CHAPTER 6

MERGERS

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Chapter 6

Mergers

1. INTRODUCTION

A. MERGERS DEFINED

This chapter addresses mergers and their treatment under the antitrust laws. A merger, as distinct from a joint venture or cartel, occurs when one firm acquires ownership or control of, or assets of, another firm. Mergers are addressed most directly by Section 7 of the Clayton Act, which applies when a “person engaged in commerce” acquires, directly or indirectly, “the whole or any part of the stock or other share capital” of, or the whole or any part of “the assets” of, “another person engaged also in commerce or any activity affecting commerce.”1 For this purpose, a “person” includes both natural persons and business entities.

The antitrust agencies describe the differences between mergers and other forms of collaboration among competitors as follows in their Guidelines for Collaborations among Competitors:

[I]n some cases, competitor collaborations have competitive effects identical to those that would arise if the participants merged in whole or in part. The Agencies treat a competitor collaboration as a horizontal merger in a relevant market and analyze the collaboration pursuant to the Horizontal Merger Guidelines if appropriate, which ordinarily is when: (a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a

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sufficiently limited period\(^2\) by its own specific and express terms. Effects of the collaboration on competition in other markets are analyzed as appropriate under these Guidelines or other applicable precedent.\(^3\)

The central reason why mergers are treated more leniently than other forms of horizontal collaboration is that the integration achieved through a merger can produce certain efficiencies or synergies that are less likely from joint ventures and other types of agreements.\(^4\) There are, moreover, antitrust issues that can arise for non-horizontal mergers, but as in the case of Section 1 of the Sherman Act, vertical mergers are treated more favorably than horizontal ones. Consequently, the vast majority of this chapter focuses on horizontal mergers.

**B. BACKGROUND**

Lax or permissive merger enforcement can result in markets becoming concentrated, either directly or indirectly. That, in turn, can lead to non-competitive or inefficient performance, including harmful anticompetitive collusive, the ability to raise prices on account of the merger, and exclusionary conduct by a dominant firm. Because these harms are often difficult to address by other means, merger enforcement plays a central role in antitrust law.

1. **REASONS FOR MERGERS**

**F.M. Scherer & D. Ross, Industrial Market Structure and Economic Performance**


The Motives for Merger

Mergers occur for a myriad of reasons, and in any given case, several different motives may simultaneously influence the merging parties’ behavior. Still it is useful to attempt a preliminary sorting-out of the diverse motivating forces.

The Monopoly Motive

In horizontal mergers, and especially in the massive consolidations that took place around the turn of the century, the desire to achieve or strengthen monopoly power played a prominent role. Some 1887–1904 consolidations gained monopoly power by creating firms that dominated their industries. Others fell short of dominance, but transformed market structures sufficiently to curb the tendencies toward price competition toward which sellers gravitated in the rapidly changing market conditions of the time. As Thomas Edison remarked to a reporter concerning reasons for the formation of the General Electric Company in 1892:

> “Recently there has been sharp rivalry between [Thomson–Houston and Edison General Electric], and prices have been cut so that there has been little profit in the manufacture of electrical machinery for anybody. The consolidation of the companies . . .

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\(^2\) In general, the Agencies use ten years as a term indicating sufficient permanence to justify treatment of a competitor collaboration as analogous to a merger. The length of this term may vary, however, depending on industry-specific circumstances, such as technology life cycles.


\(^4\) See Joseph Farrell & Carl Shapiro, Scale Economies and Synergies in Horizontal Merger Analysis, 68 Antitrust L. J. 685, 687 (2001).
will do away with a competition which has become so sharp that the product of the factories has been worth little more than ordinary hardware. . . .”

Those were days when businesspeople were not yet intimidated by the wrath of trustbusters or public opinion. Now they are more circumspect, and evidence of monopoly-creating intent is harder to find. . . .

Speculative Motives

Monopoly and speculative motives interacted to propel the great merger wave of 1887–1904. The value of a company’s common stock depends upon investor expectations regarding future profits. If competition can be eliminated or reduced through merger, profits will presumably rise, making the new consolidated firm’s shares worth more than the sum of the previously competing companies’ share values. Entrepreneurs sought to achieve such capital value transformations by arranging competition-reducing mergers. However, many went farther. Because investors were captivated by the prospect of pursuing this road to fortune, and because there were no effective controls on the quality of information disseminated in connection with new stock flotations, promoters arranged mergers with little chance of securing appreciable monopoly power, but simultaneously issued prospectuses, planted rumors, and primed the market to convince investors otherwise. By exciting false expectations, the promoters were able to sell the stocks of newly consolidated firms at prices far exceeding their true economic value—a practice known at the time as stock watering. As in honestly monopolistic consolidations, the promoters were paid in newly issued stock for their contribution. Only in this case, the merger makers hastened to sell their shares to unwary outsiders before the bubble burst. . . .

Alarm over such abuses led to passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, establishing federal regulation of securities issue information and other promotional practices. They and the antitrust laws made it difficult for promoters to repeat the experiences of the 1890s and 1920s. . . .

Normal Business Motives

Any explanation of mergers that ignores such speculative inducements is likely to miss the mark. Yet it must be recognized that there are many normal, wholesome business motives for merger. These compel careful examination.

It is widely believed that mergers serve as an efficient, humane escape route for companies that are otherwise about to fail. This is true, but not very important quantitatively. As a rule, merger makers seek healthy acquisition targets, not basket cases. Among 698 sizable manufacturing companies acquired between 1948 and 1968, only 4.8 percent had negative profits in the year before acquisition occurred.6 In a 634 company sample including a cross section of both small and large acquisition targets, 5.8 percent had negative operating income (before deduction of interest charges) in the year before acquisition.7

Small companies are often acquired because their owner-managers are aging or weary of business pressures and lack heirs or other successors to take their place. Interacting with this motive is the desire of family company owners to diversify their investment portfolios, thereby reducing their risk exposure, and to raise funds for paying the sometimes substantial estate taxes levied when an owner-manager dies.

Tax considerations also affect the urge to merge in a variety of more complex ways. When an acquisition premium is paid above the values at which a company’s depreciable assets are recorded in tax accounts, the acquired assets can under U.S. law be stepped

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7 Ravenscraft and Scherer, Mergers, p. 60.
up and subjected to higher depreciation charges, shielding the acquirer from tax liabilities. Until reforms were enacted in 1986, acquiring companies making such step-ups could normally escape immediate capital gains taxation. Such tax advantages appear to have been an important consideration in many merger decisions, but not critical enough to determine whether merger would or would not occur. Under the structure of U.S. and many other nations’ tax laws, corporate profits are taxed directly when realized by the corporation and again at the personal level when they are distributed as dividends to individual (but not institutional) stockholders. To avoid this double taxation, corporations are tempted to reinvest their profits in merger-making rather than paying them out as dividends. When capital gains are taxed more lightly than dividend income, as was true in the United States until 1989, successful reinvestment increased the value of the company’s stock, permitting shareholders to sell some of their shares and realize their gains under the more lightly-taxed capital gains provisions. Expanding upon this theme, Oliver Williamson argued that conglomerate firms achieved efficiencies by reinvesting earnings in internal capital markets better able than external markets to assimilate information on investment opportunities. However, intracompany capital markets are often highly bureaucratic and politicized, and it is unclear whether they actually do a better job allocating capital than is achieved in the give-and-take between a firm and its outside investors.

Other merger-based economies of scale are even more difficult to evaluate. Distinctions must be made inter alia between horizontal mergers, in which the merging firms produce and sell similar products, and conglomerates, in which the product lines differ, perhaps greatly.

Economies of scale in production are much more likely to be achieved following horizontal (or perhaps vertical) mergers than when unrelated operations are combined. Even then, problems arise.

When firms that make the same products merge, their plants are already built; not much can be done in the short run to unbuild them and achieve the principal plant-specific economies of scale. Exceptions are most likely to be found in declining or severely depressed industries. When multiple plants are combined, the least efficient units can be shut down and the most efficient units retained or even expanded.

Mergers may also confer advantages in marketing—for example, through the pooling and streamlining of field sales forces, the ability to offer distributors a broader product line, the use of common advertising themes, and (to the extent they exist) the sharing of advertising media quantity discounts. In a survey of sixty-nine U.S. acquisitions, mostly conglomerate, John Kitching found marketing complementarities to be much more important than production economies, and second only in importance to capital-cost economies. However, conflicting evidence emerged from analyses by the Federal Trade Commission, the Economic Council of Canada, and (for the United Kingdom) Gerald Newbould, all of whom found post-merger marketing economies to be relatively unimportant. The Canadian study showed marketing economies to emerge even less frequently than production economies, which were reported in 6.5 percent of the 1,826 surveyed acquisitions and 15.2 percent of the horizontal manufacturing industry mergers.

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Complementarities also exist in research and development. One firm may have two or three unusually creative engineers but lack the distribution network needed to derive full commercial benefit from the new products they turn out. Another may have superb marketing channels but find its laboratories populated by unimaginative clods. Together they can make beautiful music. Ideas and money can also be brought together through merger. There is reason to believe that such motives have influenced an appreciable number of mergers, especially those in which small research-based enterprises were acquired. Once such creative individuals are ensconced in the larger, more bureaucratic R & D organizations of large acquirers, however, they often become frustrated. A study by super-computer specialist Control Data Corporation revealed that fewer than 15 percent of the innovative engineers and scientists recruited through acquisitions over a period of twenty-two years remained with the company. More generally, a statistical analysis covering 2,955 lines of business showed that having all of a line’s assets stemming from conglomerate mergers was associated with R & D/sales ratios 18 percent lower on average than those prevailing generally in the industry in which the unit operated. Finally, there is the possibility that mergers infuse superior new management into companies suffering from talent or motivational deficiencies. Or they may permit managerial overhead streamlining.

2. THE CLAYTON ACT, SECTION 7

Clayton Act, Section 7

That no person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create monopoly. . . .

This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition. . . .

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13 See Murray N. Friedman, The Research and Development Factor in Mergers and Acquisitions, Study No. 16, U.S. Senate Committee on the Judiciary; Subcommittee on Patents, Trademarks, and Copyrights (Washington: USGPO, 1958). In a survey of venture capital institutions, Robert Premus found that approximately 42 percent of the new high-technology companies in which the funds invested were expected to “go public” with their own stock exchange listings, 26 percent would merge with larger firms, 19 percent would “just survive,” and 13 percent would fail outright. Venture Capital and Innovation, study prepared for the Joint Economic Committee, U.S. Congress (Washington: USGPO, 1985), p. 35. Premus’ percentages for three size categories were weighted to yield the overall averages reported here.


15 Ravenscraft and Scherer, Mergers, pp. 120–121.
3. THE INCIPIENCY STANDARD OF SECTION 7

The language of Section 7 of the Clayton Act articulates what is known as the "incipiency standard." The statute prohibits mergers whose effect "may be substantially to lessen competition or to tend to create monopoly." This is a forward-looking standard that focuses on the likely future effect of a merger on competition in a particular market. The drafters of the Clayton Act sought to create an alternative to the broad prohibitions of the Sherman Act and to prevent "the creation of trusts, conspiracies, and monopolies in their incipiency and before consummation." In so doing, they focused on the likely future effect as the touchstone for whether a merger violates the antitrust laws. Finally, as we will discuss below, the statute also makes clear that those purchasing stock "solely for investment" are not subject to the law's provisions.

4. THE HART SCOTT RODINO ACT AND THE ROLE OF THE PREMERGER NOTIFICATION GUIDELINES

The procedural mechanisms added by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"), discussed further infra, enhanced the agencies' ability to conduct the forward-looking analysis contemplated by Section 7. The HSR Act requires merging entities to notify the antitrust agencies of any large transaction before it takes place, to provide the agencies with information needed to analyze potential anticompetitive effects, and to defer completion of a merger for a specified period so that the agencies may assess the likely competitive effects of the merger before it is consummated.

To implement the HSR Act, the agencies established a Premerger Notification Program ("the Program"), which administered by the FTC on behalf of both agencies. The agencies describe the Program as follows:

The Act requires that parties to certain mergers or acquisitions notify the Federal Trade Commission and the Department of Justice (the "enforcement agencies") before consummating the proposed acquisition. The parties must wait a specific period of time while the enforcement agencies review the proposed transaction. The Program became effective September 5, 1978, after final promulgation of the Rules.

The Program was established to avoid some of the difficulties and expense that the enforcement agencies encounter when they challenge anticompetitive acquisitions after they have occurred. In the past, the enforcement agencies found that it is often impossible to restore competition fully once a merger takes place. Furthermore, any attempt to reestablish competition after the fact is usually very costly for the parties and the public. Prior review under the Program enables the Federal Trade Commission ("FTC" or the "Commission") and the Department of Justice ("DOJ") to determine which acquisitions are likely to be anticompetitive and to challenge them at a time when remedial action is most effective.

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6 Most of the material in this note is adapted from the guide to the Premerger Notification Program, published by the FTC. See THE FEDERAL TRADE COMMISSION, PREMERGER NOTIFICATION OFFICE, WHAT IS THE PREMERGER NOTIFICATION PROGRAM? AN OVERVIEW (March 2009), available at https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf (hereinafter PREMERGER NOTIFICATION GUIDE).

7 The Premerger Notification Rules are found at 16 C.F.R. Parts 801, 802 and 803. The Rules also are identified by number, and each Rule beginning with Rule 801.1 corresponds directly with the section number in the C.F.R. (so that Rule 801.40 would be found in 16 C.F.R. § 801.40). In this Guide, the Rules are cited by Rule number.
Whether a particular acquisition is subject to these requirements depends upon the value of the acquisition and the size of the parties, as measured by their sales and assets. Small acquisitions, acquisitions involving small parties and other classes of acquisitions that are less likely to raise antitrust concerns are excluded from the Act’s coverage.

If either agency determines during the waiting period that further inquiry is necessary, it is authorized by Section 7A(e) of the Clayton Act to request additional information or documentary materials from the parties to a reported transaction (a “second request”). A second request extends the waiting period for a specified period, usually 30 days (ten days in the case of a cash tender offer or a bankruptcy sale), after all parties have complied with the request (or, in the case of a tender offer or a bankruptcy sale, after the acquiring person complies). This additional time provides the reviewing agency with the opportunity to analyze the submitted information and to take appropriate action before the transaction is consummated. If the reviewing agency believes that a proposed transaction may violate the antitrust laws, it may seek an injunction in federal district court to prohibit consummation of the transaction.8

Under the Act, only proposed business transactions that satisfy certain size criteria need to be reported to the enforcement agencies through the Program. Whether a transaction is “reportable” is determined by the Act, the Rules, and agency interpretations. Reportability depends on the total value of voting securities and/or assets that will be held by the acquiring party after the transaction (“size of transaction”) and the sales or assets of the parties before the transaction (“size of person”).9 There are exemptions from reportability even if the size of person and size of transaction test have been satisfied. These include acquisitions of assets in the ordinary course of business, acquisition of certain types of real property, and acquisitions of certain foreign assets.10

If a transaction is reportable, the parties involved must provide information to the agencies using the Notification and Report Form. The required information includes the nature and structure of the transaction, balance sheets and financial data, documents filed with the Securities and Exchange Commission, whether the acquiring and acquired parties derive revenue from businesses that fall within any of the same industry and product North American Industry Classification System (“NAICS”) codes, and acquisitions by them within the last five years of companies or assets engaged in business in any of the overlapping NAICS codes.11 Once the form, the certification, and the filing fee are submitted to the Premerger Notification Office, the waiting period begins.

