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CLIENT ADVISORY

ANTITRUST MODERNIZATION COMMISSION RELEASES REPORT AND RECOMMENDATIONS

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On April 2, 2007, after three years of hearings, public comments, and deliberations, the Antitrust Modernization Commission submitted its report and recommendations to the President and the Congress. The 12-member bipartisan Commission was created by the Antitrust Modernization Act of 2002 to evaluate and report on proposals for revising the antitrust laws, and first met three years before issuing its report.

The Commission Report does not propose large-scale substantive changes to the antitrust laws. Rather, it concludes that the state of US antitrust enforcement is generally "sound," and that "on balance," current enforcement appropriately fosters innovation, protects and promotes competition rather than the interests of competitors, and aggressively punishes criminal cartels. The Commission Report also rejected claims that changes in substantive law or analysis are warranted for today's economy—a conclusion applauded by the DOJ's Antitrust Division in a press release issued the day after the Report was presented.

Notwithstanding the Report's general conclusion that the antitrust laws generally function well and do not require significant overhaul, the Commissioners issued 80 separate recommendations for certain improvements. Several of their recommendations propose specific legislative action (and are accompanied in the Report by proposed statutes for Congress to consider); others would require action by the federal enforcement agencies. A smaller number of the Commission's recommendations, however, constitute guidance for applying Sherman Act case law, and might therefore prove persuasive in future litigation. This client advisory summarizes and analyzes some of the most salient of the Commission's varied recommendations.

I. RECOMMENDED STATUTORY REFORMS

A. Repeal of the Robinson-Patman Act

Not unexpectedly, the Commission recommended that the Robinson-Patman Act be entirely repealed. That Act prohibits the sale of commodities of like grade and quality for different prices to different purchasers, where the price

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difference "injures competition." The Commission Report had harsh words for the Act, noting that it was "antithetical to core antitrust principles," (Report at iii), as it has caused consumers to pay higher prices by reducing the volume and variety of discounts otherwise available and creating substantial compliance costs for businesses. As the Report acknowledged, studies of the antitrust laws have expressed similar concerns about reconciling the Act to broader antitrust policies since as early as 1955. (Report at 312.) In the face of the stubborn resilience of the Act to proposals for its modification or further judicial narrowing, the Commission concluded that the time had come to "abandon piecemeal proposals for legislative change," and simply repeal the Act.[1] The Commission Report hopes that such a repeal, were it to pass, would also provide the impetus for the States to remove similar such price discrimination statutes from their books, rather than to increase activity under state statutes that have remained largely dormant in favor of the federal price discrimination law.

B. Antitrust Litigation Reform

The Commission also set forward several recommendations that, if adopted by Congress, would reform antitrust litigation by: (a) consolidating all claims of persons injured by an antitrust violation in one court under federal law; and (b) reforming the judicial rules against contribution to apportion liability more evenly among the participants in an alleged conspiracy. Current law provides for joint and several liability of all co-conspirators without a right of contribution and only a limited reduction in the amount of a final judgment to account for settlements.

1. Federalizing Indirect Purchaser Litigation

In the Commission's view, "to the maximum extent possible, a single federal court should hear all proceedings relevant to actions by direct and indirect purchasers alleging the same antitrust violation." (Report at 275.) To that end, the Commission recommended a federalization of indirect purchaser law and a number of procedural changes that would drive all antitrust litigation to federal courts. More specifically, the Commission called for: (1) a legislative overrule of *Illinois Brick v. Illinois*, 431 US 720 (1977), and *Hanover Shoe v. United Shoe Machinery*, 392 US 481 (1972), to allow both direct and indirect purchasers to recover their actual damages, trebled, in a single forum under federal law[2]; (2) a concomitant expansion of federal jurisdiction to allow removal of all indirect purchaser actions brought under state antitrust law to the same court; and (3) a legislative overrule of *Lexecon v. Milberg Weiss Berhad Hynes & Lerach*, 523 US 26 (1998) to provide for consolidation of trials—not merely pretrial proceedings—in a single federal court.

