right to require production of a Complete Log in "appropriate cases," the reforms provide no insight into what would constitute an "appropriate case." In each case, counsel should consider whether, given the potential disadvantages associated with the privilege log reforms, it may be better to produce a Complete Log after negotiating limitations with the FTC.

Electronic production and deduplication

The FTC added an additional instruction to the Second Request to address issues concerning the "deduplication" of electronic files. Deduplication software tools, usually provided by a third party vendor, allow parties to eliminate exact duplicates of electronic documents from employee files, increasing the efficiency of the review process. However, deduplication "across" custodians can remove key documents from the files of many individuals, concealing the fact that such individuals received the documents. For this reason, the FTC added an instruction requiring parties to notify the FTC if a party intends to "deduplicate" its document production. In turn, the FTC will inform the party whether and in what manner the party may use such deduplication software or services.

Deduplication software tools, usually provided by a third party vendor, allow parties to eliminate exact duplicates of electronic documents from employee files, increasing the efficiency of the review process. However, deduplication "across" custodians can remove key documents from the files of many individuals, concealing the fact that such individuals received the documents.

Deduplication generally provides significant cost savings (*e.g.*, often reducing the volume of potentially responsive documents by 30 percent or more). Considering the tremendous volume of electronic documents covered by the typical Second Request, the FTC took a step in the right direction in formalizing procedures regarding elimination of redundant documents. However, a party should not be required to seek the *approval* of the FTC to "utilize any De-duplication or Near-de-duplication software or services when collecting or reviewing information." "Reduplication," or the replacing of deduplciated documents to their original location in the custodian files prior to production, is standard practice among law firms experienced with Second Request productions and eliminates the FTC's concern regarding unintended cherry-picking of documents from the files of particular custodians. Thus, confirmation that a party "reduplicates" its production prior to submission should be all that the FTC requires.

Additional reforms to the merger review process

Specification l(b)

Specification l(b) of the model Second Request requires a party to provide a list of all agents and representatives of a company. Because Specification 1(b) is unnecessarily overbroad in scope, the reforms presumptively modify the Second Request to require parties to list only those agents who are involved in the transaction and the relevant markets. This reform will eliminate the need for counsel to negotiate relevant limitations at the outset of a Second Request.

Specification 4: Facilities

Specification 4 requires a party to provide information about the location, replacement cost, and capacity of the party's facilities. While Specification 4 also is typically overbroad in scope, unlike Specification 1(b), there is no plausible bright-line modification to the scope of Specification 4 that would not compromise the FTC's investigation. Thus, the reforms provide that the FTC will modify Specification 4 on a case-by-case basis.

Definition of "documents"

In announcing the Second Request reforms, the FTC acknowledged that the Second Request definition of "documents" requires the production of categories of documents that do not further the FTC's analysis of whether a transaction is likely to violate the antitrust laws, such as tax and other types of regulatory documents that do not concern the potential competitive impact of the transaction under investigation. The FTC therefore announced its intention to modify the Second Request instructions to presumptively exclude these types of materials. While parties usually are successful in negotiating the elimination of many such categories of documents from production, staff is not uniform with respect to its approach, and often requires the review and production of numerous documents that do not further the FTC's investigation. Thus, a reform presumptively removing these documents from the scope of production would significantly improve the process.

While parties usually are successful in negotiating the elimination of many such categories of documents from production, staff is not uniform with respect to its approach, and often requires the review and production of numerous documents that do not further the FTC's investigation. Thus, a reform presumptively removing these documents from the scope of production would significantly improve the process.

Reforms do not preclude other modifications to second requests

In her February 16 announcement of the reforms, Chairman Majoras advocated "quick look" investigations in appropriate circumstances. This approach to Second Request productions typically involves the production of a limited set of principal documents and information, such as strategic plans and bid data, in exchange for staff's commitment to analyze the materials in a very short period, *e.g.*, three weeks, and then advise the parties about the status of the investigation. This approach could result in significant relief to merging parties, as "quick look" investigations, when conducted in good faith, often shortcut the Second Request process and allow parties to proceed with their transaction.

Internal reforms

In addition to implementing reforms intended to reduce the scope of the Second Request process, Chairman Majoras announced that the Bureaus of Competition and Economics have implemented several new internal practices, including a requirement that a Bureau of Competition staff lawyer with *substantial experience* participate in the negotiations over Second Request modifications. This requirement should make negotiations more efficient as the staff who negotiate the Second Request will have sufficient authority to agree to modifications in a reasonable time period. The Chairman noted that the Bureaus' work in this area is ongoing.

Conclusion

The FTC intends to continue to work to streamline its procedures, and improve its technology, so that it can quickly clear transactions that do not raise anticompetitive concerns. As Chairman Majoras indicated, the announced Second Request reforms are "only one stage of an ongoing process to improve the merger review process." The reforms clearly are a step in the right direction, but they are limited in scope and effect, and parties need to consider

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Oil industry price gouging: Legislative and agency action

"Price gouging" among petroleum refiners, wholesalers and retailers is a hot topic in Washington, DC. A proposed bill criminalizing oil price gouging has passed the House, and a similar bill is expected to be introduced by a senior Republican Senator. Numerous other Senate Bills await consideration. In May, following a Congressional directive, the Federal Trade Commission ("FTC") issued an exhaustive report examining whether there was oil price gouging in the wake of Hurricane Katrina, and concluded that industry participants acted legally and competitively. The Chairman of the FTC, echoing the conclusions in the report, has criticized the proposed price gouging legislation. And no one has ever provided a clear definition of price gouging. This article summarizes and places in context the recent FTC report.

Price gouging: Legislative overview

As gas prices for consumers have risen, members of Congress have introduced legislation to address the problem. This has led to several legislative initiatives.

On May 3, 2006, the House overwhelmingly passed a bill designed to crack down on what it describes as oil price gouging.[1] If passed by the Senate, the bill, sponsored by U.S. Rep. Heather Wilson, R-N.M., would direct the FTC to come up with a definition of price gouging and investigate possible violations.[2] The bill provides for strong civil enforcement by the FTC and states' attorneys general, as well as criminal enforcement by the U.S. attorney general and the Department of Justice. Penalties for violations include up to $150 million for wholesale sales, $2 million for retail sales, and prison terms of up to 2 years.[3] The legislation, which passed 389-34, covers crude oil (the largest cost component of gasoline), diesel, heating oil, and biofuel prices.

While the Senate has not passed its own price gouging legislation, there has been some activity in that regard. Currently, seven bills with price gouging implications are pending in the Senate, although all of these were introduced more than 6 months ago.[4] Also, in May, Alaska Republican Senator Ted Stevens, Chairman of the Senate Committee on Commerce, Science, and Transportation, announced that he is preparing legislation. The form of Senator Stevens's legislation has not been made public.

In addition, although not directly dealing with price gouging, Senator Arlen Specter, a Republican from Pennsylvania and Judiciary Committee Chairman, introduced legislation earlier this spring that would prohibit companies from withholding oil and gas in an effort to raise prices, and would create a joint federal and state task force to investigate practices (such as information exchanges) that could result in higher gasoline prices.[5]

Definition of price gouging

Everyone is against price gouging but no one seems to know what it is. The legal definition of price gouging is elusive. Currently, no federal statute prohibits price gouging. The pending federal legislation would leave it to the FTC to define price gouging, although the FTC has made it clear it wants no part in defining the term.[6]

While twenty-nine states and the District of Columbia have laws that prohibit the excessive pricing of motor fuels during periods of abnormal supply disruption, the states differ in their approach to defining, proscribing, and regulating the conduct.[7] Twenty-five states require a declared state of emergency or other triggering event before their price gouging laws may be enforced. Four states limit retail price increases to increases in wholesale costs, while six others and the District of Columbia cap price increases to a specified percentage. The remaining nineteen states prohibit unconscionable or excessive price increases, but use a variety of terms to do so, including "unconscionably excessive," "exorbitant," "unjustified," and "grossly excessive."[8] Because these terms require subjective interpretation, compliance with the various state statutes, as well as enforcement, can be difficult.[9]

Any prohibition on price gouging would amount to a price control, and economists generally believe that price controls are bad for consumers because they discourage the behavior necessary to alleviate the imbalance of supply and demand that led to higher prices in the first place.