The filing parties must observe a statutory waiting period during which they may not consummate the transaction; the waiting period is 30 days for most reportable transactions and 15 days for cash tender offers and certain bankruptcy related transactions. Once the FTC’s Premerger Notification Office (“PNO”) has confirmed that the required information was submitted and has notified the parties of the dates of the beginning and ending of the waiting period, the substantive antitrust review of the transaction begins. The agencies explain the process as follows:

Initially, both agencies undertake a preliminary substantive review of the proposed transaction. The agencies analyze the filings to determine whether

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8 PREMERGER NOTIFICATION GUIDE at 1.

9 See PREMERGER NOTIFICATION GUIDE at 2-5. 16 CFR §§ 801.10, 801.12, 801.13, 801.14, and 801.15 contain the rules for determining the “size of transaction.”

10 PREMERGER NOTIFICATION GUIDE at 5.

11 PREMERGER NOTIFICATION GUIDE at 6.
the acquiring and acquired firms are competitors, or are related in any other way such that a combination of the two firms might adversely affect competition. Staff members rely not only on the information included on the Form but also on publicly available information. The individuals analyzing the Form often have experience either with the markets or the companies involved in the particular transaction. As a result, they may have industry expertise to aid in evaluating the likelihood that a merger may be harmful.

If, after preliminary review, either or both agencies decide that a particular transaction warrants closer examination, the agencies decide between themselves which one will be responsible for the investigation. Only one of the enforcement agencies will conduct an investigation of a proposed transaction. Other than members of the PNO, no one at either agency will initiate contact with any of the persons or any third parties until it has been decided which agency will be responsible for investigating the proposed transaction. This clearance procedure is designed to minimize the duplication of effort and the confusion that could result if both agencies contacted individual persons at different times about the same matter. The clearance decision is made pursuant to an agreement that divides the antitrust work between the two agencies.\(^\text{12}\)

Once the investigating agency has clearance to proceed, it may ask certain parties to the transaction to submit additional information or documents through what is called a “second request.” The second request must be issued by the investigating agency before the initial waiting period expires. The second request extends the statutory waiting period generally until 30 days after both parties are deemed to have complied with the request.\(^\text{13}\) The time delay imposed by a second request is considerable and the costs involved in assembling the necessary documents are substantial. In a 2013 survey of second request compliance (with 17 responding firms), conducted by the American Bar Association’s Mergers and Acquisitions Committee, the median data production for second requests was around 1.6 million pages and the median cost was $4.3 million.\(^\text{17}\) In terms of timing, the survey respondents reported second request processes that ranged from 5 weeks to 11 months.

A second request generally solicits information on particular products or services and includes interrogatory-style questions and requests for production.\(^\text{14}\) Parties can meet with agency staff to confer regarding the scope of the second request, and agencies have a formal internal appeals process to resolve issues relating to the scope of and compliance with second requests.\(^\text{15}\) Sometimes the agencies and the parties agree on more focused sequence for production and review of information:

The enforcement agency issuing the second request may have determined that certain data sought in the request can resolve one or more issues critical to the investigation. In such a situation, the agency’s staff may suggest use of the informal “quick look” procedure. Under the quick look, the staff will request the parties to first submit documents and other information, which specifically address the critical issues (e.g., product market definition or ease of entry). If the submitted information resolves the staff’s concerns in these areas, the waiting period will be terminated on a sua sponte basis and the parties will not have to expend the time and cost of responding to the full second request. Of

\(^\text{12}\) PREMERGER NOTIFICATION GUIDE at 11.

\(^\text{13}\) PREMERGER NOTIFICATION GUIDE at 9.


\(^\text{14}\) PREMERGER NOTIFICATION GUIDE at 12.

course, if the submitted information does not resolve the staff's concerns on determinative issues, then the parties will need to respond to the full second request.\textsuperscript{16}

After agency investigative staff analyze all information available to them, they will make a recommendation to the FTC Commissioners or to the Assistant Attorney General in charge of the Antitrust Division to (1) take no further action, cease the investigation, and allow the parties to consummate the merger; (2) seek injunctive relief against the transaction by filing a suit in U.S. district court; or (3) discuss and negotiate terms of a proposed settlement with the merging parties.\textsuperscript{17}

5. THE STATE OF MERGER ACTIVITY AND ENFORCEMENT

Merger enforcement activity at the federal level in the first decade of the 21st Century was very different from that in the last decade of the 20th Century. Premerger notification filings generally decreased in the decade beginning in 2000; second requests (i.e., formal requests from the government for additional information about the transaction) declined during that period; and challenges leading to consent orders or litigated cases declined even more rapidly. There were fewer government challenges to horizontal mergers than in previous decades, and there was a very limited attention paid to mergers during the Bush Administration. The declines were more pronounced at the Antitrust Division of Department of Justice than at the Federal Trade Commission.\textsuperscript{18}

Critics of what they perceive to have been more relaxed merger enforcement during the Bush Administration point, for example, to the Justice Department’s 2006 decision not to challenge the proposed merger of Whirlpool and Maytag.\textsuperscript{19} Both companies were very large in a number of household appliances, including dishwashers and clothes dryers. Whirlpool’s share of unit shipments in the U.S. was 51%, and Maytag’s share was 20%. GE was a distant third with 17%, and Electrolux fourth with 9%. Nevertheless, the Justice Department decided not to challenge the merger because two small foreign companies were on the edge of initiating sales in the United States, the merger was expected to generate substantial efficiencies, and the typical customers were “Big Buyers.” Some commenters noted that this case reflected a move, at least at the Bush Administration Justice Department, away from a willingness to challenge mergers based on very high levels of market concentration.

The government’s caution might have been motivated in part by a number of defeats in litigated merger cases early in the decade. For example, in FTC v. Arch Coal Inc., 329 F.Supp. 2d 109 (D.D.C. 2004), the FTC and six states sought to enjoin a merger between two companies that owned a total of four mines in the Southern Powder River Basin of Wyoming (an area that produces one-third of coal produced in the United States). Arch indicated an intention to sell one of the acquired mines upon completion of transaction. The court rejected the challenge on the ground that the government had failed to prove that competitive harm was “sufficiently probable and imminent.”

In United States v. Oracle Corp., 331 F. Supp. 2d 1098 (D.C. Cal. 2004), the Department of Justice and 10 states sought a preliminary injunction to block Oracle Corporation from acquiring People Soft, Inc., two companies that manufactured and sold a type of application software that automated business data processing (“EAS”). Programs that provide EAS functions include human relations management (“HRM”),

\textsuperscript{16} Premerger Notification Guide at 12.

\textsuperscript{17} Premerger Notification Guide at 13-14.


\textsuperscript{19} Baker & Shapiro, Reinvigorating Horizontal Merger Enforcement, 235 249, Chapter 6, in Pitofsky (ed.), How the Chicago School Overshot the Mark (2008).
financial management systems ("FMS"), customer relations management, supply chain management, product life cycle management, and business intelligence, among many others. The government argued that the combination of high end HRM and FMS functions constituted a relevant market. One other large company—SAP—(like Oracle and PeopleSoft) offered a comprehensive set of software, and many other companies offered specific sets of software. In support of their proposed product market definition, the government plaintiffs presented at trial or through depositions 10 customer witnesses, five industry witnesses, two systems integration witnesses, three expert witnesses. The District Court rejected the government’s theory of the case, finding that:

these witnesses did not establish by a preponderance of the evidence that the products offered by Oracle, PeopleSoft and SAP are in a distinct line of commerce or product market from those offered by other ERP vendors. The court finds that these witnesses did not establish that it was more likely than not that customers of a post-merger Oracle would have no choice but to submit to a small but significant non-transitory price increase by the merged entity. These findings do not rest alone on the court’s skepticism about the testimony of plaintiffs’ customer witnesses.

The election of President Obama did not bring an immediate change in merger enforcement because the Great Recession of 2008-09 effectively froze merger activity. As mergers picked up in the 2010s, the antitrust agencies—following the publication of the 2010 Merger Guidelines—brought a number of notable merger challenges, including the challenge of the AT&T and T-Mobile merger in 2011. Overall, the Obama Administration challenged substantially more mergers than the Bush Administration. In particular, the Obama Administration successfully challenged, or caused parties to abandon, 32 proposed mergers during its first seven years, compared to 10 during the same time period of the Bush Administration.

2. THE MERGER GUIDELINES

The agencies’ Horizontal Merger Guidelines, or “the merger guidelines” as they are often called, are designed to help businesses predict the enforcement intentions of the federal antitrust agencies. The Justice Department released the first version of the merger guidelines in 1968. They have been revised several times since then, sometimes very substantially, in light of new economic learning and agency experience. Beginning in 1992, the guidelines have been issued jointly by the Justice Department and the Federal Trade Commission. The most recent version of the Guidelines was released in 2010.18

In principle, the Guidelines are merely a statement of agency intent and have no formal legal impact (on courts or otherwise). In practice, however, many courts take the Guidelines and their analytical approaches into account (whether or not they apply them in the same fashion that the agency does in a particular case). Because the Supreme Court has not taken a case on substantive merger law 1974, the Guidelines have become the central source of new thinking about merger policy and are influential both in the United States and in other countries.

State governments and private parties can sue to enjoin mergers, but they do so only very rarely. As a practical matter, therefore, merger enforcement decisions under U.S. law are almost always made by the federal agencies. As discussed in Chapter 7, however, some mergers that are subject to U.S. antitrust laws are also subject to the competition laws of other countries.

18 The Justice Department also issued vertical merger guidelines in 1984. They have not been very influential, and they have not been updated them since.
The U.S. agencies challenge only a small percentage of mergers that are reported to them. If the agencies assigned to review the merger believes that it would violate Section 7, the parties will often attempt to negotiate a settlement (frequently selling a portion of the acquired assets in order to allow the rest of the deal to go through) or abandon the deal. As explained more fully in Chapter 10 infra, when the agencies settle a merger case, they generally issue a “competitive impact statement” explaining the analysis behind their complaint and the settlement. In the case of the Justice Department, these settlements must be reviewed by a federal court (under the Tunney Act) to ensure that they are consistent with the public interest.\(^{20}\)

Because few cases are challenged and most of those that are challenged are abandoned or settled, litigated merger cases are the exception. And when merger disputes are litigated, the litigation often ends after the preliminary injunction stage. If the court issues a preliminary injunction barring consummation of the merger, the parties almost always abandon the merger because they anticipate a litigation defeat and/or business considerations make prolonging the uncertainty about the merger for several more months unacceptable. If the court denies a preliminary injunction, the agencies often abandon the case because they anticipate a litigation defeat and/or there is no effective remedy, or way to “unscramble the eggs,” after the merger has been consummated.

Therefore, compared to other aspects of antitrust law enforcement, judicial decisions play a relatively small role in shaping the understanding of the agencies and private parties about the substantive parameters of merger law. In addition to judicial decisions, agencies and parties rely heavily upon the agencies’ enforcement practice, as reflected in the merger guidelines, “competitive impact statements,” complaints in filed cases, and statements issued when an investigation is closed, but no action is taken.

The most recent Guidelines are reprinted below.

U.S. Department of Justice and Federal Trade Commission
Horizontal Merger Guidelines, 2010

1. Overview

These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the “Agencies”) with respect to mergers and acquisitions involving actual or potential competitors (“horizontal mergers”) under the federal antitrust laws.\(^{1}\) The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. § 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Most particularly, Section 7 of the Clayton Act prohibits mergers if “in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the

\(^{20}\) See 15 U.S.C. § 16(e)–(f) (2015) (stating that “[b]efore entering any consent judgment proposed by the United States under this section, the court shall determine that the entry of such judgment is in the public interest” and setting out the factors and procedures for the public interest determination).

\(^{1}\) These Guidelines replace the Horizontal Merger Guidelines issued in 1992, revised in 1997. They reflect the ongoing accumulation of experience at the Agencies. The Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines. These Guidelines may be revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning. These Guidelines do not cover vertical or other types of non-horizontal acquisitions.
congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.

These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. They are not intended to describe how the Agencies analyze cases other than horizontal mergers. These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies’ enforcement decisions. They may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.

These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.2

The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm’s behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as “unilateral effects.” A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as “coordinated effects.” In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

These Guidelines principally describe how the Agencies analyze mergers between rival suppliers that may enhance their market power as sellers. Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called “monopsony power,” has adverse effects comparable to enhancement of market power by sellers. The Agencies

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2 These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation.
employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers. See Section 12.

2. Evidence of Adverse Competitive Effects

The Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition. This section discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers. The list provided here is not exhaustive. In any given case, reliable evidence may be available in only some categories or from some sources. For each category of evidence, the Agencies consider evidence indicating that the merger may enhance competition as well as evidence indicating that it may lessen competition.

2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or “natural experiments,” that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative.

The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties’ market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a “maverick” firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position
and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

2.2 Sources of Evidence

The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.

2.2.1 Merging Parties

The Agencies typically obtain substantial information from the merging parties. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct and decisions. Documents created in the normal course are more probative than documents created as advocacy materials in merger review. Documents describing industry conditions can be informative regarding the operation of the market and how a firm identifies and assesses its rivals, particularly when business decisions are made in reliance on the accuracy of those descriptions. The business decisions taken by the merging firms also can be informative about industry conditions. For example, if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern, see Section 4.1.3) or that the firm and its rivals are engaged in coordinated interaction (see Section 7). Incremental cost depends on the relevant increment in output as well as on the time period involved, and in the case of large increments and sustained changes in output it may include some costs that would be fixed for smaller increments of output or shorter time periods.

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies. The Agencies give careful consideration to the views of individuals whose responsibilities, expertise, and experience relating to the issues in question provide particular indicia of reliability. The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm’s stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies.

2.2.2 Customers

Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself.

Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing

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3 High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.
patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers. In evaluating such evidence, the Agencies are mindful that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.

When some customers express concerns about the competitive effects of a merger while others view the merger as beneficial or neutral, the Agencies take account of this divergence in using the information provided by customers and consider the likely reasons for such divergence of views. For example, if for regulatory reasons some customers cannot buy imported products, while others can, a merger between domestic suppliers may harm the former customers even if it leaves the more flexible customers unharmed. See Section 3.

When direct customers of the merging firms compete against one another in a downstream market, their interests may not be aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase. A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger’s harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.