The Commission's recommendations regarding centralizing indirect purchaser litigation would extend and consolidate the effect of recent developments in antitrust class action litigation practice. The enactment of the Class Action Fairness Act ("CAFA") in February 2005, which expanded federal jurisdiction to encompass most class actions for damages equal to or greater than $5 million, has led to many indirect purchaser cases being filed in federal court, rather than in state courts as had previously been the case. The MDL transfer procedure of 28 USC. § 1407 allows for all federal cases alleging harm from the same claimed conspiracy to be transferred for coordinated and consolidated

1 Even so, Commissioner John Shenefield disagreed with the other Commissioners on the advisability of a blanket repeal, instead favoring "preserving a kernel of the Act," (Report at 443). Commissioner Jonathan Yarowsky similarly recommended retaining a more limited provision.

2 Three Commissioners would have been willing to revise the litigation landscape even further: Commissioners Carlton, Litvack, and Warden would have permitted only direct purchasers to recover for injury under the antitrust laws and preempted state statutes allowing for indirect purchaser recovery. The Report, however, states that "federalism and political pragmatism" require deference to the conclusion of many states that indirect purchaser recovery remains proper.

pre-trial proceedings—regardless of whether the claims arise under federal law or the state laws allowing indirect purchasers recovery. Additionally, the consolidation of all direct and indirect purchaser cases in one federal court and the subsequent filing of consolidated complaints now allows for at least the possibility for joint trials of national direct purchaser and indirect purchaser claims.

Nevertheless, the Commissioners were apparently unconvinced that these devices consolidate litigation to the maximum degree possible. The Report noted that exceptions to CAFA still allow for certain indirect purchaser cases to remain in the state courts and that suits of large indirect purchasers who opt out of certified classes can also proceed in state court. These exceptions to CAFA's reach therefore leave open the possibility of inconsistent and duplicative litigation. Furthermore, the Commission Report notes that absent consolidation of all claims in one court, fair apportionment of damages may not be possible, and the possibility of duplicative recovery remains. In the face of objections as to the manageability of a litigation that includes the claims of hundreds of different plaintiffs alleging claims arising under multiple different statutes, the Commission Report stated that it had every confidence in the managerial ability of the federal courts.

2. Statutory Right of Contribution

The Commission also characterized the current rules governing apportionment of damages among defendants as "fundamentally unfair." (Report at 252.) Currently, all defendants are jointly and severally liable and are entitled to a reduction of the judgment only by the pre-trebled amount paid by other defendants that have settled. Unlike tort law, there is no right of contribution among antitrust co-defendants. As a result "less culpable defendants may pay an unfairly large share of total damages, while more culpable defendants escape significant (or any) liability." (Report at 252.) Such a rule "may" be overdeterrent. Therefore, the Commission recommended Congress enact legislation that would: (a) permit non-settling defendants to reduce plaintiffs' remaining claims against the non-settling defendants by the ratable share of liability (usually market share) or actual amount of the settlement; and (b) permit non-settling defendants to seek contribution from other non-settling defendants to the extent a plaintiff has collected a disproportionate share of its judgment from one or more of the non-settling defendants. Interestingly, the first part of this recommendation was unanimous, while the second was not. Two Commissioners found the concern for the "fairness" of damages payable by cartel participants misplaced and did not join the recommendation that a right of contribution among non-settling defendants be enacted.

II. RECOMMENDATIONS FOR REFINING MERGER ANALYSIS AND REVIEW PROCESS

The Commission did not recommend any large-scale changes in the legal landscape affecting merger analysis, concluding that Section 7 of the Clayton Act should remain unchanged and that the dual enforcement system in which both the FTC and DOJ's Antitrust Division have jurisdiction over merger challenges be retained. The Commission did, however, issue over twenty different recommendations that would fine-tune current merger enforcement. Most of those recommendations addressed: (a) refining existing merger substantive law to accord greater weight to efficiencies that might enhance innovation over the long-term; (b) standardizing the legal standards governing challenge of a proposed merger by the FTC or DOJ; (c) lowering the burden placed on parties subject to a second request under the Hart-Scott-Rodino Act; and (d) increasing the overall transparency and predictability of agency merger enforcement actions to practitioners and businesses.