Most economists agree that prohibitions on price gouging can lead to inefficient behavior. Any prohibition on price gouging would amount to a price control, and economists generally believe that price controls are bad for consumers because they discourage the behavior necessary to alleviate the imbalance of supply and demand that led to higher prices in the first place. Price caps and price gouging statutes can not only reduce the incentive of consumers to conserve, but also reduce the incentive of producers to increase needed capacity. Experience with past markets demonstrates that artificially low prices through price controls can result in shortages as well as allocation schemes that rely on other than the market clearing-price, *e.g.*, politically designed allocation systems or illegal "black markets."[10]

The FTC report on hurricane-related oil price increases

If there were to be substantial agency regulation and enforcement in the area of oil price gouging, the FTC would likely be the responsible agency. The FTC's recent Congressionally mandated report on price manipulation and price gouging in the wake of Hurricanes Katrina and Rita provides valuable insight into how the FTC views competition and price gouging in the oil industry.

Motivated by growing negative sentiment regarding increased gasoline prices in the aftermath of hurricanes Katrina and Rita, Congress charged the FTC with investigating the gasoline market, determining the reasons for the price increases, and issuing a report within 180 days.[11]

On May 22, 2006, the FTC issued its Congressionally mandated report, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases." The report details the results of the FTC's investigation into whether nationwide gasoline prices were "artificially manipulated by reducing refinery capacity or by any other form of market manipulation or price gouging practices," and into gasoline pricing by refiners, large wholesalers, and retailers in the aftermath of Hurricane Katrina. The report concentrated on three areas: (1) the refinery production and transportation of bulk supplies of gasoline, along with inventory practices and other issues involving potential gasoline price manipulation, (2) the effects of Hurricanes Katrina and Rita on the United States' gasoline markets, the wholesale and retail price increases seen in the wake of these storms, and an assessment of whether price gouging occurred in the aftermath of the storms, and (3) a number of important policy issues arising from the investigation as well as the Commission's recommendations.

Gasoline price manipulation

The FTC investigated possible manipulation at various levels of the industry, including refining, transportation, and wholesale distribution, as well as possible price manipulation through inventory management, control of storage assets relevant to futures market prices, and reporting and publishing of bulk spot prices. The FTC found no instance of illegal market manipulation leading to higher prices.

Refineries

The FTC's investigation revealed no evidence of price manipulation at the refining level, either through unilateral or coordinated conduct. Rather, the evidence collected by the FTC indicated that refiners behaved competitively.

The FTC investigated whether refiners manipulated short run prices by running refineries below full productive capacity, by altering their product output to produce less gasoline, or by diverting gasoline from the United States to foreign markets. The agency concluded that refiners operated at full utilization, scheduling maintenance downtime during periods of low demand. Refiners did not make product output decisions in order to manipulate prices. Instead, refiners responded to price increases by trying to produce as much of higher-valued products as possible, as would be expected in a competitive market. The FTC also found no evidence to indicate that firms manipulated gasoline prices through exports, and concluded that any attempt to do so would result in increased imports, as evidenced by the increased imports in response to the hurricanes.

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The FTC also investigated whether firms manipulated long run prices by refusing to invest in new capacity in order to tighten supply. The FTC determined that expansion decisions did not result from an attempt by refineries to acquire or exercise market power – rather, the rate of capacity growth was in response to competitive market forces that made further investment in refining capacity unprofitable.

The report concluded that no single refiner is large enough to manipulate prices unilaterally, and coordination among refiners to manipulate prices is unlikely considering the different structures and incentives of refiners as well as the potential for imports to respond to any coordinated effort to raise prices.[12]

Bulk distribution infrastructure

The FTC examined the extent to which constraints on transportation (pipelines and marine vessels) and terminal storage facilities gave firms the ability or incentive to manipulate gasoline prices, or limit the ability of marketers to move additional supply to specific markets when an unexpected need arose. The FTC concluded, as discussed below, that there is a very limited potential to manipulate prices through exploiting the distribution infrastructure because transportation and storage costs do not significantly impact final product costs. However, the Commission cautioned that individual markets may exhibit specific infrastructure concerns and the FTC will investigate future mergers or acquisitions as necessary to protect competition.[13]

Pipelines

While the FTC's investigation revealed that pipeline companies behaved competitively, the FTC identified several factors that could influence the ability of pipeline owners to manipulate gasoline prices: (1) price regulation; (2) tariff discounts; (3) capacity expansion decisions; and (4) vertical foreclosure.

Regulation

The FTC considered the extent to which Federal Energy Regulatory Commission ("FERC") regulations limit the ability of pipelines to manipulate prices for the transportation of gasoline and light petroleum products. Interstate pipeline tariffs are subject to FERC regulation. In most markets, tariff rates are adjusted annually based on changes in the Producer Price Index. Pipelines generally cannot increase rates over the published tariff. Pipelines also cannot withhold available capacity from nominating shippers.[14] While pipelines can offer discounts to shippers (*e.g.*, based on volume), FERC regulations prohibit pipelines from price discriminating against customers. Thus, pipelines must offer the same rates to all customers that meet stipulated requirements (*e.g.*, minimum volumes).

While the FTC's investigation revealed that pipeline companies behaved competitively, the FTC identified several factors that could influence the ability of pipeline owners to manipulate gasoline prices: (1) price regulation; (2) tariff discounts; (3) capacity expansion decisions; and (4) vertical foreclosure.

While the FTC concluded that FERC regulations limit the ability of pipelines to exercise market power by charging higher tariffs or withholding capacity, the FTC acknowledged that FERC regulations do not cover all aspects of the pipeline industry. For example, pipelines charge unregulated fees for certain services, such as terminaling, storage, and "pumpover" services (i.e., transfer of product between different pipelines). Also, pipelines are not required to expand capacity to accommodate increased shipper volume.

Curtailing discounts on tariffs

The FTC investigated whether pipelines could manipulate prices by curtailing tariff discounts (*e.g.*, based on volume). Because pipelines are not required to give discounts, the FTC concluded that pipelines could increase prices to some extent by eliminating discounts. The FTC recognized that any such increase would have a relatively small impact on the price of gasoline as pipeline rates are a small portion of the price of delivered gasoline. However, the FTC asserted that it would investigate and take action against price increases achieved from reduced discounts resulting from anticompetitive behavior.

Expansion decisions

The FTC further examined whether a pipeline owner could manipulate prices through decisions concerning capacity expansions. The investigation revealed that pipelines do not typically expand until existing capacity is fully utilized and excess demand causes the pipeline to prorate volume among shippers for significant portions of the year. The FTC indicated that added capacity would have little impact on the price at which existing capacity is sold because most pipelines have sold their capacity under long term contracts and would continue to charge the maximum regulated rates despite the new capacity. While the FTC concluded that disparity in rate regulation among various regions of the country may impact a pipeline's expansion decisions, the FTC found no evidence of capacity expansion decisions being linked to an incentive to raise prices.

Vertical foreclosure

The FTC considered whether a pipeline that is vertically integrated into the downstream supply of bulk gasoline could manipulate the price of gasoline in the markets that it serves by limiting pipeline deliveries to those markets. The FTC concluded that a pipeline would have the incentive to increase wholesale and retail gasoline prices in such markets by restricting its competitor's access to its pipeline and restricting supply. While FERC regulations prohibit pipelines from excluding shippers, the Commission acknowledged that a pipeline could take certain actions (*e.g.*, slowing down deliveries) that would make it more costly for a shipper to compete in the downstream markets. However, the FTC's investigation revealed no evidence of such anticompetitive conduct. The FTC noted that its prior enforcement actions have prevented firms from gaining control of pipeline assets that could be used to manipulate prices.[15]

Terminals

The FTC investigated the extent to which gasoline prices could be manipulated through the control of refined products terminals. Terminals store bulk quantities of products received from pipelines or marine vessels, and dispense gasoline and light petroleum products in smaller lots that are delivered by truck to retail outlets. "Proprietary" terminals (terminals owned by upstream refiners or downstream marketers) generally serve their firm's own needs and do not store product for third parties. "Public" terminals, on the other hand, provide storage and marketing services to local marketers. Public terminals lease fixed volumes of storage to customers for specified time periods and charge fees for throughputting products from storage tanks into trucks for delivery. The investigation revealed that storage fees comprise a relatively small percentage of the price of delivered gasoline (*e.g.*, storage fees are approximately one-half cent per gallon per month, and throughputting fees range between one-half cent to one cent per gallon).

The investigation also revealed that demand for terminal storage in most areas of the country has declined over the past few decades due to factors such as supply management techniques (*e.g.*, just-in-time inventory) and new blending techniques that allow for certain fuels (*e.g.*, mid-grade gasoline) to be blended from stocks of regular and premium grade gasoline. However, the FTC acknowledged that demand in certain geographic areas may run counter to this trend due to boutique gasoline mandates that require suppliers to use multiple blending components.