Example 1: As a result of the merger, Customer C will experience a price increase for an input used in producing its final product, raising its costs. Customer C’s rivals use this input more intensively than Customer C, and the same price increase applied to them will raise their costs more than it raises Customer C’s costs. On balance, Customer C may benefit from the merger even though the merger involves a substantial lessening of competition.

2.2.3 Other Industry Participants and Observers

Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry. The interests of firms selling products complementary to those offered by the merging firms often are well aligned with those of customers, making their informed views valuable.

Information from firms that are rivals to the merging parties can help illuminate how the market operates. The interests of rival firms often diverge from the interests of customers, since customers normally lose, but rival firms gain, if the merged entity raises its prices. For that reason, the Agencies do not routinely rely on the overall views of rival firms regarding the competitive effects of the merger. However, rival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.

Example 2: Merging Firms A and B operate in a market in which network effects are significant, implying that any firm’s product is significantly more valuable if it commands a large market share or if it is interconnected with others that in aggregate command such a share. Prior to the merger, they and their rivals voluntarily interconnect with one another. The merger would create an entity with a large enough share that a strategy of ending voluntary interconnection would have a dangerous probability of creating monopoly power in this market. The interests of rivals and of consumers would be broadly aligned in preventing such a merger.

3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to
others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

First, the suppliers engaging in price discrimination must be able to price differently to targeted customers than to other customers. This may involve identification of individual customers to which different prices are offered or offering different prices to different types of customers based on observable characteristics.

*Example 3:* Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.

In other cases, suppliers may be unable to distinguish among different types of customers but can offer multiple products that sort customers based on their purchase decisions.

Second, the targeted customers must not be able to defeat the price increase of concern by arbitrage, e.g., by purchasing indirectly from or through other customers. Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers. Arbitrage is inherently impossible for many services. Arbitrage between customers at different geographic locations may be impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger’s likely competitive effects.

The Agencies’ analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares. Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding
competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

**Example 4:** Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A’s prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term “market.”

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.
4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one product in the market, including at least one product sold by one of the merging firms. For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

Example 5: Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

Example 6: In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

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If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter’s control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.
The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

**Example 7:** In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

### 4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger. If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a “small but significant” increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify “small but significant” adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a “small but significant” increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms’ positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms’ specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

**Example 8:** In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as “pipeline transportation of oil from point A to point B” than as “oil at point B.”

**Example 9:** In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

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5 Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.
**Example 10:** In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

**4.1.3 Implementing the Hypothetical Monopolist Test**

The hypothetical monopolist’s incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties’ documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers’ likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers’ business decisions or business documents indicating sellers’ informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants’ behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;
- legal or regulatory requirements; and
- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a “critical loss analysis” to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist’s profits. While this “breakeven” analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The “critical loss” is defined as the number of lost unit sales that would leave profits unchanged. The “predicted loss” is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase
raises the hypothetical monopolist’s profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

Example 11: Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers’ willingness or ability to substitute to some products, or some suppliers’ willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and

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6 While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.
familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers’ locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller’s location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted
customers. Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage, e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

**Example 13:** Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

**Example 14:** Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms’ plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms’ plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

**Example 15:** Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms’ competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm’s existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms’ capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

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7 For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.
5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants. These firms are termed “rapid entrants.” Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

Example 16: Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.

Example 17: Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier’s ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available “swing” capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant.8 However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm’s possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm’s future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm’s historical market share

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8 If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.
overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms’ future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm’s market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm’s competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm’s competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms’ readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

Example 18: The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X’s market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X’s market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm’s market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.

5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market.
or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm’s important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index (“HHI”) of market concentration. The HHI is calculated by summing the squares of the individual firms’ market shares, and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.10

Based on their experience, the Agencies generally classify markets into three types:

- **Unconcentrated Markets:** HHI below 1500
- **Moderately Concentrated Markets:** HHI between 1500 and 2500
- **Highly Concentrated Markets:** HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- **Small Change in Concentration:** Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- **Unconcentrated Markets:** Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.

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9 For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 (30^2 + 30^2 + 20^2 + 20^2 = 2600). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.

10 For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 (5 \times 10 \times 2 = 100).
• **Moderately Concentrated Markets:** Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.

• **Highly Concentrated Markets:** Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably
available and reliable information to evaluate the extent of direct competition between
the products sold by the merging firms. This includes documentary and testimonial
evidence, win/loss reports and evidence from discount approval processes, customer
switching patterns, and customer surveys. The types of evidence relied on often overlap
substantially with the types of evidence of customer substitution relevant to the
hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one
of the merging firms normally requires that a significant fraction of the customers
purchasing that product view products formerly sold by the other merging firm as their
next-best choice. However, unless pre-merger margins between price and incremental
cost are low, that significant fraction need not approach a majority. For this purpose,
incremental cost is measured over the change in output that would be caused by the
price change considered. A merger may produce significant unilateral effects for a given
product even though many more sales are diverted to products sold by non-merging
firms than to products previously sold by the merger partner.

Example 19: In Example 5, the merged entity controlling Products A and B would
raise prices ten percent, given the product offerings and prices of other firms. In that
example, one-third of the sales lost by Product A when its price alone is raised are
diverted to Product B. Further analysis is required to account for repositioning, entry,
and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition
between a product sold by one merging firm and a second product sold by the other
merging firm by estimating the diversion ratio from the first product to the second
product. The diversion ratio is the fraction of unit sales lost by the first product due to
an increase in its price that would be diverted to the second product. Diversion ratios
between products sold by one merging firm and products sold by the other merging firm
can be very informative for assessing unilateral price effects, with higher diversion
ratios indicating a greater likelihood of such effects. Diversion ratios between products
sold by merging firms and those sold by non-merging firms have at most secondary
predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity
an incentive to raise the price of a product previously sold by one merging firm and
thereby divert sales to products previously sold by the other merging firm, boosting the
profits on the latter products. Taking as given other prices and product offerings, that
boost to profits is equal to the value to the merged firm of the sales diverted to those
products. The value of sales diverted to a product is equal to the number of units
diverted to that product multiplied by the margin between price and incremental cost on
that product. In some cases, where sufficient information is available, the Agencies
assess the value of diverted sales, which can serve as an indicator of the upward pricing
pressure on the first product resulting from the merger. Diagnosing unilateral price
effects based on the value of diverted sales need not rely on market definition or the
calculation of market shares and concentration. The Agencies rely much more on the
value of diverted sales than on the level of the HHI for diagnosing unilateral price
effects in markets with differentiated products. If the value of diverted sales is
proportionately small, significant unilateral price effects are unlikely.\footnote{For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product’s price.}

Where sufficient data are available, the Agencies may construct economic models
designed to quantify the unilateral price effects resulting from the merger. These models
often include independent price responses by non-merging firms. They also can
incorporate merger-specific efficiencies. These merger simulation methods need not rely
on market definition. The Agencies do not treat merger simulation evidence as
conclusive in itself, and they place more weight on whether their merger simulations
consistently predict substantial price increases than on the precise prediction of any single simulation.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers’ needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers’ information about one another’s costs and about buyers’ preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm’s market share is relatively high; (2) the share of the merged firm’s output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.
A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

Example 20: Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable. This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm’s ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger

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12 Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.
is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

**Example 21:** Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B’s product. Firm A expects to retain most of Firm B’s customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B’s more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B’s product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm’s incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm’s incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival’s response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals’ responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in
Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act’s incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm’s significant competitive initiatives can be promptly and confidently observed by that firm’s rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another’s prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm’s prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase.
Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer’s needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer’s negotiating leverage will harm that buyer.

*Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C’s needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

*Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry.
Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the
relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants’ competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm’s incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm’s ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

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13 The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.
Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger’s potential to harm customers in the relevant market, e.g., by preventing price increases in that market. In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies’ experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms

14 The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

15 The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.
to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.16

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;17 and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

16 Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

17 Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.
12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called “monopsony power.”

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

**Example 24:** Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

13. Partial Acquisitions

In most horizontal mergers, two competitors come under common ownership and control, completely and permanently eliminating competition between them. This elimination of competition is a basic element of merger analysis. However, the statutory provisions referenced in Section 1 also apply to one firm’s partial acquisition of a competitor. The Agencies therefore also review acquisitions of minority positions involving competing firms, even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction.

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.
Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.

NOTES AND QUESTIONS

1. Structural presumption. The Guidelines (in section 2.1.3) retain the structural presumption adopted in the Philadelphia National Bank case (see pp ___ infra). The Guidelines do, however, raise the level of concentration necessary to trigger the presumption, concluding that mergers that result in markets with a Herfindal-Hirschman Index (HHI) level of above 2500 and an increase in the HHI of more than 200 points “will be presumed to be likely to enhance market power. This presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.” (The previous iteration of the Guidelines suggested that a level of 1800 would trigger such a presumption.) The fact that this presumption is rebuttable is significant (and see the Cruise Line Closing Statement for a good example of this in practice) because, in the post-Philadelphia National Bank cases, the presumption was rebuttable more in theory than in fact.

2. HHI. The HHI is equal to the sum of the squares of the market shares of all the firms in the market. The Guidelines illustrate the calculation in a footnote, stating that “a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 (30² + 30² + 20² + 20² = 2600).” The HHI can be as high as 10,000 (100², for a pure monopoly) and as low as little more than zero (in the theoretical case of an almost infinite number of atomistic competitors). The change in the HHI attributable to a merger is equal to twice the product of the pre-merger market shares of the merging firms. Thus, for example, if the pre-merger shares of the firms in the market are those in the example above and one of the twenty percent firms merged with one of the thirty percent firms, the merger would increase the HHI by 1200 points (2 x (20 x 30)), and the post-merger HHI would be 3800 (30² + 20² + 50²).

3. Other concentration indicators. The agencies could use (and sometimes do use) different measures of concentration. In earlier times, the agencies used four-firm or eight-firm concentration measures, which were based on the aggregate market shares of the four or eight largest firms in the market. As discussed below, the agencies today focus heavily on the number of major competitors in the market.

4. Coordinated effects. Most of the attention in the 1992 Guidelines, and most of the cases challenging horizontal mergers in the several decades after Section 7 was revised in 1950, were concerned with lessening of competition through coordinated interaction (commonly called “coordinated effects”). In particular, the concern on which agencies and the courts focused was that a more concentrated market structure would facilitate collusion (tacit or otherwise). Why couldn’t coordinated effects be addressed by post-merger enforcement? (Hint: think back to the oligopoly problem discussed in Chapter 3.) Is the often
burdensome process of pre-merger review a cost-effective way of preventing coordinated
effects, given among other things the small percent of reported mergers that are actually
challenged by the agencies?

5. Unilateral effects. In the 2010 Guidelines, a core concern is that the merged firm will
unilaterally raise prices to consumers as a result of the merger. This theory of harm is called
“unilateral effects.” The prototypical case of unilateral effects involves a merger of companies
that sell products (A and B) that are differentiated but close substitutes for one another.
Before the merger, neither party would raise prices for fear of losing too many sales to the
other. After the merger, the merged firm could raise prices on one of the products (A), gain
increased revenues from those that continue to buy product A, and retain that portion of the
revenues that are diverted to the other product that are diverted to product B, which the
merged firm would also own. The merged firm would thus be more likely to increase prices
after the merger than either of the firms before the merger. For example, suppose products A
and B are the closest substitutes and that, if A raises its price 10%, it will lose 20% of its
business, but 15% moves to B and only 5% moves to other competitors. After A and B merge,
the combined firm could increase the price of A’s product by 10% and lose only 5% of its sales.
In such a circumstances, the merger will increase the incentive for the merging parties to
raise prices (at least on product A).

6. Upward Pricing Pressure. The Guidelines refer to the concept of “upward pricing
pressure.” This concept advances the unilateral effects framework outlined above, combining
the relevant profit margins with the “diversion ratio” showing the percentage of sales that
would be switched to other firms (as opposed to staying with the merged firm) in response to
a price increase by the merged firm. The Agencies are more skeptical about the legality of a
merger to the extent that it results in an increase in the upward pricing pressure. The use of
profit margins as part of this analysis is controversial because profit margins could reflect a
variety of factors, such as the superiority of a product (say, more technologically advanced)
over available substitutes, and are thus not generally used in merger analysis. Perhaps for
that reason, the Guidelines elsewhere state, in a footnote, that “high [profit] margins are not
themselves an antitrust concern.”

7. Uncommitted entrants. It is sometimes not obvious whether a firm should be regarded
as being in the relevant market. The Guidelines provide that even firms that do not
presently sell in the market will be regarded as “in the market” if through supply responses
or geographic diversion they are able to make sales into a market without incurring
significant sunk costs. Such firms are called “uncommitted entrants.” A firm will be regarded
as having no significant sunk costs, and therefore as being an “uncommitted entrant,” if it
can make sales in the market without any sunk investments or such investments are
sufficiently modest that they can be recouped within one year. A firm that would have to
incure more substantial sunk costs and is called a “committed” entrant, and its competitive
potential will be taken into account only if it satisfies the requirements of “new entry.”

8. New entry. A showing that new competitors are likely to enter the market can be an
effective defense, even where the post-merger market share of the largest firm is 40% or
more. See, e.g., United States v. Waste Management Inc., 743 F.2d 976 (2d Cir.1984); United
States v. Calmar Inc., 612 F. Supp. 1298 (D.N.J.1985). These early cases treated entry as
likely to ameliorate competitive concerns if a firm could enter the market (i.e., there were no
substantial barriers to entry), apparently on the theory that firms that could enter would do
so if profitable opportunities were created by price increases after the merger. The agencies
have been more skeptical of the likely benefits of potential entry. Section 3 of the 1992
Guidelines (retained by the 2010 Guidelines) took a much tougher stand on the question of
entry, noting that entry can justify an otherwise problematic merger only if it “would be
timely, likely and sufficient in its magnitude, character and scope to deter or counteract the
competitive acts of concern.” Why might the agencies have become skeptical that a firm that
could enter actually would enter? In thinking about that question, keep in mind that an
“uncommitted entrant” is regarded as already being in the market and the question of new
entry involves only firms that are not already in the market. It is also worth considering how
a new entrant might expect the merged firms to react to new entry.

9. Direct evidence of competitive effects. In practice, the most significant question in a
merger is usually the determination of the “relevant market.” The Merger Guidelines
suggest, however, that the agencies need not begin with market definition; rather, the Guidelines explain, the agencies might begin by looking for direct evidence of competitive effects. What kinds of evidence might constitute direct evidence of competitive effects of a merger that has not yet been consummated?

10. *Price discrimination markets.* The 2010 Guidelines take a new approach to what are often called “price discrimination” markets. In such markets, the Guidelines state, “adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers.” Such markets require that the merged firm is able to discriminate against certain vulnerable customers by identifying them and acting in ways that affect those customers but not other customers that have alternatives to the merged firm. For an example of such a market, see the Vail Resorts ski area merger discussed below (in which local Colorado skiers were potentially vulnerable to price increases in the form of withholding discounts that were offered to out-of-state skiers with more ski resort options). This point is also discussed further in the Staples/Office Depot merger case, which involved businesses that were very likely to purchase certain office supplies only from Staples and Office Depot.