A. Refining Substantive Merger Law

Although the Commission largely refrained from making specific

recommendations regarding merger analysis, the Commissioners did recommend that enforcement agencies give greater weight to innovation efficiencies in merger review. The Report is somewhat muted in defending this claim, stating that the Commission had been presented with "little evidence the agencies were routinely failing to take efficiencies into account," or that the agencies set the burden for demonstrating off-setting efficiencies too high. (Report at 57.) Nevertheless, the Report concludes that the agencies "may be giving insufficient credit" to fixed-cost efficiencies, such as those that would increase innovation through research and development. As a result, enforcement policy "may give insufficient recognition to innovation efficiencies" when enforcement personnel believe anticompetitive effects might result in the short term. (Report at 58.) Similarly, the Commission also recommended an additional tweak in the Merger Guidelines to "ensure that innovation that will change competitive conditions more than two years in the future receives proper credit" and that the agencies correspondingly apply the Merger Guidelines' two-year horizon for considering whether a proposed merger would alter competitive conditions more flexibly. (Report at 60.)

B. Amending the FTC Act to Equalize FTC Merger Authority with that of DOJ

Several of the Report's recommendations would equalize the legal regime covering administrative challenge of merger transactions so that parties would face the same procedures and legal standards whether their merger is challenged by the DOJ or the FTC. The Commission would conform the FTC's authority and practices to those of the DOJ, eliminating areas where the FTC arguably has greater authority or discretion compared to the DOJ. The Commission made three recommendations that would cabin the FTC's authority: (1) the FTC, when proceeding in district court to challenge a merger, should adopt a policy requiring it to seek both preliminary and permanent relief in the same proceeding, as the DOJ does, rather than potentially pursuing permanent relief in a separate administrative proceeding; (2) the FTC Act should be amended to eliminate the possibility that the FTC can pursue administrative litigation in merger cases after an injunction against the transaction has been denied in federal court; and (3) amending the FTC Act to provide the FTC with the same legal standard for grant of a preliminary injunction in HSR cases as the DOJ.

None of these three recommendations were unanimous, reflecting disagreement among the Commissioners as to both the potential need for, and the significance of, such changes. As that disagreement perhaps acknowledges, it is debatable how significant these three recommendations would be were they implemented, as each concerns eliminating authority that the FTC has seldom recently invoked. (The Report acknowledged that the FTC has failed to use its authority to pursue a full administrative trial after denial of a preliminary injunction against a merger "in at least fifteen years." (Report at 139-40.)) Nevertheless a majority of the Commissioners concluded that the possibility that the FTC could invoke this authority "create[s] uncertainty as to the legal status" of a transaction that is not faced when DOJ is the challenging authority. (Report at 139.) After recommending that the FTC adopt a policy that it would disclaim this authority, a majority of Commissioners went one step further and in their next recommendation recommended statutory change to eliminate the FTC's ability to pursue administrative litigation in merger cases.[3]

3 Four Commissioners did not join this recommendation, however, either on the grounds that they believed the provision was unnecessary, or because they thought it appropriate for the FTC to retain the possibility of pursuing follow-on administrative action in certain narrow circumstances.

A similar dispute arose among the Commissioners as to the necessity of amending Section 13(b) of the FTC Act to subject the FTC to the same statutory requirements to obtain a preliminary injunction against a proposed merger as the DOJ's Antitrust Division. Three Commissioners refused to join this recommendation, claiming that legislative action would be more confusing than clarifying because—as applied by the courts—the preliminary injunction test is in practice the same for both agencies notwithstanding the differing statutory language. Three other Commissioners, however, joined the recommendation on the converse position that, while they believe that any such enactment is unnecessary, an amendment to the statute would do no harm and might therefore be useful in remedying the perception among certain in the antitrust bar that an injunction is more likely to be granted if the FTC rather than the DOJ is the challenging party.

C. Reducing Delay of the Clearance Process and the Costs of Second Requests on Merging Parties

A number of the Commission Report's Recommendations addressed ways to reduce the cost of complying with merger review and the delays inherent in the current review process.