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The FTC has taken enforcement actions to prevent acquisitions that likely would lessen competition among terminal operators.[16] Based on its extensive knowledge of terminal markets, the FTC concluded that competition and capacity for terminal storage appears sufficient in *most areas* of the country to limit potential anticompetitive conduct. The FTC found no evidence that terminal operators in these areas are likely to engage in price manipulation.

However, the FTC acknowledged that marine terminals in California warrant special attention. The investigation revealed that California's relative geographic isolation as well as unique gasoline specifications contribute to tight supply conditions that result in higher prices and volatility. Insufficient in-state refinery production and lack of pipelines to transport bulk supply of gasoline into the state (as well as demand from neighboring states sharing the same pipelines) leads California refiners to rely on waterborne imports for about 10% to 15% of the state's total gasoline supply. Refiners and traders build stocks of gasoline during the off-season so that they can sell more profitably during the mandatory change to summer-grade gasoline. In addition, California's strict regulatory environment impedes timely terminal expansions and improvements. Other factors, such as permitting requirements and land scarcity issues, also contribute to the problem.

The FTC noted that its 2005 consent order in connection with the acquisition by Valero L.P. of Kaneb required Valero to divest two California marine terminals in order to protect competition in the market for terminaling services for bulk suppliers of refining and blending components as well as finished transportation fuels in Northern California.[17] The FTC alleged that the acquisition likely would give Valero the incentive to increase transportation fuel prices by restricting the movement of products into and through Kaneb terminals.

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Product inventory practices

The FTC found no evidence that firms reduced inventory levels in order to manipulate prices or exacerbate the effects of price spikes due to supply disruptions. Rather, the agency concluded that petroleum firms recognize and balance the costs and benefits of holding additional inventories, and that these efforts over time to manage inventories more efficiently have led to a steady decline in inventory-to-sales ratios for gasoline.[18]

Other issues involving potential gasoline price manipulation

The FTC found no evidence indicating that a firm or group of firms could manipulate gasoline futures prices by using storage assets to restrict gasoline movements into New York Harbor, the key delivery point for gasoline futures contracts, and no evidence that firms were using published bulk spot prices to manipulate prices. The FTC also concluded that mergers and acquisitions have not increased the ability of firms to increase prices, and that it takes several years for firms to fully realize cost savings resulting from a merger or acquisition.[19]

Price gouging in the aftermath of hurricane Katrina

Next, the FTC examined whether the price increases after hurricanes Katrina and Rita were consistent with competition, and whether firms engaged in "price gouging." Ultimately, the FTC found minimal, if any, price gouging.

First, the FTC concluded that the conduct of firms in response to the supply shocks caused by the hurricanes generally was consistent with competition. The investigation revealed that companies with unaffected assets increased output and diverted supplies to high-priced areas, and refiners deferred scheduled maintenance in order to keep refineries operating. In addition, imports increased and companies drew down existing inventories to help meet the shortfall in supply. The FTC determined that, in light of the amount of crude oil production and refining capacity knocked out by Katrina and Rita, the sizes of the post-hurricane price increases were approximately what would be expected in a competitive market.[20]

The FTC also examined possible "price gouging" by firms in the aftermath of the hurricanes and whether certain firms or groups of firms took unfair advantage of supply disruptions by increasing prices beyond what was justified by cost and supply factors. For purposes of its investigation, the FTC used the Congressionally mandated definition of "price gouging" – a firm's monthly average sales price for gasoline in a particular area is higher than for a previous month, *and* such higher prices are not substantially attributable to *either* (1) increased costs, or (2) national or international market trends.[21] The FTC found 15 examples of price gouging at the refining, wholesale, or retail levels that fit the definition.

The FTC investigated data from 30 refiners, 23 wholesalers, and 24 individual, single-location retailers. While seven refiners were identified as having unusually large price increases based on a comparison to the national benchmark average, staff concluded that the increases were due to variations in geographical location, distribution networks, and increased gasoline costs.[22] With respect to non-refining wholesalers, staff found that their operating margins generally did not increase, suggesting that increased costs primarily caused the price increase. While a few wholesalers were identified as having significantly higher operating margins such that their price increases did satisfy the study's definition of price gouging, the Commission determined that the gains were derived from either (1) retail operations in areas that experienced the largest post-Katrina price increases, or (2) activities not directly related to gasoline sales, such as futures market trading or distillate sales.[23]

Finally, the FTC determined that, as a group, the 24 individual retailers investigated did not have significantly increased operating margins, and their average price increases were generally consistent with the national average. Six of the 24 single-location retailers had price increases that met the definition of price gouging because they could not be substantially attributed to cost increases or the national market trend. However, the FTC concluded that, in all but one case, local or regional market trends appeared to explain the price increases.[24]

Having completed its analysis of oil price gouging, the FTC concluded that legislation that would criminalize price gouging would not benefit consumers. While the report acknowledged that price gouging legislation might protect consumers from higher prices in the short run, the Commission recognized that price controls would be harmful to consumers' economic well-being in the long run.

The FTC's policy implications and recommendations

Having completed its analysis of oil price gouging, the FTC concluded that legislation that would criminalize price gouging would not benefit consumers. While the report acknowledged that price gouging legislation might protect consumers from higher prices in the short run, the Commission recognized that price controls would be harmful to consumers' economic well-being in the long run. The report concluded that, in situations where pricing signals are not present or are distorted by legislative or regulatory command, markets may not function efficiently and consumers may be worse off. The report cautioned that the offense of price gouging is difficult to define and that courts have refused to tread the question of what constitutes a "reasonable price." "Ultimately, the lack of consensus on which conduct should be prohibited could yield a federal statute that would leave businesses with little guidance on how to comply and would run counter to consumers' best interest."[25]

The FTC recommended that, if Congress insists on passing federal price gouging legislation, it should: (1) define the offense of price gouging clearly, since an ambiguous standard would only confuse consumers and businesses and would make enforcement difficult and arbitrary, (2) account for increased costs, including anticipated costs, that businesses face in the marketplace,

(3) provide for consideration of local, national, and international market conditions that may be a factor in the tight supply situation, and (4) attempt to account for the market-clearing price as holding prices too low for too long could result in wholesalers and retailers running out of gasoline.[26]

Commissioner Leibowitz issued a concurring statement in which he echoed the Commission's sentiments regarding the difficulty of defining and prosecuting price gouging.[27] However, Commissioner Leibowitz noted that a number of industry participants, including refiners and retailers, were found to meet the Congressionally mandated definition of price gouging.

Commissioner Leibowitz also pointed to other factors that contributed to the current rise in gasoline prices. The Commissioner described OPEC as a major "villain in the long-lasting saga of high oil prices," responsible for "massive transfers of wealth from the United States to oil-exporting nations" during the last 30 years—"The conduct of its members would be criminal if undertaken by private companies." Other contributing factors recognized by Commissioner Leibowitz were increased demand from China and India, complicated environmental requirements, and American over-dependence on both foreign oil sources and inefficient automobiles.[28]

The FTC's conclusion that the oil industry remains competitive is consistent with the two other reports that the FTC has released in the last two years regarding petroleum industry competition.

Prior FTC reports related to the gasoline industry

The FTC's conclusion that the oil industry remains competitive is consistent with the two other reports that the FTC has released in the last two years regarding petroleum industry competition. On August 13, 2004, the FTC's Bureau of Economics released a report analyzing the impact of mergers in the oil industry on competition.[29] The report concluded that mergers of large private oil companies over the prior 20 years had not significantly affected worldwide concentration levels in crude oil, which for the most part remained low to moderate, and economies of scale had become increasingly significant in shaping the petroleum industry. Industry developments allowed firms to place less emphasis than in prior years on vertical integration throughout all or most levels of production, distribution, and marketing—several significant refiners had no crude oil production, and integrated petroleum companies depended less on their own crude oil production.[30]

Similarly, on July 5, 2005, the FTC issued a report concluding that changes in the price of crude oil were responsible for 85 percent of the fluctuations in the retail price of gasoline in the U.S.[31] The main influences on crude oil prices included production decisions by OPEC, as well as significant increases in demand factors. Other important factors included supply restrictions, environmental regulations such as "clean fuel" requirements, the number of competing gasoline stations among which consumers can switch purchases, as well as state and local taxes. While U.S. demand increased substantially from 1984 to 2004, average retail gasoline prices during this period remained at their lowest levels since 1919 due in large part to increased gasoline supplies from U.S. refineries and imports as well as the adoption of more efficient technologies and business strategies by U.S. refiners, which allowed the production of a more refined product per barrel of crude oil processed. The report noted that it is difficult, if not impossible, to predict whether the sharp rate of price increase experienced during the first several months of 2005 represented the beginning of a longer-term trend.[32]

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New leniency program in Germany

Introduction

In Europe, companies that are involved in hard-core cartels (cartels engaged in price fixing, setting production or sales quotas, market sharing, or bid rigging) are subject to significant fines of up to 10% of their annual worldwide turnover. The EU Commission has expressed its clear and firm intention increasingly to enforce the ban on hard-core cartels in Europe. One element of such enforcement activity is the granting of immunity from, or reduction of fines for cartel members who are willing to cooperate with the EU Commission, and thereby help the EU Commission to crack a cartel.