11. *Efficiencies.* Section 4 of the 1997 Guidelines opened the door to an efficiency defense and reflects a remarkable turnaround in United States antitrust law. In *United States v. Brown Shoe*, the first Supreme Court case to interpret revised Section 7, the Court treated the efficiencies that were likely to result from the merger as a reason to prohibit the merger. The Court reasoned as follows:

[Another] significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers... But, we cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasionally higher costs and prices might result from the maintenance of fragmented industries and markets.

Following Chicago School criticism from Judge Bork and others, the Supreme Court retreated from the position that efficiencies resulting from mergers were anticompetitive and moved on to the view that they were not relevant to evaluating the competitive effects of the merger. Early versions of the Merger Guidelines left determination of the relevance of merger-specific efficiencies to the discretion of the agencies.

Section 10 of the 2010 Guidelines, like 1997 revision, contemplates that the agencies will take efficiencies into account and describe the circumstances under which efficiencies might induce the agencies not to challenge a merger that they would otherwise regard as anticompetitive. The efficiencies must be merger specific (i.e., they could not be achieved in some less anticompetitive way), substantial, and verifiable. Moreover, efficiencies will almost never justify mergers to monopoly or near monopoly. In addition, a successful efficiency defense requires proof that the claimed efficiency likely would be sufficient to reverse the merger’s potential to harm consumers in the relevant market. So far, no party has successfully asserted an efficiency defense in court, but it is said that the agencies have allowed mergers that might otherwise have been challenged to proceed as a matter of prosecutorial discretion where significant efficiencies were demonstrated.

In *Philadelphia National Bank* (pp ___ *infra*), the Supreme Court concluded it was not permissible to justify anticompetitive effects in one market by pointing to redeeming virtues in another market. The Guidelines respond to this concern by stating that the agencies will consider efficiencies in a different market if they are so “inextricably linked” to the relevant market that they would be sacrificed by any remedy likely to eliminate the anticompetitive effects of the merger in the relevant market. Can you imagine a set of facts that would satisfy the “inextricably linked” standard?
furniture. Defendants argued that the proper product market included all outlets selling office supply products; Staples and Office Depot accounted for only 5.5 percent of total North American sales of such products. The key question was whether office supply superstores constituted, as alleged by the government, an appropriate market, since functionally interchangeable products could be purchased at many outlets, including chains that did not emphasize office supplies but carried some items, and also at small stationery stores.

In support of its request for a preliminary injunction, the FTC offered econometric evidence comparing office supply prices in cities with only superstore to prices cities where there were two or three competing superstores. In all cities reviewed, there were also non-superstore outlets selling office supplies. The court summarized the Commission’s approach as follows:

Based on the FTC’s calculations, in markets where Staples faces no office superstore competition at all, something which was termed a one-firm market during the hearing, prices are 13% higher than in three firm markets where it competes with both Office Depot and Office Max.

* * *

The evidence all suggests that office superstore prices are affected primarily by other office superstores and not by non-superstore competitors such as mass merchandisers like Wal–Mart, K–Mart or Target, wholesale clubs such as BJ’s, Sam’s and Price Costco, computer or electronic stores such as Computer City and Best Buy, independent retail office supply stores, mail-order firms like Quill and Viking, and contract stationers.

Staples’ and Office Depot’s internal documents confirmed the differences in price in one, two, and three superstore cities.

Assuming an office supply superstore market, concentration statistics showed the merged company would have a 100 percent share in 15 metropolitan areas and dominant market share, ranging from 45 to 94 percent, in 27 other geographic markets across the country. The average increase in HHI caused by the merger would be 2,715 points.

The court concluded that the Commission had shown that it was likely to succeed after a full administrative trial and granted a preliminary injunction.

3. UNILATERAL EFFECTS IN PRICE DISCRIMINATION MARKETS

In the déjà vu all over again category, Staples and Office Depot attempted to merger in 2015, after the latter had merged with OfficeMax. The FTC challenged the merger again, but on a very different theory of harm. In particular, the FTC defined the relevant market based on the ability of the merged firm to price discriminate, raising prices on one set of customers (large businesses) who were interested in particular products (certain office supplies). The district court’s opinion ruling for the FTC is excerpted below.

United States District Court, District of Columbia (May 17, 2016).

I. Introduction

SULLIVAN, J. Drawing an analogy to the fate of penguins whose destinies appear doomed in the face of uncertain environmental changes, Defendant. Staples Inc. (“Staples”) and Defendant Office Depot, Inc. (“Office Dept”) (collectively “Defendants”) argue they are like “penguins on a melting iceberg,” struggling to survive in an increasingly digitized world and an office-supply industry soon to be revolutionized by new entrants like Amazon Business. Prelim. Inj. Hrg Tr. (“Hrg Tr.”) 60:15 (Opening Statement of Diane Sullivan, Esq.). Charged with enforcing antitrust laws for the benefit of American consumers, the Federal Trade Commission (“FTC”) commenced this action in an effort to block Defendants’ proposed merger and alleged that the merger would “eliminate[e] direct competition between Staples and Office Depot” resulting in
“significant harm” to large businesses that purchase office supplies for their own use. Compl., Docket No. 3 at ¶ 4. The survival of Staples’ proposed acquisition of Office Depot hinges on two critical issues: (1) the reliability of Plaintiffs’ market definition and market share analysis; and (2) the likelihood that the competition resulting from new market entrants like Amazon Business will be timely and sufficient to restore competition lost as a result of the merger.

Subsequent to Defendants’ announcement in February 2015 of their intent to merge, the FTC began an approximate year-long investigation into the $6.3 billion merger and its likely effects on competition. Defs.’ Proposed Findings of Fact and Conclusions of Law (“Defs.’ FOF”) ¶ 58. On December 7, 2015, by a unanimous vote, the FTC Commissioners found reason to believe that the proposed merger would substantially reduce competition in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act. Compl. ¶ 34. That same day, Plaintiffs commenced this action seeking a preliminary injunction pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53 (b) to enjoin the proposed merger until the FTC’s administrative proceedings are complete.

II. Background

A. Overview

Every day millions of employees throughout the United States utilize office supplies in the course of their daily work. To sustain employees’ use of pens, Post-it notes and paperclips, large companies purchase more than two billion dollars of office supplies from Defendants annually. Companies that purchase office supplies for their own use operate in what the industry refers to as the B-to-B space. B-to-B customers prefer to work with one vendor that can meet all of the companies’ office supply needs.

To establish a primary vendor relationship, companies in the B-to-B space request proposals from national suppliers like Staples and Office Depot. The request for proposal (“RFP”) process typically results in a multi-year contract with a primary vendor that guarantees prices for specific items, includes an upfront lump-sum rebate, and a host of other services. Because the office supplies consumed by large companies are voluminous, such companies typically pay only half the price for basic supplies as compared to the average retail consumer.

B. Defendants Staples and Office Depot

Established as big-box retail stores in the 1980s, Defendants are the primary B-to-B office supply vendors in the United States today. Plaintiffs allege that Defendants sell and distribute upwards of seventy-nine percent of office supplies in the B-to-B space. Since the 2013 merger of Office Depot and Office Max, Defendants consistently engage in head-to-head competition with each other for B-to-B contracts.

Staples’ “commercial” and Office Depot’s “business solutions” segments focus on the B-to-B contracts at issue in this case. While both companies serve businesses of all sizes, this case focuses on large B-to-B customers, defined by Plaintiffs as those that spend $500,000 or more per year on office supplies. Approximately 1200 corporations in the United States are included in this alleged relevant market.

C. FTC Investigation

On February 4, 2015, Defendants entered into a merger agreement in which Staples would acquire Office Depot for a combination of cash and Staples’ stock. Shortly after the merger was announced, the FTC launched an investigation into the competitive effects of the proposed merger. Ultimately, the FTC commissioners filed an administrative complaint before an FTC Administrative Law Judge (“ALJ”) and also authorized the Plaintiffs to seek a preliminary injunction to prevent the Defendants from consummating the merger to maintain the status quo pending a full hearing on the merits. Plaintiffs filed this suit the same day.
D. Regional and local vendors

Regional and local office supply vendors exist throughout the country. However, they typically do not bid for large B-to-B contracts. When regional office supply vendors compete for RFPs, they are rarely awarded the contract.

WB Mason is a regional supplier that targets its business to thirteen northeastern states plus the District of Columbia (known in the industry as “Masonville”). WB Mason “ranks a distant third” behind Staples and Office Depot. In fiscal year 2015, WB Mason generated approximately $1.4 billion in total revenue. WB Mason has no customers in the Fortune 100 and only nine in the Fortune 1000. According to WB Mason’s CEO, Leo Meehan, “Staples and Office Depot are the only consumable office supplies vendors that meet the needs of most large B2B customer[s] across the entire country, or even most of it.”

WB Mason recently abandoned a plan to expand nationwide. When asked during the hearing if WB Mason would accept a divestiture of cash assets from the Defendants to cover the expenses of nationwide expansion, Mr. Meehan would not commit to accepting such a proposal.

III. Legal Standards

A. The Clayton Act

Section 7 of the Clayton Act prohibits mergers or acquisitions “the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly,” in any “line of commerce or in any activity affecting commerce in any section of the country.” 15 U.S.C. § 18. When the FTC has “reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act,” it may seek a preliminary injunction under Section 13(b) of the FTC Act to “prevent a merger pending the Commission’s administrative adjudication of the merger’s legality.” F.T.C. v. Staples, Inc., 970 F.Supp. 1066, 1070 (D.D.C.1997) (citing 15 U.S.C. § 53(b)); see also Brown Shoe v. U.S., 370 U.S. 294, 317 (1962) (“Congress saw the process of concentration in American business as a dynamic force; it sought to ensure the Federal Trade Commission and the courts the power to brake this force ... before it gathered momentum.”) “Section 13(b) provides for the grant of a preliminary injunction where such action would be in the public interest—as determined by a weighing of the equities and a consideration of the Commission’s likelihood of success on the merits.” F.T.C. v. Heinz Co., 246 F.3d 708, 714 (D.C.Cir.2001) (citing 15 U.S.C. § 53(b)).

B. Section 13(b) Standard for Preliminary Injunction

The standard for a preliminary injunction under Section 13(b) requires plaintiffs to show: (1) a likelihood of success on the merits; and (2) that the equities tip in favor of injunctive relief. FTC v. Cardinal Health, 12 F.Supp.2d 34, 44 (D.D.C.1998). To establish a likelihood of success on the merits, the government must show that “there is a reasonable probability that the challenged transaction will substantially impair competition.” Staples, 970 F.Supp. at 1072 (citation omitted) (internal quotation marks omitted). “Proof of actual anticompetitive effects is not required; instead, the FTC must show an appreciable danger of future coordinated interaction based on predictive judgment.” F.T.C. v. Arch Coal, Inc., 329 F.Supp.2d 109, 116 (D.D.C.2004) (internal quotations omitted).

The Court’s task, therefore, is to “measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the [proposed] merger ‘may be substantially to lessen competition, or tend to create a monopoly’ in violation of Section 7 of the Clayton Act.” Heinz, 246 F.3d at 714.

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23 In contrast, the typical preliminary injunction standard requires a plaintiff to show: (1) irreparable harm; (2) probability of success on the merits; and (3) a balance of equities favoring the plaintiff. F.T.C. v. Sysco Corporation, 113 F.Supp.3d 1, 22 (2015) (citing Heinz, 246 F.3d at 714).
(quoting 15 U.S.C. § 18). This standard is satisfied if the FTC raises questions going to the merits “so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.” Id. at 714–15 (citations omitted) (internal quotation marks omitted). As reflected by this standard, Congress’ concern regarding potentially anticompetitive mergers was with “probabilities, not certainties.” Brown Shoe Co., 370 U.S. at 323, 82 S.Ct. 1502 (other citations omitted).

In sum, the Court “must balance the likelihood of the FTC’s success against the equities, under a sliding scale.” F.T.C. v. Whole Foods Market, Inc., 548 F.3d 1028, 1035 (D.C.Cir.2008). The equities or “public interest” in the antitrust context include: “(1) the public interest in effectively enforcing antitrust laws, and (2) the public interest in ensuring that the FTC has the ability to order effective relief if it succeeds at the merits trial.” Sysco, 113 F.Supp.3d at 86.

Nevertheless, “[t]he issuance of a preliminary injunction prior to a full trial on the merits is an extraordinary and drastic remedy.” F.T.C. v. Exxon Corp., 636 F.2d 1336, 1343 (D.C.Cir.1980)(citations omitted) (internal quotation marks omitted). The government must come forward with rigorous proof to block a proposed merger because “the issuance of a preliminary injunction blocking an acquisition or merger may prevent the transaction from ever being consummated.” Id.

C. Baker Hughes Burden-Shifting Framework

In United States v. Baker Hughes, Inc., 908 F.2d 981, 982–83 (D.C.Cir.1990), the U.S. Court of Appeals for the D.C. Circuit established a burden-shifting framework for evaluating the FTC’s likelihood of success on the merits. See Heinz, 246 F.3d at 715. The government bears the initial burden of showing the merger would result in “undue concentration in the market for a particular product in a particular geographic area.” Baker Hughes, 908 F.2d at 982. Showing that the merger would result in a single entity controlling such a large percentage of the relevant market so as to significantly increase the concentration of firms in that market entitles the government to a presumption that the merger will substantially lessen competition. Id.

The burden then shifts to the defendants to rebut the presumption by offering proof that “the market-share statistics [give] an inaccurate account of the [merger’s] probable effects on competition in the relevant market.” Heinz, 246 F.3d at 715 (quoting United States v. Citizens & S. Nat’l Bank, 422 U.S. 86, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975) (alterations in original)). “The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully.” Baker Hughes, 908 F.2d at 991. “A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government’s favor.” Id.

“If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.” Id. at 983. “[A] failure of proof in any respect will mean the transaction should not be enjoined.” Arch Coal, 329 F.Supp.2d at 116. The court must also weigh the equities, but if the FTC is unable to demonstrate a likelihood of success on the merits, the equities alone cannot justify an injunction. Id.

IV. Discussion

The Court’s analysis proceeds as follows: (A) legal principles considered when defining a relevant market; (B) application of legal principles to Plaintiffs’ market definition; (C) Defendants’ arguments in opposition to Plaintiffs’ alleged market; (D) conclusions regarding the relevant market; (E) analysis of the Plaintiffs’ arguments relating to the probable effects on competition based on market share calculations; (F) Defendants’ arguments in opposition to Plaintiffs’ market share calculations; (G) conclusions regarding Plaintiffs’ market share; (H) Plaintiffs’ evidence of additional
harm; (I) Defendants’ response to Plaintiffs’ prima facie case; and (J) weighing the equities.