Unsurprisingly, the Commission unanimously recommended that the FTC and DOJ create new clearance agreements based on the "principles" of the 2002 Clearance Agreement between the agencies that was shelved in the face of Congressional opposition primarily to its allocation of media mergers to the DOJ. The Report noted that during its short time in existence the 2002 Clearance Agreement had effectively reduced the time DOJ and FTC spent determining which agency would review a merger reported under HSR.

The Commissioners appear to have concluded that resurrecting such an agreement would not itself suffice to lower the delays that the clearance process occasions. The Commission therefore also recommended that the HSR Act be amended to ensure that mergers be cleared to one agency or the other within a short period of time, "for instance, nine calendar days." A small number of the Commissioners disputed whether such a legislatively imposed deadline would be effective because "even mandatory deadlines" rarely constrain agencies absent real penalties (such as financial penalties) where the agencies failed to meet the deadline.

Similarly, the Commission also approved of efforts by the agencies to reduce the presumptive scope of the search of documents and data during the second request process. The Commission recommended that both agencies "systematically" collect and record information regarding the costs and burdens imposed on merging parties by second request compliance so as to identify ways to reduce those costs and burdens. The Commission identified five such possible reforms. Those include limiting the number of custodians subject to search—as both the FTC and DOJ have recently done (at least on a presumptive basis)—as well as informing parties of the rationale and economic bases for initiating a second request and limiting requests for data not kept in the ordinary course of business. The Commission Report also invited the agencies to employ their "collective expertise" to identify additional areas for cost reduction.

D. Enhancing Transparency of FTC and DOJ Actions to the General Public by Publishing Data and Rationales for Enforcement Action

The Commission also set forth a number of recommendations designed to increase the transparency and predictability of the merger process by providing additional data to the public and practitioners. The Commission recommended issuing closing statements "when appropriate" that explain why enforcement agencies chose not to challenge a particular transaction. (The Commission would leave to the agencies the determination of when statements would be appropriate, concluding that requiring such statements issue every time the FTC or DOJ chooses not to challenge a transaction would be too burdensome.) The Commissioners

also recommended that the agencies update their Merger Guidelines to explain in greater detail how the impact of a merger on innovation is considered and to set forth how non-horizontal mergers are evaluated. The Commission also recommended that the agencies regularly provide statistical data regarding past and present enforcement actions, such as those that were reported by the FTC in its 2004 Horizontal Merger Investigation Data.

III. PROPOSED REFINEMENTS IN THE APPLICATION OF SHERMAN ACT CASE LAW

Unlike the Recommendations discussed above, a handful of the Commission's recommendations would not require legislative or administrative action, but were instead concerned with providing guidance to courts in the application of precedent developed in applying Section 2 of the Sherman Act. The Commission issued Recommendations regarding bundled rebates, the duty to deal with rivals, and on intellectual property in tying cases. The most significant of these Recommendations, and the one in which the Commissioners appear to have come closest to a consensus on, is the recommendation related to analyzing when and whether bundled discounts can amount to exclusionary conduct.

A. Bundled Discounts

The Commission spent some time articulating a test for businesses to use to determine whether bundled discounts comport with the antitrust law, given the uncertainty of the law in this area after *LePage's, Inc. v. 3M Corporation*, 324 F.3d 141 (3d Cir. 2003) (en banc), where the Third Circuit upheld a $68 million jury award finding that 3M's discounting program violated the Sherman Act. The Commission noted that the ubiquity of bundled discounting suggests that such arrangements are generally procompetitive, rather than presumptively nefarious: "the fact that firms without market power often offer bundled discounts suggest that efficiency, not schemes to acquire or maintain monopoly power, typically explain their use." (Report at 95.)

As a solution, the Commission advanced a three-part test related to the *Brooke Group* predatory pricing standard to determine whether bundled discounts violate the Sherman Act:

> To prove a violation of Section 2, a plaintiff should be required to show each one of the following elements (as well as other elements of a Section 2 claim): (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.