Cartel members find themselves within the framework of the method of setting fines by the EU Commission for the infringement of antitrust law on the one hand, and within the criteria for receiving immunity or reduction on the other hand. In relation to the latter, since February 2002, an amended leniency notice issued by the EU Commission is in place[1]. As to the method of setting fines, the EU Commission has just recently adopted new guidelines which revise those adopted in 1998, with a view to increasing the deterrent effect of fines.[2]

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Also under national EU Member States' legislation, cartel members may be subject to substantial fines, and national enforcement agencies are increasingly committed to investigating hard-core cartels. The German competition authority (Federal Cartel Office, "FCO") identifies the fight against hard-core cartels as one of its central goals, and the national Act Against Restraints of Competition has empowered the FCO to enforce the ban on cartels since it came into force in 1957. The FCO has a proven track record of cracking cartels, two recent examples of which concerned cartels in the power cable and ready-mixed concrete sectors. Since 2002 the FCO had a special unit for combating cartels in order to increase the quota of uncovered cartel agreements and to speed up proceedings. Organizationally, the special unit assists the decision divisions of the FCO by deploying specialized personnel and material resources.

In the EU altogether, 17 EU Member States[3] operate a leniency program. The European Competition Network ("ECN"), which has been established as a forum for discussion and cooperation of European competition authorities in cases where the laws on anticompetitive agreements (Article 81 EC Treaty) and Article 82 EC Treaty (abuse of a dominant position) are applied, is expected to issue a model leniency program.

In March 2006, the FCO published a new notice on leniency ("Leniency Notice") pursuant to which companies that are involved in an illegal agreement can be entirely or partly exempted from a fine if they make a decisive contribution to uncovering a cartel and cease their anti-competitive behaviour. The 2006 notice came into force on 15 March 2006 and replaces the previous notice of 2000. It is understood that the Leniency Notice has largely anticipated the upcoming model leniency program of the ECN. The leniency program applies to natural persons, undertakings and associations of undertakings in cartels (in particular relative to price or sales quota fixing, market sharing and bid-rigging). The Leniency Notice, which will be further described below, sets out details on the immunity from and reduction of fines, obligation to cooperate, procedural and confidentiality aspects. The Leniency Notice does not establish the method of and criteria for setting fines. Such communication is expected to be issued later this year.

Immunity from fines

The FCO will grant full immunity from a fine if the following three conditions are met: the cartel member (i) is the first cartel member who contacts the FCO before the FCO has sufficient evidence to obtain a search warrant; (ii) provides verbal and written information and, where available, evidence which enables the FCO to obtain a search warrant; and (iii) was not the only ringleader of the cartel nor coerced others to participate in the cartel and cooperates fully and on a continuous basis with the FCO.

The above is not the only situation where the FCO is prepared to grant full immunity. Even in a situation where the FCO is able to obtain a search warrant, it will grant full immunity if the following five conditions are met: the cartel member (i) is the first participant in the cartel to contact the FCO before it has sufficient evidence to prove the offence; (ii) provides verbal and written information and, where available, evidence, that enables the FCO to prove the offence; (iii) was not the only ringleader of the cartel nor coerced others to participate; (iv) cooperates fully and on a continuous basis with the FCO; and (v) no other cartel member is to be granted immunity pursuant to the situation described above in the first paragraph.

Reduction of fines

If a cartel member does not meet the conditions for full immunity, he may be able to benefit from a reduction of fines of up to 50% if he (i) provides verbal or written information and, where available, evidence which makes a significant contribution to proving the offence; and (ii) cooperates fully and on a continuous basis with the FCO. The amount of the reduction shall be based on the value of the contributions to uncovering the illegal agreement and the sequence of the applications.

Obligations to cooperate

The leniency applicant must fully and continuously cooperate with the FCO during the entire duration of the proceedings. He must bring to an end his involvement in the cartel immediately upon request of the FCO, and give the FCO all the information and evidence available to him after the application for leniency has been filed. This includes in particular all information which is of significance for calculating the fine which is available to the applicant or which he can procure. The applicant must keep his cooperation with the FCO confidential, normally until the search has been concluded. The applicant must name all the employees involved in the cartel agreement (including former employees) and ensure that all employees, from whom information and evidence can be requested, cooperate fully and on a continuous basis with the FCO during the process.

Marker, application, statement of assurance

A cartel member—joint applications by cartel members are inadmissible—can contact the FCO to declare his willingness to cooperate. Such communication is called a 'marker.' The timing of the placement of the marker is decisive for the status of the application, in particular for the rank of the leniency application. The marker can be placed verbally or in writing, in German or English. It must contain details about the type and duration of the infringement, the product and geographic markets affected, the identity of those involved and with which other competition authorities applications have been or are intended to be filed. After the marker has been set, the FCO sets a time limit of at most 8 weeks for the drafting of a full leniency application.

In the application the applicant must submit information which, according to immunity levels described above, is (i) the necessary in order to obtain a search warrant, or (ii) necessary to prove the offence, or (iii) significant in proving the offence. The FCO accepts verbal and/or written applications, which can also be done in the English language. When a submission in English has been made, the applicant is required to furnish a German translation without undue delay.

Whenever an applicant does not fulfill his obligations (especially his obligation to cooperate), his status of priority lapses and the subsequent applicants move up in rank.

The FCO confirms to the applicant in writing when precisely (date and time) the marker has been placed and/or that the application has been received. If the requirements for immunity are satisfied, the FCO assures the applicant in writing that he will be granted immunity from the fine on the condition that he was neither the only ringleader of the cartel nor coerced others to participate in the cartel and fulfills his obligations to cooperate.

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Where as a result of an immunity application the FCO was in a position to obtain a search warrant, the FCO initially only informs the applicant that he is the first, second, etc., applicant and that, in principle, especially if he fulfils his duties to cooperate, is eligible for immunity. The same holds true for applications for a reduction. A decision on immunity or reduction is made at the earliest after perusal and examination of all the information and evidence obtained during the search. Only after the search the FCO can examine and assess whether the application is sufficient to prove the offence.

Confidentiality, proceedings

The FCO within the scope of the statutory limits and regulations on the exchange of information with foreign competition authorities will treat in confidence the identity of the applicant. It will protect all trade and business secrets obtained during the course of the proceedings up to the point at which a statement of objections is issued to a cartel member. After an application has been submitted the FCO will use the statutory limits of its discretionary powers to refuse applications by private third parties to get access to the file or the supply of information, insofar as the leniency application and the evidence provided by the applicant are concerned.

Skimming-off of economic benefits, order of forfeiture

If an applicant is granted immunity from a fine, the FCO, as a general rule, will neither skim off the economic benefit nor order a forfeiture. Similarly, if a fine is reduced, the FCO shall

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The European Commission appointments:

Professor Damien Neven is new Chief Economist in the Competition Directorate General, and Ms. Nadia Calviño is new Deputy Director General for Competition

Professor Damien Neven has been appointed by the European Commission as the Chief Economist in the Commission's Competition Directorate General. Professor Neven succeeds the first Chief Economist, Lars-Hendrik Roeller, whose mandate expires at the end of July, after which he will take up the post of President and Chairman of the Management Board of the European School of Management and Technology in Berlin.

Damien Neven has a Doctorate in Economics from Nuffield College (Oxford) and is currently a Professor of International Economics and the Director of Undergraduate Studies at the Graduate Institute of International Studies in Geneva, which he joined in 2001. He taught at INSEAD from 1986 to 1991, the University of Liège from 1991 to 1993 and at the University of Lausanne from 1993-2001.

The Chief Economist assists in evaluating the economic impact of the Commission's actions in the competition field, and provides independent guidance on methodological issues of economics and econometrics in the application of EU competition rules. He contributes to individual competition cases (in particular ones involving complex economic issues and quantitative analysis), to the development of general policy instruments, as well as assisting with cases pending before the Community Courts.