A. Legal principles considered when defining a relevant market

As discussed supra, the burden is on the Plaintiffs to show that the merger would result in a single entity controlling such a large percentage of the relevant market that concentration is significantly increased and competition is lessened. See e.g., Baker Hughes, 908 F.2d at 982. To consider whether the proposed merger may have anticompetitive effects, the Court must first define the relevant market based on evidence proffered at the evidentiary hearing. See United States v. Marine Bancorp., 418 U.S. 602, 618 (1974) (Market definition is a “necessary predicate’ to deciding whether a merger contravenes the Clayton Act.”). Examination of the particular market, including its structure, history and probable future, is necessary to “provide the appropriate setting for judging the probable anticompetitive effects of the merger.” F.T.C. v. Arch Coal, Inc., 329 F.Supp.2d at 116 (quoting Brown Shoe at 322 n. 28, 82 S.Ct. 1502); see also United States v. General Dynamics, 415 U.S. 486, 498, 94 S.Ct. 1186, 39 L.Ed.2d 530 (1974). “Defining the relevant market is critical in an antitrust case because the legality of the proposed merger [] in question almost always depends on the market power of the parties involved.” Cardinal Health, Inc., 12 F.Supp.2d at 45.

Two components are considered when defining a relevant market: (1) the geographic area where Defendants compete; and (2) the products and services with which the defendants’ products compete. Arch Coal, Inc., 329 F.Supp.2d at 119. The parties agree that the United States is the relevant geographic market. The parties vigorously disagree, however, about how the relevant product market should be defined.

The Supreme Court in Brown Shoe established the basic rule for defining a product market: “The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.” Brown Shoe, 370 U.S. at 325, 82 S.Ct. 1502. In other words, a product market includes all goods that are reasonable substitutes, even where the products are not entirely the same. Two factors contribute to an analysis of whether goods are “reasonable substitutes”: (1) functional interchangeability; and (2) cross-elasticity of demand. See e.g., Sysco, 113 F.Supp.3d at 25–26.

As the following discussion demonstrates, the concepts of cluster and targeted markets are critical to defining the market in this case.

a. Consumable office supplies as cluster market

Cluster markets allow items that are not substitutes for each other to be clustered together in one antitrust market for analytical convenience. The Supreme Court has made clear that “[w]e see no barrier to combining in a single market a number of different products or services where that combination reflects commercial realities.” United States v. Grinnell Corp., 384 U.S. 563, 572 (1966).

Here, Plaintiffs allege that items such as pens, file folders, Post-it notes, binder clips, and paper for copiers and printers are included in this cluster market. Although a pen is not a functional substitute for a paperclip, it is possible to cluster consumable office supplies into one market for analytical convenience. ProMedica Health Sys., Inc. v. F.T.C., 749 F.3d 559, 565–68 (6th Cir.2014). Defining the market as a cluster market is justified in this case because “market shares and competitive conditions are likely to be similar for the distribution of pens to large customers and the distribution of binder clips to large customers.” Shapiro Report at 007.

b. Large B-to-B customers as target market

Another legal principle relevant to market definition in this case is the concept of a “targeted” or “price discrimination” market. According to the Merger Guidelines:

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can
discriminate, e.g., by profitably raising price to certain targeted customers but not to others. [...] 

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away.


Defining a market around a targeted consumer, therefore, requires finding that sellers could “profitably target a subset of customers for price increases ...” See Sysco, 113 F.Supp.3d at 38 (citing Merger Guidelines Section 4.1.4.). This means that there must be differentiated pricing and limited arbitrage. Dr. Shapiro concluded that arbitrage is limited here because “it is not practical or attractive for a large customer to purchase indirectly from or through smaller customers.”

B. Application of relevant legal principles to Plaintiffs’ market definition

The concepts of cluster and targeted markets inform the Court’s critical consideration when defining the market in this case: the products and services with which the Defendants’ products compete. Arch Coal, Inc., 329 F.Supp.2d at 119. The parties vigorously disagree on how the market should be defined. As noted supra, Plaintiffs argue that the relevant market is a cluster market of “consumable office supplies” which consists of “an assortment of office supplies, such as pens, paper clips, notepads and copy paper, that are used and replenished frequently.” Compl. ¶¶ 36-37. Plaintiffs’ alleged relevant market is also a targeted market, limited to B-to-B customers, specifically large B-to-B customers who spend $500,000 or more on office supplies annually.25

Defendants, on the other hand, argue that Plaintiffs’ alleged market definition is wrong because it is a “gerrymandered and artificially narrow product market limited to some, but not all, consumable office supplies sold to only the most powerful companies in the world.” In particular, Defendants insist that ink and toner must be included in a proper definition of the relevant product market. Defendants also argue that no evidence supports finding sales to large B-to-B customers as a distinct market.

1. Brown Shoe “Practical Indicia”


24 Although the Merger Guidelines are not binding on this Court, the D.C. Circuit has relied on them for guidance in other merger cases. Sysco, 113 F.Supp.3d at 38 (citing Heinz, 246 F.3d at 716 n.9).

25 In Plaintiffs’ complaint, they alleged that the relevant market was limited to large B-to-B customers, including, but not limited to “those that buy $1 million annually of consumable office supplies for their own use.” Id. ¶¶ 41, 45. For analytical purposes, Dr. Shapiro drew the line at large B-to-B’s that spend $500,000 or more on office supplies. Hrg Tr. 2154:16-2155:14 (Dr. Shapiro noting that 90 percent of Enterprise customers spend at least $500,000 on office supplies and that there is no “magic place that’s the right place” to draw the line, but necessary for practical analytical purposes).

26 The Court is aware of the academic observation that “the rationale for market definition in Brown Shoe was very different from and at odds with the rationale for market definition in horizontal merger cases today.” Phillip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION at 237 (CCH, Inc. 2015).
The most relevant Brown Shoe indicia in this case are: (a) industry or public recognition of the market as a separate economic entity; (b) distinct prices and sensitivity to price changes; and (c) distinct customers that require specialized vendors that offer value-added services, including: (i) sophisticated information technology (IT) services; (ii) high quality customer service; and (iii) expedited delivery.

* * *

In sum, the evidence shows that the Brown Shoe factors support Plaintiffs’ alleged market definition because there is: (a) industry or public recognition of the market as a separate economic entity; (b) B-to-B customers demand distinct prices and demonstrate a high sensitivity to price changes; and (c) B-to-B customers require specialized vendors that offer value-added services, including: (i) sophisticated information technology (IT) services; (ii) high quality customer service; and (iii) expedited delivery. These factors support viewing large B-to-B customers as a target market.

2. Expert testimony of Dr. Carl Shapiro and the Hypothetical Monopolist Test

In addition to the Brown Shoe factors, the Court must consider the expert testimony offered by Plaintiffs in this case. The parties agree that the main test used by economists to determine a product market is the hypothetical monopolist test. (“HMT”). This test queries whether a hypothetical monopolist who has control over the products in an alleged market could profitably raise prices on those products. If so, the products may comprise a relevant product market. See H & R Block, 833 F.Supp.2d at 51–52. The HMT is explained in the Merger Guidelines.

[T]he test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ... likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one product in the market, including at least one product sold by one of the merging firms.

Merger Guidelines § 4.1.1 The SSNIP is generally assumed to be “five percent of the price paid by customers for the products or services to which the merging firms contribute value.” Merger Guidelines § 4.1.2.

Dr. Shapiro’s HMT analysis emphasizes that the proposed or “candidate” market consisting of the sale and distribution of consumable office supplies includes all methods of procuring office supplies by large companies, i.e. procurement through a primary vendor relationship, off contract purchases, online and retail buys. “Since the hypothetical monopolist, by definition, controls all sources of supply to large customers, it would not have to worry that raising prices would cause large customers to switch to other suppliers of consumable office supplies: by definition, there are none.” Shapiro Report at 014.

Dr. Shapiro also points out that Staples and Office Depot’s head-to-head competition “tells us that a monopoly provider of consumable office supplies would charge significantly more to large customers than Staples and Office Depot today charge these same customers.” Id. Dr. Shapiro also highlights the record evidence that demonstrates Defendants compete “fiercely” for business in the large B-to-B space. Id. Dr. Shapiro concludes that such competition implies that “the elimination of competition would lead to a significant price increase to large customers, which in turn implies that the HMT is satisfied.” Id.

Dr. Shapiro’s conclusions are supported by the testimony presented during the hearing. . . . In sum, Dr. Shapiro’s expert report and testimony, as well as the testimony

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Today the concern is that the post-merger firm might be able to raise prices without causing too much output to be lost to its rivals. In contrast, the Brown Shoe concern was that by reducing its price (or improving quality at the same price), the post-merger firm could deprive rivals of output, thus forcing them out altogether or relegating them to niche markets.

Id. at 240. Nevertheless, the Court finds the Brown Shoe factors a useful analytical tool, and as Judge Amit P. Mehta recognized in Sysco, “Brown Shoe remains the law, and this court cannot ignore its dictates.” Sysco, 113 F.Supp.3d at n. 2.
of the corporate representatives, supports Plaintiffs’ definition of the relevant market as the sale and distribution of consumable office supplies to large B-to-B customers.

C. Defendants’ arguments in opposition to Plaintiffs’ alleged market

Defendants make two primary arguments in response to Plaintiffs’ alleged market. First, although Defendants do not explicitly discuss the Brown Shoe practical indicia, they argue that exclusion of ink and toner, as well as “beyond office supplies” or “BOSS” products from the alleged market, is error. Second, Defendants argue that no evidence supports Plaintiffs’ contention that large B-to-B customers should be treated as a separate market.

1. Exclusion of ink, toner and BOSS from alleged market is proper

Defendants’ principal challenge to Plaintiffs’ alleged market centers on the exclusion of ink, toner and BOSS from the alleged relevant market. Defendants advance three arguments, none of which are persuasive. First, Defendants argue that exclusion of these products from the alleged market is a “made for litigation market,” that is inconsistent with commercial realities. Second, Defendants argue that Plaintiffs’ market definition is inconsistent with the one used by the FTC in 1997 and 2013. Id. Finally, Defendants seize on Dr. Shapiro’s admission that the FTC made the decision to exclude ink and toner from the proposed market prior to his independent determination that doing so was proper.

... In other words, because there are more companies that sell ink and toner, Defendants’ market share in an ink and toner market would be lower than they are in the alleged market.

All of the above arguments are advanced by Defendants to bolster their assertion that the Plaintiffs have “gerrymandered the market” to inflate Defendants’ market share. Defs.’ FOF ¶ 4. As discussed supra, voluminous record evidence supports excluding ink, toner and BOSS products from the relevant cluster market. To the extent Defendants sought to show that exclusion of ink and toner radically altered Defendants’ market share, Defendants could have presented expert testimony to support that proposition.

2. Antitrust laws exist to protect competition, not a particular set of consumers

Defendants’ second primary argument in opposition to Plaintiffs’ proposed relevant market is that “there is no evidence to support Plaintiffs’ claim that large B-to-Bs should be treated as a separate market.” Defendants maintain that Plaintiffs’ attempt to protect “mega companies” is misplaced because the merger “indisputably will benefit all retail customers, and more, than 99 percent of business customers.”

Antitrust laws exist to protect competition, even for a targeted group that represents a relatively small part of an overall market. See Merger Guidelines § 3 (“When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers.”). Indeed, the Supreme Court has recognized that within a broad market, “well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes.” Brown Shoe Co., 370 U.S. at 325; Cardinal Health, Inc., 12 F.Supp.2d at 47 (concluding that “the services provided by wholesalers in fact comprise a distinct submarket within the larger market of drug delivery.”);

As discussed in Section IV.A.2.a-c supra, the nature of how large B-to-B customers operate, including the services they demand, supports a finding that they are a targeted customer market for procurement of consumable office supplies. There is overwhelming evidence in this case that large B-to-B customers constitute a market that Defendants could target for price increases if they are allowed to merge. Significantly, Defendants themselves used the proposed merger to pressure B-to-B customers to lock in prices based on the expectation that they would lose negotiating leverage if the merger were approved.
D. Conclusions regarding the definition of the relevant market

The “practical indicia” set forth by the Supreme Court in *Brown Shoe* and Dr. Shapiro’s expert testimony support the conclusion that Plaintiffs’ alleged market of consumable office supplies (a cluster market) sold and distributed by Defendants to large B-to-B customers (a targeted market) is a relevant market for antitrust purposes. The *Brown Shoe* factors support Plaintiffs’ argument that the sale and distribution of consumable office supplies to large B-to-B customers is a proper antitrust market because the evidence supports the conclusion that: (1) there is industry or public recognition of the market as a separate economic entity; (2) B-to-B customers demand distinct prices and demonstrate a high sensitivity to price changes; and (3) B-to-B customers require specialized vendors that offer value-added services. Dr. Shapiro’s unrebutted testimony also supports Plaintiffs’ alleged market definition because, in his opinion, “the elimination of competition would lead to a significant price increase to large customers,” which implies the HMT is satisfied. Finally, for the reasons discussed in detail in Section IV.C *supra*, Defendants arguments against Plaintiffs’ market definition fail.

E. Analysis of the Plaintiffs’ arguments relating to probable effects on competition based on market share calculations

Having concluded that Plaintiffs have carried their burden of establishing that the sale and distribution of consumable office supplies to large B-to-B customers in the United States is the relevant market, the Court now turns to an analysis of the likely effects of the proposed merger on competition within the relevant market. “If the FTC can make a *prima facie* showing that the acquisition in this case will result in a significant market share and an undue increase in concentration” in the relevant market, then “a presumption is established that [the merger] will substantially lessen competition.” *Swedish Match*, 131 F.Supp.2d at 166. The burden is on the government to show that the merger would “produce a firm controlling an undue percentage share of the relevant market” that would result in a “significant increase in the concentration of firms in that market.” *Heinz*, 246 F.3d at 715.

The Plaintiffs can establish their *prima facie* case by showing that the merger will result in an increase in market concentration above certain levels. *Id.* “Market concentration is a function of the number of firms in a market and their respective market shares.” *Arch Coal*, 329 F.Supp.2d at 123. The Herfindahl-Hirschmann Index (“HHI”) is a tool used by economists to measure changes in market concentration. Merger Guidelines § 5.3. HHI is calculated by “summing the squares of the individual firms’ market shares,” a calculation that “gives proportionately greater weight to the larger market shares.” *Id.* An HHI above 2,500 is considered “highly concentrated”; a market with an HHI between 1,500 and 2,500 is considered “moderately concentrated”; and a market with an HHI below 1,500 is considered “unconcentrated.” *Id.* A merger that results in a highly concentrated market that involves an increase of 200 points will be presumed to be likely to enhance market power.” *Id.*; see also *Heinz*, 246 F.3d at 716–17.