The Commission believed that the initial prong of this test would serve as a "safe harbor," as it would allow businesses to objectively determine whether a particular proposed bundled rebate could be made safe from further scrutiny—something not found in *LePage's*. Under the Commission's test if the relevant product is sold above its incremental costs, even when all of the bundled discounts are attributed to the product, businesses should not have to worry that their conduct could be challenged as unlawful under the Sherman Act.

Although the decision to adopt this particular test (and its formulation of a safe harbor) was unanimous, it was apparently not without some debate, and there appears to be some lingering concern among the Commissioners about its effectiveness. Commissioners Carlton and Garza note in the Report that the first prong chosen is insufficiently capacious of a safe harbor as it would subject many non-exclusionary price schemes to further scrutiny. Commissioner Carlton elaborated separately on this criticism, pointing out that, for instance, a manufacturer who bundles razors and blades together at a price less than the price of blades

plus razor cost would be given no safe harbor, thus incurring risk from a "not uncommon" pricing strategy. (Interestingly, the Commission Report has virtually nothing to say on how the remaining two prongs should be applied, thus leaving some uncertainty remaining for a not inconsiderable number of discount programs.) The Commissioners may have concluded that this risk is a reasonable burden for businesses to bear: in choosing the particular formulation for the safe harbor, the Commission rejected a broader rule that would provide bundled discounts immunity from further antitrust inquiry as long as the price of the bundle exceed the separate costs of the constituent products.

Ultimately, the Commission concluded that the test it chose would bring analysis of the competitive effects of bundled rebates close to that employed in predatory pricing analysis under *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 US 209 (1993)—a test recently affirmed for so-called predatory overbidding in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S.Ct. 1069 (February 20, 2007). In so concluding, the Commission appears to have recognized that of the three economic justifications proffered to it for when bundled rebates can be anticompetitive (as a form of predatory pricing, as de facto tying, or as exclusionary conduct that deters entry), the narrower claim of predatory pricing is perhaps the most convincing explanation for when—if ever—bundled discounts may be economically harmful.

The Commission's test, which provides some measure of utility for businesses, might also be usefully invoked by litigants in future disputes, although it remains to be seen whether such guidance will be found persuasive by any particular court.

B. Refusals to Deal with a Rival in the Same Market

The Commissioners appear to have been unable to agree on how to, or for that matter, whether to clarify the law regarding when unilateral refusals to deal with a rival might violate the Sherman Act. The relevant recommendation merely restates the general principle that ordinarily "firms have no duty to deal with a rival in the same market." (Report at 101.) The Commission Report notes that, although the Supreme Court's recent decision in *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, 540 US 398 (2004) reiterates that conclusion, "businesses need better guidance from the courts on how to avoid antitrust scrutiny for a refusal to deal with a rival." (Report at 101.) The Report's discussion, however, does not offer that guidance, instead summarizing the economic approaches advanced to the Commission, endorsing none, and concluding its discussion on the topic with a request that courts "further clarify" the circumstances when firms can be held liable for a refusal to deal with a rival in the same market—to the extent that such circumstances exist. (Report at 104.) Commissioners Jacobson and Shenefield, at least, appear to have been willing to go further, believing that refusals to deal with a rival in the same market that would likely raise price or reduce output that are insufficiently supported by procompetitive reasons should be prohibited. (Report at 101.)

IV. CONCLUSION

The Antitrust Modernization Commission's Report recommends only a few fundamental changes to the antitrust laws: repeal of the Robinson-Patman Act, permitting suits by indirect purchasers and consolidating them with suits by direct purchasers, and permitting contribution among antitrust defendants. Most of the Commission's recommendations are instead for more modest changes to antitrust law and its administration and enforcement. By concluding that no great "modernization" is required for the twenty-first century, the Commission has likely disappointed those who argue for more radical change in current antitrust priorities. The Commission's Report nevertheless represents an important contribution to the development of antitrust law and its institutions, setting forth a number of

refinements and improvements that if implemented—even in small part—would increase the predictability of antitrust enforcement.

If you would like further information about the Antitrust Modernization Commission Report or its implications, please contact your Arnold & Porter attorney or:

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