Ms. Nadia Calviño has been appointed Deputy Director-General of the Directorate-General for Competition, in charge of mergers. She will be responsible for developing and formulating EU/Commission policies in the field of mergers. She is succeeding Mr. Götz Drauz who left for private practice.

Nadia Calviño has worked until now in Spain as Director General of Competition within the Ministry of Economy and Finance, where her main tasks were the enforcement of the Spanish competition law as well as articles 81 and 82 of the EC Treaty and the strategic design and management of competition policy in Spain. In this post she contributed to take decisions in sanctioning files of anticompetitive conduct infringing the Spanish competition Law and articles 81 or 82 of the EC Treaty and to co-ordinate the enforcement of competition policy in Spain by the national and regional administrative bodies.

From 1996 to 2004, Nadia Calviño held several posts within the Spanish Ministry of Economy and Finance, in the Competition defence service. From 2001 to 2004, she was Deputy Director-General for Mergers and from 2000 to 2001, she worked as Deputy Director-General for Legal Affairs and Institutional Relations.

Before that, from 1998 to 1999, Nadia Calviño was Deputy Director of Macroeconomic Analysis and Forecast of the Directorate-General of Economic Politics and Competition defence and from 1996 to 1998, she worked as Senior Case Officer in the Deputy Directorate-General for anticompetitive practices.

New antitrust and competition associates in Brussels and Frankfurt

The European antitrust and competition practice of Mayer, Brown, Rowe & Maw LLP has strengthened its practice with the hiring of Margaret Peristerakis and Daniel Wiedmann, associates in the Brussels and Frankfurt offices respectively.

Margaret Peristerakis, admitted in Athens, Greece, was most recently Referendaire to Judge Vilaras, President of the 5th. Chamber of the Court of First Instance of the European Communities in Luxembourg. At the Court of First Instance, she gained valuable insight in a variety of EU law matters, including trade and competition law proceedings. She also gave presentations on the introduction to EC law and the Community Courts for national judges. Prior to serving as Referendaire, Margaret started her career as an attorney in a leading Athens law firm which specialized in the area of IP law. Margaret subsequently worked as trainee at the European Commission, Directorate General for Competition, and as trainee in the antitrust and trade department in the Brussels office of Freshfields Bruckhaus Deringer. She holds a degree in law from the law school of Democritus University of Thrace, Greece, a diploma in EU/US Comparative Law from the Institute of International and Comparative law of Cornell University held in Paris and an LL.M from King's College, London, UK.

Daniel Wiedmann, admitted in Frankfurt am Main, joined the Frankfurt office of Mayer, Brown, Rowe & Maw. Daniel received his law degree from the University of Hamburg in 2000 and an LL.M. degree from New York University School of Law in 2002. During his legal clerkship he worked among others in the antitrust group of Wilmer Cutler Pickering Hale and Dorr in Berlin and the Bundesverband der Deutschen Industrie (Federation of German Industries) in Brussels. Daniel was a student and research assistant at the Institute for European Community Law, at Hamburg University. He is a doctoral candidate under supervision of Professor Franz Jürgen Säcker (Freie University Berlin). His topic is: Mutual recognition, country of origin principle and the European Freedom for Services.

"Market power" continued from page 20

benchmark also must be specified clearly, particularly for the purpose of deriving estimates of competitive prices. Consideration of all relevant evidence will lead to more meaningful conclusions than definitions that lack sufficient specificity for many practical applications (e.g., "the power to force a purchaser to do something that he would not do in a competitive market"[17]) or definitions that are very specific but often wrong (e.g., definitions that equate anticompetitive market power with prices that exceed marginal cost).

By Alan J. Daskin and Lawrence Wu*

* Alan J. Daskin is a Vice President and Lawrence Wu is a Senior Vice President at NERA Economic Consulting. The authors would like to thank Sumanth Addanki for helpful comments and Erika Ibanez for excellent research assistance. This article is a condensed version of the authors' *Observations on the Multiple Dimensions of Market Power*, which appeared in *Antitrust* 19, No. 3 (Summer 2005), published by the American Bar Association.

Endnotes

1 ABA Section of Antitrust Law, Market Power Handbook (2005).

2 *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 391-92 (1956) (stating that it is inconceivable that prices could be controlled without power over competition). *See also Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 596 n.20 (1985).

3 *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992) (citing the ability of a single seller to raise prices and restrict output). *See also Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969); SCFC ILC, Inc. v. Visa U.S.A., Inc., 36 F.3d 958, 965 (10th Cir. 1994).

4 Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 27 n.46 (1984). *See also Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17, 32 (1st Cir. 1990) ("the power to raise price significantly higher than the cost-based level that competition would otherwise bring about").

5 *See, e.g.*, U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines, § 0.1 (1992, revised 1997) [hereinafter Guidelines] and U.S. Dep't of Justice & Federal Trade Comm'n, Commentary on the Horizontal Merger Guidelines (March 2006) (defining market power as "the ability profitably to maintain prices above competitive levels for a significant period of time.") *See also* Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization 8 (4th ed. 2005) ("The ability to price profitably above the competitive level is referred to as market power, and such conduct leads to welfare losses by society.")

6 A rational profit-maximizing firm will want to sell the quantity at which the firm's marginal revenue (MR) just equals its marginal cost (MC): If selling an additional unit increases the firm's revenue more than it increases its cost—i.e., MR exceeds MC—the firm can increase its profits by selling another unit, so it should do so. Similarly, if selling one less unit reduces the firm's costs more than it reduces the firm's revenue—i.e., MC exceeds MR—the firm can increase its profits by selling one less unit, so it should do so. Only when MR *equals* MC will the firm be maximizing its profits. For a firm in a competitive industry, the MR = MC condition required for profit maximization implies that it will choose the quantity at which its marginal cost just equals the market price. That follows because, for such a firm, the extra revenue it earns from selling an additional unit is simply the market price (MR = P). If MR = P and the firm sells the quantity at which MR = MC, MC must equal P; i.e., the firm must be selling the quantity at which its marginal cost equals the market price.

7 By the same token, an individual firm selling under such market conditions would have no incentive to reduce its price below prevailing levels: Because its output is small relative to total market output, the firm can effectively sell as much as it wants at the prevailing market price.

8 There is no firm general consensus about what precisely constitutes a barrier to entry. For discussions of some of the issues, see W. Kip Viscusi, John M. Vernon & Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 156-60 (3d ed. 2000); R. Preston McAfee, Hugo M. Mialon, and Michael A. Williams, *What is a Barrier to Entry?* 94 American Economic Rev. 461; Dennis W. Carlton, W*hy Barriers to Entry are Barriers to Understanding*, 94 American Economic Rev. 466; and Richard Schmalensee, *Sunk Costs and Antitrust Barriers to Entry*, 94 American Economic Rev. 471. For further details, see Market Power Handbook, *supra* note 1, ch. VII.

9 *See supra* note 6.

10 A monopolist that sets a single price must reduce the price in order to sell a larger quantity. When it does so, the extra revenue the firm earns from selling an additional unit is offset at least partly by the reduced revenue it earns on units it *could* have sold at the higher price. The monopolist's price, therefore, exceeds its marginal revenue (P > MR). If P > MR and the firm sells the quantity at which MR = MC, the price must *exceed* marginal cost at the firm's profit-maximizing quantity (P > MC).

11 *See, e.g.*, Luís M.B. Cabral, *Introduction to Industrial Organization* 6 (2000) ("Market power may be defined as the ability to set prices above cost, specifically above incremental or marginal cost, that is, the cost of producing one extra unit." [footnote omitted])

12 More precisely, the price-cost margin, sometimes called the Lerner Index, is defined as (P-MC)/P. *See, e.g.*, Carlton & Perloff, *supra* note 5, at 93.

13 William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70 Antitrust L.J. 661, 661 (2003). For related papers, see *Symposium: Competitive Price Discrimination*, 70 Antitrust L.J. 593 (2003).

14 That is apparently consistent with the position taken by Jonathan Baker in his discussion of price discrimination: "Courts should…continue to follow the well-established analytical methodology of considering all relevant evidence of market power, direct and indirect alike, when market power is the issue, treating the inference of anticompetitive effect from

proof of market power as rebuttable, and accounting for legitimate business justifications in determining whether a practice with some anticompetitive effect is unreasonable." See Jonathan B. Baker, *Competitive Price Discrimination: The Exercise of Market Power Without Anticompetitive Effects (Comment on Klein and Wiley)*, 70 Antitrust L.J. 643, 654 (2003).