1. Concentration in the sale and distribution of consumable office supplies to large B-to-B customers

Dr. Shapiro estimated Defendants’ market shares by using data collected from Fortune 100 companies (“Fortune 100 sample” or “Fortune 100”). Shapiro Report at 017. During the data collecting process, 81 of the Fortune 100 companies responded with enough detail to be used in Dr. Shapiro’s sample. *Id.*; see also Hrg Tr. 2294:3-19. The critical data provided by the companies was fiscal year 2014 information on: (1) their overall spend on consumable office supplies; (2) the amount spent on consumable office supplies from Staples; and (3) the amount spent on consumable office supplies from Office Depot. Shapiro Report, Exhibit 5A. Some Fortune 100 companies have an established primary vendor relationship with Staples or Office Depot. *Id.* For example, Staples has 100 percent of the market share relating to [redacted text]’s spend on consumable office supplies and Office Depot has 100 percent of the market share
relating to [redacted text]'s spend on consumable office supplies. *Id.* Other Fortune 100 customers purchase office supplies from a mix of vendors. For example, Staples accounted for twenty-seven percent of [redacted text]'s spend on consumable office supplies in 2014 and Office Depot accounted for twenty-one percent. *Id.*

Defendants’ market share of the Fortune 100 sample as a whole is striking: Staples captures 47.3 percent and Office Depot captures 31.6 percent, for a total of 79 percent market share. The pre-merger HHI is already highly concentrated in this market, resting at 3,270. Put another way, Staples and Office Depot currently operate in the relevant market as a “duopoly with a competitive fringe.” If allowed to merge, the HHI would increase nearly 3,000 points, from 3,270 to 6,265. This market structure would constitute one dominant firm with a competitive fringe. Staples’ proposed acquisition of Office Depot is therefore presumptively illegal because the HHI increases more than 200 points and the post-merger HHI is greater than 2,500. Shapiro Report at 021; see also *Heinz*, 246 F.3d at 716 (noting that the pre-merger HHI for baby food was 4775, “indicative of a highly concentrated industry” and the 500 point post-merger HHI increase “creates, by a wide margin, a presumption that the merger will lessen competition in the domestic jarred baby food market.”)

**F. Defendants’ arguments in opposition to Plaintiffs’ Market Share Calculations**

Defendants make several arguments in opposition to Dr. Shapiro’s market share methodology and calculation. Defendants argue that: (1) the Fortune 100 sample overstates Defendants’ actual market share; (2) treatment of Tier 1 diversity suppliers and paper manufacturers was error; and (3) Dr. Shapiro underestimates leakage, inflating Defendants’ market shares. However, despite significant time spent cross-examining Dr. Shapiro with regard to his methodology, Defendants produced no expert evidence during the hearing to rebut that methodology. Moreover, it is significant that Defendants’ final 100-page brief devotes only seven paragraphs to challenging Dr. Shapiro’s market share calculations.

1. *The Fortune 100 is a trustworthy sample to calculate Defendants’ market shares*

Defendants’ first argument in opposition to Dr. Shapiro’s focus on the Fortune 100 is that his failure to take a sample of the other approximate 1100 companies in the relevant market is error because it results in “dramatically inflated market shares.” Dr. Shapiro conceded that the data he analyzed is imperfect because it does not include all large B-to-B customers. However, Dr. Shapiro was confident that “there is no reason to believe [the market shares] are biased when it comes to estimating the market shares of Staples and Office Depot.” To test whether his analysis of the Fortune 100 might have overstated Defendants’ market shares because the Fortune 100 companies are especially large, Dr. Shapiro measured the market share of the top half of his sample separate from the bottom half. The range of spending on consumable office supplies among the companies analyzed in Dr. Shapiro’s analysis is vast: from less than $200,000 per year on the low end, to more than $33 million per year on the high end. The combined market share for Defendants is seventy-nine percent among the top half of the Fortune 100 and eighty-nine percent among the bottom half. Thus, Dr. Shapiro states that he is “confident that the market shares for Staples and Office Depot reported in Exhibit 5B are not overstated.”

**G. Conclusion regarding Plaintiffs’ market share analysis**

Plaintiffs have met their burden of showing that the merger would result in “undue concentration” in the relevant market of the sale and distribution of consumable office supplies to large B-to-B customers in the United States. The relevant HHI would increase nearly 3,000 points, from 3270 to 6265. These HHI numbers far exceed the 200 point increase and post-merger concentration level of 2500 necessary to entitle Plaintiffs to a presumption that the merger is illegal. The Court rejects Defendants’ arguments in opposition to Dr. Shapiro’s market analysis for the reasons discussed in detail in Section IV.F *supra*. Nevertheless, to strengthen their *prima facie* case, Plaintiffs presented additional evidence of harm, which the Court analyzes next.
H. Plaintiffs’ evidence of additional harm

Sole reliance on HHI calculations cannot guarantee litigation victories. *Baker Hughes*, 908 F.2d at 992. Plaintiffs therefore highlight additional evidence, including bidding data (“bid data”), ordinary course documents, and fact-witness testimony. This additional evidence substantiates Plaintiffs’ claim that this merger, if consummated, would result in a lessening of competition.

Mergers that eliminate head-to-head competition between close competitors often result in a lessening of competition. See Merger Guidelines § 6 (“The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition.”); see also *Heinz*, 246 F.3d at 717–19; *Swedish Match*, 131 F.Supp.2d at 169; *Staples*, 970 F.Supp. at 1083. Plaintiffs’ evidence supports the conclusion that Defendants compete head-to-head for large B-to-B customers.

[Portion of the opinion rejecting claims of new entry omitted.]

V. Conclusion

As Judge Mehta observed in *Sysco*, “There can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market.” 113 F.Supp.3d at 88 (quoting J. Tatel in *Whole Foods*, 548 F.3d at 1043). The Court concludes that Plaintiffs have met their burden of showing by a “reasonable probability” that Staples’ acquisition of Office Depot would lessen competition in the sale and distribution of consumable office supplies in the large B-to-B market in the United States. The evidence offered by Defendants to rebut Plaintiffs’ showing of likely harm was inadequate as a matter of law. Plaintiffs have therefore carried their ultimate burden of showing that they are likely to succeed in proving, after a full administrative hearing on the merits, that the proposed merger “may be substantially to lessen competition, or to tend to create a monopoly” in violation of Section 7 of the Clayton Act.

For the reasons discussed herein, Plaintiffs’ Motion for Preliminary Injunction is GRANTED. A separate order accompanies this Memorandum Opinion.

NOTES AND QUESTIONS

1. *Staples I compared*. In *Staples I*, the court focused on overall retail price levels. In *Staples II*, the FTC’s complaint (and ultimately the court) focused on prices to a particular subset of customers (large businesses) purchasing certain supplies on national contracts. What explains the difference in approach? Do the different approaches reflect factual differences that developed in the years between the cases? Different legal or economic approaches to merger analysis?

2. *Price discrimination*. The most notable element of the court’s ruling in *Staples II* is its agreement with the Merger Guidelines that markets can be defined by the ability of the merged firm to engage in price discrimination. The FTC’s definition of the relevant market in *Staples II* focused in on “consumable office supplies to large business-to-business customers (excluding ink, toner, janitorial and break-room supplies).” The merging parties criticized the definition as “gerrymandered and artificial,” noting that the exclusion of ink and toner substantially increased the market share of the merged firms. The court concluded that this market definition, like the focus on “front range skiers” in the *Vail* case above, was appropriate. In both cases, the court agreed that the ability to price discriminate—that is, targeting some customers for price increases (say, those buying paper, but not toner) even when other customers would not be affected by them—can create narrowly defined markets for purposes of analyzing the competitive effects of a merger. Does that theory mean that a merger is unlawful whenever it disadvantages any customer?

3. *The Merger Guidelines*. The district court, as is common, accorded the Guidelines considerable weight. In a footnote, the court explained that “[a]lthough the Merger Guidelines are not binding on this Court, the D.C. Circuit has relied on them for guidance in
other merger cases. Sysco, 113 F.Supp.3d at 38 (citing Heinz, 246 F.3d at 716 n.9).” As it turned out, one of the principal authors of the 2010 Merger Guidelines, Dr. Carl Shapiro, served as the expert for the FTC in this case.

4. Market Definition = Game Over. In many merger cases, the definition of the relevant market is the whole ballgame. In this case, that was certainly the case, as the entry argument was rejected very easily by the court. With respect to the competitive impact of the merger, the FTC’s market definition meant that this merger was, in effect, a merger to monopoly. Citing the Merger Guidelines, the court concluded that “[m]ergers that eliminate head-to-head competition between close competitors often result in a lessening of competition.” In addition to emphasizing the relevant market shares, the FTC also provided considerable empirical support that the merging firms “compete head-to-head for large B-to-B customers.”

5. The subtleties of price discrimination. Given the relatively narrowly defined set of customers—very large businesses—the merging firms thought they could justify the merger by focusing on other customers. As the court noted, “Defendants maintain that Plaintiffs’ attempt to protect ‘mega companies’ is misplaced because the merger ‘indisputably will benefit all retail customers, and more, than 99 percent of business customers.’” Citing the Merger Guidelines, the court rejected this argument, concluding that “Antitrust laws exist to protect competition, even for a targeted group that represents a relatively small part of an overall market.” Assume that defendants were able to prove that 99% of consumers would gain more from the merger than the 1% of adversely affected consumers would lose. On that assumption, should the merger have been permitted?

6. The analytical challenge of price discrimination. If the concept of price discrimination as a tool that facilitates a more nuanced merger analysis strikes you as challenging, counter-intuitive, or confusing, you have company. In the decision below, the D.C. Circuit splits as it evaluates the competitive impact of a merger between Whole Foods and Wild Oats. In that case, the court focuses on “core” and “marginal” consumers, meaning those who are committed Whole Foods or Wild Oats shoppers and those who are less discerning and happy with regular supermarkets. In short, the court confuses two different concepts—(1) price discrimination in terms of targeting specific customers (the issue in Staples), which goes to the question whether those customers constitute a separate market; and (2) different segments of consumers, some of whom prefer a specific product (in that case, “premium, natural, and organic supermarkets”) to more generic ones, that cannot be separated by price discrimination. The second concept goes to the basic issue of market definition – the question whether a monopolist of a hypothetical market that included those segments would be able profitably to charge a supracompetitive price. As you read the opinion and dissent, see how they confuse and misuse these concepts.

548 F.3d 1028.
BROWN, J. [The FTC unsuccessfully sought a preliminary injunction to block the merger of Whole Foods and Wild Oats in the district court. The Federal Trade Commission appealed.]

Whole Foods Market, Inc. (“Whole Foods”) and Wild Oats Markets, Inc. (“Wild Oats”) operate 194 and 110 grocery stores, respectively, primarily in the United States. In February 2007, they announced that Whole Foods would acquire Wild Oats. . . .

The FTC contended Whole Foods and Wild Oats are the two largest operators of what it called premium, natural, and organic supermarkets (“PNOS”). Such stores “focus on high-quality perishables, specialty and natural organic produce, prepared foods, meat, fish[,] and bakery goods; generally have high levels of customer service; generally target affluent and well educated customers [and] . . . are mission driven with an emphasis on social and environmental responsibility.” FTC v. Whole Foods Market, Inc., 502 F. Supp. 2d 1, 28 (D.D.C. 2007). In eighteen cities, asserted the FTC, the merger would create monopolies because Whole Foods and Wild Oats are the only PNOS. To
support this claim, the FTC relied on emails Whole Foods’s CEO John Mackey sent to other Whole Foods executives and directors suggesting the purpose of the merger was to eliminate a competitor. In addition the FTC produced pseudonymous blog postings in which Mr. Mackey touted Whole Foods and denigrated other supermarkets as unable to compete. The FTC’s expert economist, Dr. Kevin Murphy, analyzed sales data from the companies to show how entry by various supermarkets into a local market affected sales at a Whole Foods or Wild Oats store.

On the other hand, the defendants’ expert, Dr. David Scheffman, focused on whether a hypothetical monopolist owning both Whole Foods and Wild Oats would actually have power over a distinct market. He used various third-party market studies to predict that such an owner could not raise prices without driving customers to other supermarkets. In addition, deposition testimony from other supermarkets indicated they regarded Whole Foods and Wild Oats as critical competition. Internal documents from the two defendants reflected their extensive monitoring of other supermarkets’ prices as well as each other’s.

The district court concluded that PNOS was not a distinct market and that Whole Foods and Wild Oats compete within the broader market of grocery stores and supermarkets. Believing such a basic failure doomed any chance of the FTC’s success, the court denied the preliminary injunction without considering the balance of the equities.

On August 17, the FTC filed an emergency motion for an injunction pending appeal, which this court denied on August 23.

[Before turning to the merits of the district court decision, the Court of Appeals addressed Whole Foods’ argument that the injunction issue was moot because, after the district court denied a preliminary injunction, some stores were closed and others sold. The court rejected the argument on the ground that the FTC has broad equity powers and could improve the competitive situation by, for example, requiring divestiture of some stores that had not been closed or sold.]

... The FTC complains the district court improperly focused on whether Whole Foods and Wild Oats operate within a PNOS market. However, this was not an abuse of discretion given that the district court was simply following the FTC’s outline of the case.

Inexplicably, the FTC now asserts a market definition is not necessary in a § 7 case, in contravention of the statute itself, (barring an acquisition “where in any line of commerce . . . the effect of such acquisition may be substantially to lessen competition”); see also Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962) (interpreting “any line of commerce” to require a “determination of the relevant market” to find “a violation of the Clayton Act”). The FTC suggests “market definition . . . is a means to an end—to enable some measurement of market power—not an end in itself.” But measuring market power is not the only purpose of a market definition; only “examination of the particular market—its structure, history, and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.” Brown Shoe, 370 U.S. at 322 n.38.

In this case, however, the FTC itself made market definition key. It claimed “[t]he operation of premium natural and organic supermarkets is a distinct ‘line of commerce’ within the meaning of Section 7,” and its theory of anticompetitive effect was that the merger would “substantially increase concentration in the operation of [PNOS].” Throughout its briefs, the FTC presented a straightforward § 7 case in which “whether the transaction creates an appreciable danger of anticompetitive effects . . . depends upon . . . [the] relevant product . . . [and] geographic market . . . and the transaction’s probable effect on competition in the product and geographic markets.” It purported to show “undue concentration in the relevant market,” as the mainstay of its case. Because of the concentration in the supposed PNOS market, the FTC urged the district court to hold the merger “presumptively unlawful,” and this was its sole reason for blocking the merger.
Thus, the FTC assumed the burden of raising some question of whether PNOS is a well-defined market. As the FTC presented its case, success turned on whether there exist core customers, committed to PNOS, for whom one should consider PNOS a relevant market. The district court assumed “the ‘marginal’ consumer, not the so-called ‘core’ or ‘committed’ consumer, must be the focus of any analysis.” To the contrary, core consumers can, in appropriate circumstances, be worthy of antitrust protection. See Horizontal Merger Guidelines § 1.12 (explaining the possibility of price discrimination for “targeted buyers”). The district court’s error of law led it to ignore FTC evidence that strongly suggested Whole Foods and Wild Oats compete for core consumers within a PNOS market, even if they also compete on individual products for marginal consumers in the broader market.

A market “must include all products reasonably interchangeable by consumers for the same purposes.” Microsoft, 253 F.3d at 52. Whether one product is reasonably interchangeable for another depends not only on the ease and speed with which customers can substitute it and the desirability of doing so, but also on the cost of substitution, which depends most sensitively on the price of the products. A broad market may also contain relevant submarkets which themselves “constitute product markets for antitrust purposes.” Brown Shoe. “The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.”

To facilitate this analysis, the Department of Justice and the FTC developed a technique called the SSNIP (“small but significant non-transitory increase in price”) test, which both Dr. Murphy and Dr. Scheffman used. In the SSNIP method, one asks whether a hypothetical monopolist controlling all suppliers in the proposed market could profit from a small price increase. Horizontal Merger Guidelines § 1.11. If a small price increase would drive consumers to an alternative product, then that product must be reasonably substitutable for those in the proposed market and must therefore be part of the market, properly defined.

Experts for the two sides disagreed about how to do the SSNIP of the proposed PNOS market. Dr. Scheffman used a method called critical loss analysis, in which he predicted the loss that would result when marginal customers shifted purchases to conventional supermarkets in response to a SSNIP. He concluded a hypothetical monopolist could not profit from a SSNIP, so that conventional supermarkets must be within the same market as PNOS. In contrast, Dr. Murphy disapproved of critical loss analysis generally, preferring a method called critical diversion that asked how many customers would be diverted to Whole Foods and how many to conventional supermarkets if a nearby Wild Oats closed. Whole Foods’s internal planning documents indicated at least a majority of these customers would switch to Whole Foods, thus making the closure profitable for a hypothetical PNOS monopolist. One crucial difference between these approaches was that Dr. Scheffman’s analysis depended only on the marginal loss of sales, while Dr. Murphy’s used the average loss of customers. Dr. Murphy explained that focusing on the average behavior of customers was appropriate because a core of committed customers would continue to shop at PNOS stores despite a SSNIP.

In appropriate circumstances, core customers can be a proper subject of antitrust concern. In particular, when one or a few firms differentiate themselves by offering a particular package of goods or services, it is quite possible for there to be a central group of customers for whom “only [that package] will do.” United States v. Grinnell Corp., 384 U.S. 563, 574 (1966); see also United States v. Phillipsburg Nat’l Bank & Trust Co., 399 U.S. 350, 360 (1970). . . .

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2 Dr. Scheffman did not actually calculate the amount of this loss. He simply predicted that because many Whole Foods and Wild Oats customers also shop at conventional supermarkets, the loss would at any rate be too large.
Such customers may be captive to the sole supplier, which can then, by means of price discrimination, extract monopoly profits from them while competing for the business of marginal customers. Not that prices that segregate core from marginal consumers are in themselves anticompetitive; such pricing simply indicates the existence of a submarket of core customers, operating in parallel with the broader market but featuring a different demand curve. See United States v. Rockford Mem’l Corp., 898 F.2d 1278, 1284 (7th Cir. 1990). Sometimes, for some customers a package provides “access to certain products or services that would otherwise be unavailable to them.” Because the core customers require the whole package, they respond differently to price increases from marginal customers who may obtain portions of the package elsewhere. Of course, core customers may constitute a submarket even without such an extreme difference in demand elasticity. After all, market definition focuses on what products are reasonably substitutable; what is reasonable must ultimately be determined by “settled consumer preference.” Phila. Nat’l Bank.

In short, a core group of particularly dedicated, “distinct customers,” paying “distinct prices,” may constitute a recognizable submarket, Brown Shoe, whether they are dedicated because they need a complete “cluster of products,” Phila. Nat’l Bank, because their particular circumstances dictate that a product “is the only realistic choice,” SuperTurf, Inc. v. Monsanto Co., or because they find a particular product “uniquely attractive,” Nat’l Collegiate Athletic Ass’n v. Bd. of Regents of the Univ. of Okla. For example, the existence of core customers dedicated to office supply superstores, with their “unique combination of size, selection, depth[,] and breadth of inventory,” was an important factor distinguishing that submarket. FTC v. Staples, Inc., 970 F. Supp. 1066, 1078–79 (D.D.C. 1997). As always in defining a market, we must “take into account the realities of competition.” Weiss v. York Hosp., 745 F.2d 786, 826 (3d Cir. 1984). We look to the Brown Shoe indicia, among which the economic criteria are primary.

The FTC’s evidence delineated a PNOS submarket catering to a core group of customers who “have decided that natural and organic is important, lifestyle of health and ecological sustainability is important.” Whole Foods, 502 F. Supp. at 223, It was undisputed that Whole Foods and Wild Oats provide higher levels of customer service than conventional supermarkets, a “unique environment,” and a particular focus on the “core values” these customers espoused. The FTC connected these intangible properties with concrete aspects of the PNOS model, such as a much larger selection of natural and organic products, FTC’s Proposed Findings of Fact (noting Earth Fare, a PNOS, carries “more than 45,000 natural and organic SKUs”) and a much greater concentration of perishables than conventional supermarkets, (“Over 60% of Wild Oats’ revenues” and “[n]early 70% of Whole Foods sales are natural or organic perishables.”). See also Whole Foods, 502 F. Supp. 2d at 22–23 (citing defendants’ depositions as evidence of Whole Food’s and Wild Oats’s focus on “high-quality perishables” and a large variety of products).

Further, the FTC documented exactly the kind of price discrimination that enables a firm to profit from core customers for whom it is the sole supplier. Dr. Murphy compared the margins of Whole Foods stores in cities where they competed with Wild Oats. He found the presence of a Wild Oats depressed Whole Foods’s margins significantly. Notably, while there was no effect on Whole Foods’s margins in the product category of “groceries,” where Whole Foods and Wild Oats compete on the margins with conventional supermarkets, the effect on margins for perishables was substantial. Confirming this price discrimination, Whole Foods’s documents indicated that when it price-checked conventional supermarkets, the focus was overwhelmingly on “dry grocery,” rather than on the perishables that were 70% of Whole Foods’s business. Thus, in the high-quality perishables on which both Whole Foods and Wild Oats made most of their money, they competed directly with each other, and they competed with supermarkets only on the dry grocery items that were the fringes of their business.

Additionally, the FTC provided direct evidence that PNOS competition had a greater effect than conventional supermarkets on PNOS prices. Dr. Murphy showed the opening of a new Whole Foods in the vicinity of a Wild Oats caused Wild Oats’s prices to
drop, while entry by non-PNOS stores had no such effect. Similarly, the opening of Earth Fare stores (another PNOS) near Whole Foods stores caused Whole Foods’s prices to drop immediately. The price effect continued, while decreasing, until the Earth Fare stores were forced to close.

Finally, evidence of consumer behavior supported the conclusion that PNOS serve a core consumer base. Whole Foods’s internal projections, based on market experience, suggested that if a Wild Oats near a Whole Foods were to close, the majority (in some cases nearly all) of its customers would switch to the Whole Foods rather than to conventional supermarkets. Since Whole Foods’s prices for perishables are higher than those of conventional supermarkets, such customers must not find shopping at the latter interchangeable with PNOS shopping. They are the core customers. Moreover, market research, including Dr. Scheffman’s own studies, indicated 68% of Whole Foods customers are core customers who share the Whole Foods “core values.”

Against this conclusion the defendants posed evidence that customers “cross-shop” between PNOS and other stores and that Whole Foods and Wild Oats check the prices of conventional supermarkets. But the fact that PNOS and ordinary supermarkets “are direct competitors in some submarkets . . . is not the end of the inquiry,” United States v. Conn. Nat’l Bank. Of course customers cross-shop; PNOS carry comprehensive inventories. The fact that a customer might buy a stick of gum at a supermarket or at a convenience store does not mean there is no definable groceries market. Here, cross-shopping is entirely consistent with the existence of a core group of PNOS customers. Indeed, Dr. Murphy explained that Whole Foods competes actively with conventional supermarkets for dry groceries sales, even though it ignores their prices for high-quality perishables.

In addition, the defendants relied on Dr. Scheffman’s conclusion that there is no “clearly definable” core customer. However, this conclusion was inconsistent with Dr. Scheffman’s own report and testimony. Market research had found that customers who shop at Whole Foods because they share the core values it champions constituted at least a majority of its customers. Moreover, Dr. Scheffman acknowledged “there are core shoppers [who] will only buy organic and natural” and for that reason go to Whole Foods or Wild Oats. Re contended they could be ignored because the numbers are not “substantial.” Again, Dr. Scheffman’s own market data undermined this assertion.

In sum, the district court believed the antitrust laws are addressed only to marginal consumers. This was an error of law, because in some situations core consumers, demanding exclusively a particular product or package of products, distinguish a submarket. The FTC described the core PNOS customers, explained how PNOS cater to these customers, and showed these customers provided the bulk of PNOS’s business. The FTC put forward economic evidence—which the district court ignored—showing directly how PNOS discriminate on price between their core and marginal customers, thus treating the former as a distinct market. Therefore, we cannot agree with the district court that the FTC would never be able to prove a PNOS submarket. We do not say the FTC has in fact proved such a market, which is not necessary at this point. To obtain a preliminary injunction under § 53(b), the FTC need only show a likelihood of success sufficient, using the sliding scale, to balance any equities that might weigh against the injunction.

It remains to address the equities, which the district court did not reach, and see whether for some reason there is a balance against the FTC that would require a greater likelihood of success. The FTC urges us to carry out the rest of this determination, but “[w]e believe the proper course of action at this point is to remand to the district court. . . .

■ TATEL, J. concurring: . . . I write separately because although I agree with Judge Brown that the district court erred in focusing only on marginal customers, I believe the district court also overlooked or mistakenly rejected evidence supporting the FTC’s view that Whole Foods and Wild Oats occupy a separate market of “premium natural and organic supermarkets.” . . .
Following the FTC’s lead, the court focused on defining the product market in which Whole Foods and Wild Oats operate, saying:

[I]f the relevant product market is, as the FTC alleges, a product market of “premium natural and organic supermarkets” . . ., there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market. If, on the other hand, the defendants are merely differentiated firms operating within the larger relevant product market of “supermarkets,” the proposed merger will not tend to harm competition.

Thus, the “‘case hinges’—almost entirely—‘on the proper definition of the relevant product market.’” And after reviewing the evidence, the district court concluded that “[t]here is no substantial likelihood that the FTC can prove its asserted product market and thus no likelihood that it can prove that the proposed merger may substantially lessen competition or tend to create a monopoly.”

I agree with the district court that this “‘case hinges’—almost entirely—‘on the proper definition of the relevant product market.’” for if a separate natural and organic market exists, “there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market.” But I respectfully part ways with the district court when it comes to assessing the FTC’s evidence in support of its contention that Whole Foods and Wild Oats occupy a distinct market. . . . In this case the FTC presented a great deal of credible evidence—either unmentioned or rejected by the district court—suggesting that Whole Foods and Wild Oats are not “reasonably interchangeable” with conventional supermarkets and do not compete directly with them.

To begin with, the FTC’s expert prepared a study showing that when a Whole Foods opened near an existing Wild Oats it reduced sales at the Wild Oats store dramatically. By contrast, when a conventional supermarket opened near a Wild Oats store, Wild Oats’s sales were virtually unaffected. This strongly suggests that although Wild Oats customers consider Whole Foods an adequate substitute, they do not feel the same way about conventional supermarkets. Rejecting this study, the district court explained that it was “unwilling to accept the assumption that the effects on Wild Oats from Whole Foods’ entries provide a mirror from which predictions can reliably be made about the effects on Whole Foods from Wild Oats’ future exits if this transaction occurs.” But even if exit and entry events differ, this evidence suggests that consumers do not consider Whole Foods and Wild Oats “reasonably interchangeable” with conventional supermarkets. *Brown Shoe.*

The FTC also highlighted Whole Foods’s own study-called “Project Goldmine” showing what Wild Oats customers would likely do after the proposed merger in cities where Whole Foods planned to close Wild Oats stores. According to the study, the average Whole Foods store would capture most of the revenue from the closed Wild Oats store, even though virtually every city contained multiple conventional retailers closer to the shuttered Wild Oats store. This high diversion ratio further suggests that many consumers consider conventional supermarkets inadequate substitutes for Wild Oats and Whole Foods. The district court cited the Project Goldmine study for the opposite conclusion, pointing only to cities in which Whole Foods expected to receive a low percentage of Wild Oats business. These examples, however, do not undermine the study’s broader conclusion that Whole Foods would capture most of the revenue from the closed Wild Oats, and the district court never mentioned the FTC expert’s testimony that the diversion ratio estimated here “is at least {Sealed} times the diversion ratio needed to make a price increase of 5% profitable for a joint owner of the two stores.” The dissent also ignores this testimony, saying incorrectly that the Project Goldmine study “says nothing about whether Whole Foods could impose a five percent or more price increase” . . .

In addition to direct evidence that Whole Foods and Wild Oats occupy a separate market from conventional supermarkets, the FTC presented an enormous amount of evidence of “industry or public recognition” of the natural and organic market “as a separate economic entity”—one of the “practical indicia” the Supreme Court has said can
be used to determine the boundaries of a distinct market. *Brown Shoe*. For example, dozens of record studies about the grocery store industry—including many prepared for Whole Foods or Wild Oats—distinguish between “traditional” or “conventional” grocery stores on the one hand and “natural food” or “organic” stores on the other. *See, e.g., FOOD MKTG. INST., U.S. GROCERY SHOPPER TRENDS 2007*, at 20–22 (2007). Moreover, record evidence indicates that the Whole Foods and Wild Oats CEOs both believed that their companies occupied a market separate from the conventional grocery store industry. In an email to his company’s board, Whole Foods CEO John Mackey explained that “[Wild Oats] is the only existing company that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means eliminating this threat forever, or almost forever.” Echoing this point, former Wild Oats CEO Perry Odak said that “there’s really only two players of any substance in the organic and all natural [market], and that’s Whole Foods and Wild Oats. . . . [T]here’s really nobody else in that particular space.” Executives from several conventional retailers agreed.

... As Judge Bork explained, this evidence of “industry or public recognition of the submarket as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities.” *Rothery Storage & Van Co. v. Atlas Van Lines,* Inc.

The FTC also presented strong evidence that Whole Foods and Wild Oats have “peculiar characteristics” distinguishing them from traditional supermarkets, another of the “practical indicia” the Supreme Court has said can be used to determine the boundaries of a distinct market. *Brown Shoe*, 370 U.S. at 325. Most important, unlike traditional grocery stores, both Whole Foods and Wild Oats carry only natural or organic products. Glossing over this distinction, the dissent says “the dividing line between ‘organic’ and conventional supermarkets has been blurred” because “[m]ost products that Whole Foods sells are not organic” while “conventional supermarkets” have begun selling more organic products. But the FTC never proposed market as “organic supermarkets,” it defined it as “premium natural and organic supermarkets.” And everything Whole Foods sells is natural and/or organic, while many of the things sold by traditional grocery stores are not...