15 Baumol & Swanson, *supra* note 13, at 681-82. Baumol and Swanson recognize the "substantial practical difficulties in method of economic profit estimation and acknowledge that the profit standard is no easy solution." *Id.* at 683. As Baumol and Swanson note, there is no well-defined distinction between market power and monopoly power; they use "market power" to encompass "monopoly power." *Id.* at 662, n.2.

16 For other criticisms of inferences of market power from prices that exceed marginal cost and the use of the degree of inelasticity of demand to measure the degree of market power, see Benjamin Klein & John Shepard Wiley Jr., *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 Antitrust L.J. 599 (2003), and *Market Power in Economics and in Antitrust: Reply to Baker*, 70 Antitrust L.J. 655, 657-58 (2003).

17 Eastman Kodak Co. v. Image Technical Servs., Inc.

"Merger review" continued from page 32

carefully whether it is beneficial to take advantage of the reforms in the particular circumstances of their transactions.

Michael P. Bodosky (Washington, D.C.)

Endnotes

1 *See* 16 C.F.R. §801 *et seq*.

2 In the past, the FTC and DOJ relied largely on structural indicators, such as market share and concentration data, in determining whether transactions were likely to result in harm to competition. The agencies often presumed that combinations resulting in high or moderate-sized increases in market share were unlawful unless the parties produced compelling evidence indicating that the transaction would not harm competition. Today, the agencies rely less on structural indicators and more on direct examination of competition in the particular industry at issue. The agencies' analyses often involves fact intensive econometric modeling which generally requires analysis of large amounts of data. *See* Deborah Platt Majoras, Chairman, Federal Trade Commission, Reforms To The Merger Review Process (Feb. 16, 2006). In addition to the costs associated with the identification, retrieval, and production of data, parties often conduct their own econometric analyses in order to substantiate claims that their transaction will not harm competition.

3 Susan A. Creighton, Director, Bureau of Competition, Federal Trade Commission, Hart-Scott-Rodino Second Request Process: Prepared Remarks before the Antitrust Modernization Commission (Nov. 17, 2005).

4 In 2002, the Bureau of Competition published "Guidelines for Merger Investigation," *available at* www.ftc.gov/os/2002/12/bcguidelines 021211.htm. Also, in 2000, the American Bar Association addressed the topic with "Guidelines for Mergers," *available at* www.abanet.org/antitrust/comments/2000/mergerguidelines.html. Notably, the tremendous cost and delay associated with Second Request productions have not declined as a result of these publications.

5 Staff may agree to waive the requirement that a party make its employees available in person.

6 If the Director authorizes a larger search group, the party will not be required to produce materials 30 days prior to certification of substantial compliance, or agree to timing agreements or a 60-day discovery period.

7 The Bureau of Economics previously articulated best practices concerning data issues in 2002. *See* Bureau of Economics, Federal Trade Commission, Best Practices for Data, and Economic and Financial Analyses in Antitrust Investigations (Nov. 2002), available at www.ftc.gov/be/ftcbebp.pd. Also in 2002, the Bureau of Competition released guidelines intended to increase transparency associated with agency review of mergers and acquisitions. See "Guidelines for Merger Investigation," *available at* www.ftc.gov/os/2002/12/bcguidelines021211.htm.

8 *See* U.S. Department of Justice and Federal Trade Commission Commentary on Horizontal Merger Guidelines (Mar. 2006).

9 See FTC Model Second Request, available at www.ftc.gov/bc/modelguide.htm.

"Damages actions" continued from page 4

Endnotes

1 ECJ, jud gment of 13 July 2006, joined Cases C-295/04 to C-298/04, *Vincenzo Manfredi and Others v. Lloyd Adriatico Assicurazioni SpA and Others*, not yet published.

2 European Commission, Green Paper — Damages actions for breach of EC antitrust rules, 19 December 2005, COM (2005) 672 final.

3 Council Regulation (EC) No. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (2003) OJ L1 p.1.

4 ECJ, Case C-453/99 *Courage v. Crehan* [2001] ECR I-6297.

5 European Commission, Green Paper — Damages actions for breach of EC antitrust rules, 19 December 2005, COM (2005) 672 final.

6 European Commission, Staff Working Paper, Annex to the Green Paper — Damages actions for breach of EC antitrust rules, 19 December 2005, SEC (2005) 1732.

7 Study on the conditions of claims for damages in case of infringement of EC competition rules, 2004 available at http://ec.europa.eu/comm/competition/antitrust/others/actions_for_damages/study.html.

"PolyGram" continued from page 14

stand. PolyGram's theory may very well have worked if it had been supported by the record.

Finally, lawyers matter, and clients should consult with and listen to them. If a restraint like the moratorium is truly important, the deal should be structured to minimize the antitrust exposure. In this case, contributing 3T1 and 3T2, at least temporarily, would probably have been sufficient. If this integration is impossible, but a restraint like the moratorium is important, it should be identified early on, ideally as part of the initial agreement. The earlier it is implemented, the more credible the story that it is important.

The justifications in favor of such a restraint also should be scrutinized by counsel, and the facts supporting each justification developed. If, for example, a client wants to justify a restraint by claiming a "free riding" problem, counsel should test the assertions. There are several questions counsel should ask. First, counsel should inquire whether the free riding problem is significant, or just run of the mill competition; in order words, in the absence of the restraints, will free riding have the effect of eliminating a venture product or service (such as advertising), or causing the product or service to be delivered in an inefficient manner. Second, counsel should test whether there is a less restrictive way of dealing with the problem. For instance, counsel should explore whether there is any way to fix the free riding problem through compensation, by ensuring that the potential free rider will pay for its ride.

Undoubtedly, *PolyGram* is an important antitrust case, from a theoretical and doctrinal point of view. But its facts are unusual. Extrapolating to create general rules based on the facts of *PolyGram* is not useful; viewing the facts to try to avoid *PolyGram's* pitfalls is.

John Roberti (Washington, D.C.)

Endnotes

1 *E.g., Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).

2 *Augusta News Co. v. Hudson News Co.*, 269 F.3d 41 (1st Cir. 2001).

3 *Northrop Corp. v. McDonnell Douglas Corp*., 705 F.2d 1030 (9th Cir. 1983).

4 *Continental Airlines, Inc. v. United Air Lines, Inc*., 277 F.3d 499 (4th Cir. 2002)

5 *Addamax v. Open Software Found., Inc.*, 152 F.3d 48 (1st Cir. 1998).

6 Federal Trade Commission and U.S. Department of Justice, *Antitrust Guidelines for Collaboration Among Competitors* (Apr. 7, 2000) (hereinafter, "*Collaboration Guidelines*") at 1.

7 *Id*.

8 416 F.3d 29 (D.C. Cir. 2005)

9 The author was trial counsel in the FTC staff's case in front of the Administrative Law Judge and played a significant role in the appeals to the Commission and the D.C. Circuit.

10 *PolyGram* is indeed important, and stands for the proposition that restraints analysis generally involves a continuum rather than a black lines between per se and the rule of reason. In this sense, it reintroduces the Commission's approach in *In re Massachusetts Board of Optometry*, 110 FTC 549 (1988). It also supports the proposition that restraints on advertising price outside of the professional context are inherently suspect.

11 *PolyGram*, 416 F.3d at 31.

12 I*n Re PolyGram Holding, Inc.*, Docket No. 9298, 2002 WL 1422222 (FTC, Jun. 20, 2002) ("Initial Decision") ¶ 33.

13 Initial Decision ¶¶ 200-234.

14 *PolyGram*, 416 F.3d at 31.

15 Initial Decision ¶¶ 51-53

16 *PolyGram*, 416 F.3d at 31.

17 *Id.* at 32.

18 *Id*.

19 *Id*.

20 In an FTC antitrust conduct investigation, the process is as follows. First, staff of the FTC's Bureau of Competition ("BC") makes a recommendation either to file a complaint or to close. If there is a recommendation to sue, the full Commission must vote to approve the complaint. If approved, staff prosecutes the matter under FTC adjudicatory rules, called "Part 3 rules," before an Administrative Law Judge (ALJ). Staff prosecuting the case (including BC staff, Bureau of Economics staff and occasionally individuals from the General Counsel's office) is then "walled off" from Commissioners and their staff (including attorney advisors, the office of the secretary and most members of the General Counsel's office). The ALJ renders an Initial Decision and recommended Order, which then is reviewed *de novo* as to both law and facts. The Commission in turn renders an Opinion and Order, which is appealable to any Circuit in which the Respondent is present.

21 In Re *PolyGram Holding, Inc*., Docket No. 9298, 2003 WL 21770765 (Jul. 28, 2003), available at http//www.ftc.gov/os/2003/07/polygramopinion.pdf (hereinafter "FTC Opinion").

22 *Yamaha Motor Co., Ltd. v. Federal Trade Commission*, 657 F.2d 971, 981 (8th Cir. 1981) (joint venture that prohibited one venture partner from competing in the United States condemned after being found not to be reasonably necessary to the purpose of the venture); *In re General Motors Corp.,* 103 FTC 374 (1984) (consent order allows

coordination for venture products, but prohibits exchange of information or coordination on non-venture products).

23 *Id*. at 37.

24 *Collaboration Guidelines* Ex. 10 at ¶¶ 34-35. See also *Polk Bros., Inc. v. Forest City Enterprises, Inc*., 776 F.2d 185, 188 (7th Cir. 1985) (joint venture to build facility; ancilliary agreement not to compete on any products sold at joint facility not condemned).

25 *PolyGram Holding, Inc. v. FTC*, Docket No. 03-1293, Brief for the Respondent 48 (March 8, 2004) ("FTC Brief").

26 *Collaboration Guidelines* 9.

27 776 F.2d 185, 187 (7th Cir. 1985)

28 792 F.2d 210, 229-230 (D.C. Cir. 1986).

29 FTC Opinion at 43.

30 *PolyGram*, 416 F.3d at 37-38, citations omitted.

31 *Rothery*, 792 F.2d at 212-213, 221-223.

32 *Polk Bros.*, 776 F.2d at 190.

33 *Collaboration Guidelines* at 24; see also id. at Ex. 2 at 29.

"Mexican law" continued from page 24

it more difficult for an investigatory target to oppose such information requests.

Additional CFC powers[14]

The Reform spells out that the CFC has authority to issue official advisory opinions regarding any anti-competitive effect resulting from projects, decisions, rules and policies of other federal agencies or offices of the executive branch. Such opinions may be opposed by the President of Mexico, in which case both the CFC opinion and the opposing opinion of the executive branch shall be published. The Commission also is empowered to issue rulings regarding any anticompetitive effects of acts, rules or laws of municipal and state authorities. These rulings shall be sent to the President or to the Federal Attorney General, as the case may be, both of which have discretion to enforce such rulings or not. Finally, the Commission may issue non-binding opinions on proposed federal legislation that might affect the free flow of commerce, as well as on any relevant matter, as requested by a business.

Senate confirmation of commissioners[15]

The Senate may now reject the appointment of any CFC commissioner, by a majority vote.

The Chairman of the CFC will hold his office for six years and that individual shall serve an additional four years as a commissioner.

David Hurtado, (Jáuregui, Navarrete y Nader, S.C., Mexico City)

Endnotes

1 Article 10.

2 Reglamento de la Ley Federal de Competencia Económica, Article 7.

3 Under Mexican Law, regulations may not include sanctionable conducts not expressly defined by Congress in the Law they regulate.

4 Article 33, bis 3.

5 An absolute monopolistic practice is considered as any contract, agreement, arrangement or combination between or among competitors, whose purpose or effect is any of the following: (i) to fix, raise, combine or manipulate prices of products or services, or to exchange information with the same purpose or effect; (ii) to impose any obligation to produce, manufacture, distribute, commercialize or acquire but only in restricted or limited amounts, or to restrict or limit the number, volume or frequency of services that may be provided by others; (iii) to divide, allot, assign or impose portions or segments of a particular market of products or services on the basis of clients, suppliers, time or space; (iv) to fix, rig or coordinate bids or restrict participation in any competitive biddings, tenders, public sales and auctions.

6 Article 35.

7 A relative monopolistic practice is considered as any contract, agreement, procedure, arrangement or accord whose purpose or effect is or may be to unduly displace other economic agents from participating in, or prevent such other economic agents from having access to a relevant market, or to establish any advantage in favor of one or more persons.

8 Article 20.

9 The value of the "Mexican portion of the transaction" is the value the parties assign to the assets located in Mexico or Mexican entities being sold as part of the transaction or, if no such value has been assigned, as is common in foreign transactions, the determination as to whether the transactions should be notified to the Commission is based upon the elements established in the other two thresholds of paragraphs II and III of Article 20, successively, which are described in the next two bullet points above.

10 Article 20.

11 Article 21, bis.

12 Article 35.

13 Article 31.

14 Article 24, and Article 14.

15 Articles 26 and 28.

“Price gouging” continued from page 40

Price regulation in the oil industry: Possible next steps

While the FTC report will not provide any ammunition for price regulation in the oil industry, we believe that there will continue to be inquiry and activity relating to oil price regulation in the near future.

For example, on April 25, 2006, President Bush directed the Department of Justice and the Department of Energy to join forces with the FTC in conducting a new inquiry into the increases in gasoline prices and the reasons for the increases. The FTC report acknowledges this directive, and suggests the possibility of collaboration. The FTC suggests that, utilizing its knowledge, it will look into oil industry profitability; the DOJ will use its expertise in criminal cartel investigations to sniff out collusion; and the DOE will bring its technical expertise to further the mission.

In its report, the FTC also noted that the Commission plans to continue to work with state attorneys general to refine its analysis of petroleum industry issues. The FTC currently works closely with state attorneys general to assist in law enforcement activities. However, the involvement of state attorneys general does not make an antitrust claim more viable. While it is possible that the FTC will share its expertise with the state attorneys general to assist in price gouging or similar investigations under state law, it appears unlikely that there will be any significant antitrust enforcement activity.

Legislation also remains a serious possibility. The current House legislation would require the FTC to define price gouging; however, in its report, the FTC clearly signaled hostility to such legislation. Because FTC staff appears to believe that price gouging legislation is anti-consumer, it is unlikely that the FTC has dedicated significant resources to coming up with a definition for such activity. Thus, short of new legislation creating an entirely new regulatory regime, it appears unlikely that there will be any federal enforcement action relating to price gouging or increased prices in the oil industry.

John Roberti (Washington, D.C.)
Michael P. Bodosky (Washington, D.C.)

Endnotes

1 H.R. 5253., 109th Cong. (2006).

2 In addition to “price gouging,” the bill directs the FTC to define “wholesale sale” and “retail sale” through rule-making within six months of enactment, regardless of whether price gouging occurs amid crisis conditions (like those following Hurricane Katrina) or through business as usual.

3 If passed, the bill will establish civil penalties for price gouging by wholesalers and retailers of three times the ill-gotten gains of the seller. Wholesalers will be fined an additional amount not to exceed $3 million per day of a continuing violation. Funds derived from civil penalties will be deposited into any account or fund used for paying compensation to consumers for violation of state consumer protection laws or into a state’s treasury general fund. In addition to civil penalties, the bill also provides strong criminal penalties for price gouging violations—wholesale and retail violations will be punishable by imprisonment for up to two years.

4 S.1640, 109th Cong. (2005); S.1717, 109th Cong. (2005); S.1735, 109th Cong. (2005); S.1743, 109th Cong. (2005); S.1744, 109th Cong. (2005); S.1854, 109th Cong. (2005); S.1973, 109th Cong. (2005).

5 S. 2557, 109th Cong. (2006).

6 *See* Federal Trade Comm’n, Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases, File No. 051-0243 (2006) at 196-197 [hereinafter Federal Trade Comm’n, Gasoline Price Investigation].

7 *See id*. at 189-90.

8 *See id*. at 190-91.

9 Unconscionability cases have been particularly difficult for courts to analyze because there are no clear criteria as to when a price term is unconscionable. Unconscionability provides an uncertain basis for relief because the term “unconscionability itself is incapable of precise definition.” *See id*. at 191-92 n.33 citing E. ALLAN FARNSWORTH, CONTRACTS § 4.28, at 310 (1982). The FTC identified only five cases addressing the definition of unconscionability, none of which involved gasoline. *See id.* at 192 n.34 citing *State v. Strong Oil Co.*, 433 N.Y.S.2d 435 (Sup. Ct. 1980), rev’d on other grounds, 451 N.Y.S.2d 437 (N.Y. App. Div. 1982); *People v. Two Wheel Corp.*, 525 N.E.2d 692 (N.Y. Ct. App. 1988); *People v. Chazy Hardware, Inc.*, 675 N.Y.S.2d 770 (Sup. Ct. 1998); *People v. Beach Boys Equipt. Co.*, 709 N.Y.S.2d 72 (2000); *People v. Dame*, 734 N.Y.S.2d 789 (Sup. Ct. 2001).

10 During World War II, the price of gasoline was strictly regulated and the market was cleared through a system of coupon rations. *See id*. at 184-85 n.3. Over the years, Congress has passed statutes imposing price regulations in a number of industries, including airlines, trucking, and other industries originally deemed ill-suited for market-based competition. However, a number of formerly regulated industries have been substantially deregulated as a general consensus has emerged that competition in most markets is more effective than any form of price control. *See id*.

11 *See* Energy Policy Act of 2005 and Section 632 of the Science, State, Commerce, Justice and Related Agencies Appropriations Act 2006.

12 *See* Federal Trade Comm’n, Gasoline Price Investigation at 20.

13 *See id*. at 43.

14 Pipeline owners ship different products and different grades of product (e.g., premium gasoline, regular gasoline, and diesel fuel) on a single line by transporting "batches" of product in sequence. Each sequence is known as a "cycle," with each product or grade of product allocated a "slot" within each cycle. If a shipper misses its slot, it must wait until the next cycle to transport its product. Shippers "nominate" the volume of product to be included in each cycle. During periods of high demand when the aggregate volume of nominated product exceeds capacity, pipelines rely on tariff provisions to prorate the available capacity among shippers, typically in a manner that reflects each shipper's historical shipment volumes and current needs, but also taking into consideration the needs of new shippers not having an historical base. *See id.* at 37; *see also* Richard A. Rabinow, *The Liquid Pipeline Industry In The United States: Where It's Been, Where It's Going* at 37 (2004) (report prepared for Ass'n of Oil Pipe Lines), *available at* www.aopl.org/posted/888/Rabinow_report.112734.pdf.

15 *See, e.g.*, *Valero L.P.*, FTC Dkt. No. C-4141 (July 22, 2005); *Exxon Corp.*, FTC Dkt. No. C-3907 (Jan. 26, 2001); and *Shell Oil Co.*, 125 F.T.C. 769 (1998).

16 The FTC Petroleum Merger Report identified seven instances since 1981 in which the Commission alleged that an acquisition threatened to reduce competition in a terminaling market. *See* PETROLEUM MERGER REPORT at 38. Since publication of the report in 2004, the FTC has addressed terminaling issues in three cases: *Magellan Midstream Partners, L.P.*, FTC Dkt. No. C-4122 (Nov. 23, 2004); *Buckeye Partners, L.P.*, FTC Dkt. No. C-4127 (Dec. 17, 2004); and *Valero L.P.*, FTC Dkt. No. C-4141 (July 22, 2005).

17 *See Valero L.P.*, FTC Dkt. No. C-4141 (June 15, 2005) (Analysis of Proposed Consent Order to Aid Public Comment).

18 *See id.* at 49.

19 *See id.* at 58.

20 *See id*. at 65-67.

21 The definition of price gouging for purposes of the FTC's report is set forth in Section 632 of the Science, State, Commerce, Justice and Related Agencies Appropriations Act 2006.

22 *See* Federal Trade Comm'n, Gasoline Price Investigation at 150.

23 *See id*. at 154.

24 *See id*. at 152.

25 *See id*. at 196.

26 *See id*. at 196-97.

27 *See* Concurring Statement of Commissioner Jon Leibowitz Regarding the Commission's Report, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," File No. 051-0243 (2006).

28 *See id*. at 2-3.

29 *See* Federal Trade Comm'n, The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement (2004).

30 *See id.*

31 *See* Federal Trade Comm'n, Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition (2005).

32 See id.

"New leniency" continued from page 43

only skim off a proportion of the economic benefit or order partial forfeiture which corresponds to the proportion by which the fine is reduced.

Relationship to EU Commission

The Leniency Notice acknowledges the fact that for certain cartel investigations the EU Commission may be the best placed authority to deal with the situation. The concept of "best placed authority" stems from the NCA Notice[4] pursuant to which an authority can be considered to be well placed to deal with a case if (i) the agreement or practice has substantial direct actual or foreseeable effects on competition within its territory, is implemented within or originates from its territory; (ii) the authority is able effectively to bring to an end the entire infringement, i.e., it can adopt a cease-and-desist order the effect of which will be sufficient to bring an end to the infringement and it can, where appropriate, sanction the infringement adequately; and (iii) it can gather, possibly with the assistance of other authorities, the evidence required to prove the infringement. If in such a case the EU Commission is better placed, the FCO can exempt the applicant who has placed a marker for full immunity before the FCO had sufficient evidence to obtain a search warrant from filing a full application, if he has filed an application with the Commission or intends to do so. However, if the EU Commission does not pick up the case, the FCO can request that the applicant submits a full application pursuant.

Jens Peter Schmidt (Brussels)

Endnotes

1 Commission Notice on immunity from fines and reduction of fines in cartel cases (2002/C 45/03).

2 See article of *Kiran Desai i*n this issue.

3 Belgium, Cyprus, Czech Republic, Estonia, Finland, France, Germany, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Netherlands, Poland, Slovakia, Sweden, and the UK.

4 Commission Notice on cooperation within the Network of Competition Authorities (2004/C 101/03).

"MasterCard decision" continued from page 8

had had an opportunity to consider the issue. As to the relative advantages of withdrawal or setting aside, the CAT was of the opinion that the end result would be more or less the same, although in the present case it recognized that there is a need for legal clarity and certainty. While the legal effect of a withdrawal is not entirely clear, an Order of the CAT setting aside the decision is "*a clear and definite judicial act which avoids uncertainty and which at the same time gives the appellants the essence of the relief that they seek in this appeal.*"

The CAT concluded that, overall, whether or not to hear the appeals for the purpose of determining MasterCard's claims for declaratory relief is a discretionary matter for the Tribunal to decide and that under the circumstances the CAT had not been persuaded that it would be appropriate for it to continue to hear a case in which the competition authorities have indicated that there are continuing investigations.

Conclusions

In this case, particularly due to the fact that a parallel investigation is taking place at EU level, the CAT was reluctant to come to a conclusion as to the legality of the interchange fees. However, the CAT was not as cautious in asserting its powers. In its capacity as an appellate tribunal, the CAT has decided in some past cases that there was an infringement of competition laws and substituted its judgment for the OFT's decision. The CAT is of the view that it can make the same decisions as the OFT, including to come to a finding that there is no infringement of competition laws when considering a contested OFT decision.

It should also be noted that the CAT decided to set aside the contested decision rather than allow the OFT to simply withdraw the decision. This indicates that the CAT is not comfortable with encouraging the OFT to withdraw decisions when an appeal has been lodged, mainly due to the lack of legal certainty that is entailed in a withdrawal taking place as such a late stage in the proceedings before the CAT.

Overall, the CAT's decision is likely to have a substantial, and potentially decisive, impact on the new MasterCard investigation that has recently been launched by the OFT. It can be predicted that the OFT will now pursue its investigation with renewed energy since it has not been criticised by the CAT for its procedural conduct or for its findings in the previous investigation. Moreover, it will be able to use arguments similar to the previous case when and if, as it looks likely, it decides to issue an infringement decision against MasterCard in the near future.

Ilaria Filippi (London)

Endnotes

1 Current members of MMF are Abbey National plc, AIB Group (UK) plc, Alliance & Leicester plc, Bank of Ireland, Bank of Scotland, Barclays Bank plc, Capital One Bank (Europe) plc, Goldfish Bank Limited, HFC Bank plc, HSBC Bank plc, Lloyds TSB Bank plc, MBNA Europe Bank Limited, Morgan Stanley Dean Witter Bank Limited, National Australia Group Europe Limited, National Westminster Bank plc, and The Royal Bank of Scotland plc.

2 Decision CA98/05/05.

3 OFT press release on 20 June 2006.

4 *Association of British Insurers v Office of Fair Trading.*

5 *The Association of Convenience Stores v. Office of Fair Trading* [2005] CAT 36.

6 By Decision 2003/741/EC of 13 August 2003 relating to a proceeding under art. 82 of the EC Treaty (Case COMP D3/38.044 – *NDC Health v. IMS Health: Interim measures)* (OJ 2003 L 268, p. 69), the Commission withdrew Decision 2002/165. In Case T-354/02: Bristol-Myers Squibb International Corporation the Commission withdrew Decision C(2002)3370 of 9 September 2002.

7 In *ME Burgess JJ Burgess and SJ Burgess* (trading as JJ Burgess & Sons) *v. Office of Fair Trading* and in *Institute of Independent Insurance Brokers v Director General of Fair Trading*.

8 *Floe Telecom Ltd* (In Administration) *v. Office of Communications*, (CA (Civ Div)) Court of Appeal (Civil Division), 15 June 2006.

9 *Napp Pharmaceutical Holdings Limited and Subsidiaries v. Director General of Fair Trading*.

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