Insisting that all this evidence of a separate market is irrelevant, Whole Foods and the dissent argue that the FTC’s case must fail because the record contains no evidence that Whole Foods or Wild Oats charged higher prices in cities where the other was absent—i.e., where one had a local monopoly on the asserted natural and organic market—than they did in cities where the other was present. This argument is both legally and factually incorrect.

As a legal matter, although evidence that a company charges more when other companies in the alleged market are absent certainly indicates that the companies operate in a distinct market, *see, e.g., Staples* that is not the only way to prove a separate market. Indeed, *Brown Shoe* lists “distinct prices” as only one of a non-exhaustive list of seven “practical indicia” that may be examined to determine whether a separate market exists. Furthermore, even if the FTC could prove a section 7 violation only by showing evidence of higher prices in areas where a company had a local monopoly in an alleged market, the FTC need not prove a section 7 violation to obtain a preliminary injunction; rather, it need only raise “serious, substantial” questions as to the mergers legality. *Heinz*. Thus, the dissent misses the mark when it cites the FTC’s Horizontal Merger Guidelines to assert that the Commission may obtain a preliminary injunction only by presenting “solid evidence that the post-merger company could profitably impose a significant nontransitory price increase of 5% or more.” Such evidence in a case like this, which turns entirely on market definition, would be enough to prove a section 7 violation in the FTC’s administrative proceeding. *See Hosp. Corp., [p. 1010 supra]* (stating that “[a]ll that is necessary” to prove a section 7 case “is that the merger create an appreciable danger of [higher prices] in the future”). Yet our precedent dearly holds that to obtain a preliminary injunction “[t]he FTC is not required to establish that the proposed merger would in fact violate section 7 of the Clayton Act.” *Heinz*, [p. 1059 supra]. Moreover, the Merger Guidelines—which “are by no means to be
considered binding on the court,” *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 n.4 (D.C. Cir. 1986) specify how the FTC decides which cases to bring, “not . . . how the Agency will conduct the litigation of cases to bring, “not . . . how the Agency will conduct the litigation of cases that it decides to bring, “Horizontal Merger Guidelines § 0.1 . . .

In any event, the FTC did present evidence indicating that Whole Foods’ and Wild Oats charged more when they were the only natural and organic supermarket present. The FTC’s expert looked at prices Whole Foods charged in several of its North Carolina stores before and after entry of a regional natural food chain called Earth Fare. Before any Earth Fare stores opened, Whole Foods charged essentially the same prices at its five North Carolina stores, but when an Earth Fare opened near the Whole Foods in Chapel Hill, that store’s prices dropped 5% below those at the other North Carolina Whole Foods. Prices at that store remained lower than at the other Whole Foods in North Carolina . . .

The FTC’s expert presented similar evidence regarding Whole Foods store opening near a Wild Oats caused immediate and lasting reductions in prices at the Wild Oats store compared to prices at other Wild Oats stores. In addition to this quantitative evidence, the FTC pointed to Whole Foods CEO John Mackey’s statement explaining to the company’s board why the merger made sense: “By buying [Wild Oats] we will . . . avoid nasty price wars in [several cities where both companies have stores]” . . .

The district court next emphasized that when a new Whole Foods store opens, it takes business from conventional grocery stores, and even when an existing Wild Oats is nearby, most of the new Whole Foods store’s revenue comes from customers who previously shopped at conventional stores. According to the district court, this led “to the inevitable conclusion that Whole Foods’ and Wild Oats’ main competitors are other supermarkets, not just each other.” As the FTC points out, however, “an innovative [product] can create a new product market for antitrust purposes” by “satisf[y]ing a previously-un satisfied Consumer demand.” To use the Commission’s example, when the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers. See, e.g., *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 712–14 (7th Cir. 1979) (finding a distinct market of drive-up photo-processing companies even though such companies took photo-processing customers from drugstores, camera stores, and supermarkets); *Staples* (finding a distinct market of office supply superstores even though such stores took sales primarily from mail-order catalogues and stores carrying a broader range of merchandise).

The district court also cited evidence that Whole Foods compares its prices to those at conventional stores, not just natural foods stores. But nearly all of the items on which Whole Foods checks prices are dry grocery items, even though nearly 70% of Whole Foods’s revenue comes from perishables. As the majority opinion explains, this suggests that any competition between Whole Foods and conventional retailers may be limited to a narrow range of products that play a minor role in Whole Foods’s profitability.

Finally, the district court observed that more and more conventional stores are carrying natural and organic products, and that consumers who shop at Whole Foods and Wild Oats also shop at conventional stores. But as noted above, other record evidence suggests that although some conventional retailers are beginning to offer a limited range of popular organic products, they have difficulty competing with Whole Foods and Wild Oats . . .

Because we have decided that the FTC showed the requisite likelihood of success by raising serious and substantial questions about the merger’s legality, all that remains is
to “weigh the equities in order to decide whether enjoining the merger would be in the public interest.” Although in some cases we have conducted this weighing ourselves, three factors lead me to agree with Judge Brown that the better course here is to remand to the district court for it to undertake this task. First, in cases in which we have weighed the equities, the district court had already done so, giving us the benefit of its factfinding and reasoning. Here, by contrast, the district court never reached the equities and the parties have not briefed the issue, leaving us without the evidence needed to decide this question. Second, this case stands in a unique posture, for in cases where we reversed a district court’s denial of a section 13(b) injunction either the district court or this court had enjoined the merger pending appeal. See Heinz. Here, by contrast, the companies have already merged, and although this doesn’t moot the case, it may well affect the balance of the equities, likely requiring the district court to take additional evidence. Finally, given this case’s unique posture, the usual remedy in section 13(b) cases—blocking the merger—is no longer an option. Therefore, if the district court concludes that the equities tilt in the FTC’s favor, it will need to craft an alternative, fact-bound remedy sufficient to achieve section 13(b)’s purpose, namely allowing the FTC to review the transaction in an administrative proceeding and reestablish the premerger status quo if it finds a section 7 violation. To accomplish this, the district court could choose anything from issuing a hold separate order, see FTC v. Weyerhaeuser Co., 665 F.2d 1072, 1083–84 (D.C. Cir. 1981), to enjoining further integration of the companies, to ordering the transaction partially or entirely rescinded, see FTC v. Elders Grain, 868 F.2d 901, 907–08 (7th Cir. 1989) (Posner, J.). Without more facts, however, we are in no position to suggest which remedy is most appropriate.

KAVANAUGH, J. dissenting [largely on the grounds that Whole Food’s prices did not differ based on the presence or absence of Wild Oats in the market and that conventional supermarkets place a limit on Whole Food’s prices].

... Moreover, the record evidence in this case does not show that Whole Foods changed its prices in any significant way in response to exit from an area by Wild Oats. In the four cases where Wild Oats exited and a Whole Foods store remained, there is no evidence in the record that Whole Foods then raised prices. Nor was there any evidence of price increases after Whole Foods took over two Wild Oats stores.

The facts here contrast starkly with Staples, where Staples charged significantly different prices based on the presence or absence of office-superstore competitors in a particular area. The evidence there showed that Staples charged prices 13 percent higher in markets without office-superstore competitors than in markets with such competitors. There is nothing remotely like that in this case.

... [T]he FTC points to evidence that Whole Food's entry into a particular area, unlike the entry of conventional supermarkets, caused Wild Oats to lower its prices. Dr. Murphy’s reliance on Wild Oats's reaction to Whole Foods's entry is questionable. Dr. Murphy based his entire analysis on a meager two events, hardly a large sample size. In addition, Dr. Murphy’s analysis did not control for the reaction of conventional supermarkets to Whole Foods’s entry. In other words, he assumed that the relevant product market was so-called organic supermarkets (the point he was trying to prove) and therefore assumed that all changes in Wild Oats's prices were directly caused by Whole Foods's entry. But if conventional supermarkets also lowered prices to compete with Whole Foods when Whole Foods entered, Wild Oats's price decreases may well have been due to the overall reduction in prices by all supermarkets in the area. If that were true, the relevant product market would obviously be all supermarkets, not just so-called organic supermarkets. Dr. Murphy’s analysis never confronted that possibility or the complexity of how competition works in this market; his analysis appears to have assumed the conclusion and reasoned.

In any event, I respectfully disagree with Judge Brown’s emphasis on core customers. For a business to exert market power as a result of a merger, it must be able to increase prices (usually by five percent or more) while retaining enough customers to make that price increase profitable. See 2B Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 501, at 109 (3d ed. 2007) (“A defendant firm has market power if it can raise price without a total loss of sales.”). If too many "marginal" customers are turned
off by a price hike, then the hike will be unprofitable even if a large group of die-hard “core” customers remain active clients. Therefore, a focus on core customers alone cannot resolve a merger case. The question here is whether Whole Foods could increase prices by five percent or more without losing so many marginal customers as to make the price increase unprofitable. See id. ¶ 536, at 284. As discussed above, the FTC has not come close to making that showing. Moreover, there is no support in the law for that singular focus on the core customer. Indeed, if that approach took root, it would have serious repercussions because virtually every merger involves some core customers who would stick with the company regardless of a significant price increase. So under this "core customer" approach, many heretofore permissible mergers presumably could be blocked as anticompetitive. That cannot be the law, and it is not the law.

NOTES AND QUESTIONS

1. Theory of harm. The government’s theory in Whole Foods cases was that too few customers would switch in response to a post-merger price increase to make the price increase unprofitable. The government relied in the Vail case on a more complex theory that a price increase at one of the merged parties’ mountains would be profitable because they would recapture at their other mountains a portion of the customers who would switch from the first mountain in response to the price increase. Both cases fall under the heading of “unilateral effects,” as they do not predict price increases on account of coordination with rivals.

2. Core customers and marginal customers. The parties and the judges in Whole Foods disagreed about whether to focus on “marginal” customers or “core” customers. Which is correct? Does the answer to the question depend upon which theory of harm is at issue? Is the difference between core and marginal customers analogous to the difference between destination skiers and Front Range skiers in Vail, and between large business-to-business customers and others in Staples II? If not, what is the significance of the difference between core and marginal customers? Is this about targeting specific customers as was the case in Vail and Staples II?

3. Entry and exit. The dissent in Whole Foods acknowledged that Whole Foods’ entry into a local market, unlike the entry of conventional supermarkets, caused Wild Oats to lower its price; but it gave more weight to the absence of statistically significant evidence that prices increased when Wild Oats exited a local market. Under what circumstances might the price effect work in one way but not the other? Which is more important in assessing the competitive effects of the merger?

4. Is monopoly or dominance required? Monopoly power was not alleged in the Vail case, and a number of cases decided after Oracle (discussed at the beginning of the chapter) have rejected the view that a monopoly position is required in a unilateral effects case. E.g., United States v H&R Block, Inc., 833 F. Supp. 2d 36, 83 (D.D.C. 2011). The majority opinion in Whole Foods noted in dicta that even defining a market might be unnecessary: “That is not to say market definition will always be crucial to the FTC’s likelihood of success on the merits. . . . Although the framework we have developed for a prima facie § 7 case rests on defining a market and showing undue concentration in that market, [citation omitted] this analytical structure does not exhaust the possible ways to prove a § 7 violation on the merits.” 548 F.3d at 1036.

4. MONOPSONY

The Merger Guidelines state that mergers of “competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market.” Market power on the buyer side is called “monopsony power.” Mergers among buyers can be analyzed by the same basic framework as that used to determine whether a merger among sellers is likely to create or enhance market power on the selling side of the market.
directors serve on multiple boards, and then use the high costs of antitrust suits to extort settlements (including undeserved attorneys' fees) from the targets.

Robert F. Booth Trust v. Crowley, 687 F.3d 314, 319 (7th Cir. 2012). In the last major contested Section 8 case, in Borg–Warner Corp. v. FTC, the FTC lost its challenge, with the court concluding that “petitioner corporations cannot be viewed as knowing or conscious violators, or firms that acted in violation or disregard of their known legal obligations.” 746 F.2d 108, 111 (2d Cir.1984).

4. NON-HORIZONTAL MERGERS

EARLY CASES

1. Brown Shoe Co. Inc., v. United States, 370 U.S. 294 (1962), involved a merger between the third largest shoe manufacturer and a retailer that owned or controlled more than 1200 retail stores throughout the country. The Court held that the merger was unlawful because it would enable Brown to foreclose competing manufacturers from access to the acquired firm's retail outlets, even though shoes were sold at the time through 70,000 different retail outlets. The Court noted that there was a “trend” of shoe manufacturers acquiring retail outlet. Although the case was influential and has never been overruled, it is of questionable validity today. As Professors Areeda and Turner explain:

Both the reasoning and the result in Brown Shoe seem indefensible. As a Supreme Court precedent never subsequently repudiated, the decision was undoubtedly responsible in large part for those subsequent court and Federal Trade Commission decisions invalidating vertical mergers involving relatively small “foreclosures” and no substantial threats to competition. Accordingly, those subsequent decisions do not “add” to the weight of precedent or impose any significant obstacle to those courts willing to think hard about the competitive implications of vertical mergers while confining Brown Shoe to its particular facts as perceived by the 1962 Court.


2. Ford Motor Co. v. United States, 405 U.S. 562 (1972), concerned the acquisition by Ford Motor Company, the nation's second largest producer of automobiles, of among other things the spark plug business of Electric Autolite Co. Electric Autolite continued in business, and a year later began manufacturing spark plugs under the brand name Prestolite. The district court ruled that the acquisition violated Section 7 of the Clayton Act, and the Supreme Court affirmed.

The three leading automobile manufacturers, General Motors, Ford and Chrysler (which together accounted for 90% of the nation's automobile production), were matched by three leading spark plug manufacturers. General Motors manufactured spark plugs under its AC brand for its own automobiles; Ford purchased spark plugs from Champion for its automobiles; and Chrysler purchased spark plugs from Autolite for its automobiles. In addition, the spark plug manufacturers sold spark plugs as replacement parts in the aftermarket. At the time of the acquisition, Autolite's share of the overall spark plug market was 15%; Champion's share was 50%; and AC's share was 30%. Subsequently, Champion's share declined to 33%.

The merger was held to be unlawful on two grounds. First, Ford was a potential entrant into the spark plug business and exerted a moderating influence on Champion and the other spark plug companies because it was both a prime candidate for entry that would have deconcentrated the market and because it was a major customer of Champion. Second, the acquisition of the Autolite business foreclosed Champion and other manufacturers from access to Ford, which accounted for approximately 10 percent of all spark plug purchases. Together with General Motors ownership of AC, the acquisition tended to transmit to the spark plug industry the rigidity of the automobile industry, reducing the chances for future deconcentration of the spark plug industry and raising barriers to entry. The Court rejected
as not material the argument that the acquisition would make Autolite a more vigorous and effective competitor against Champion and AC than Autolite had been as an independent.

The merger was consummated before the antitrust challenge. In addition to ordering divestiture, the district court's decree included other remedies, some of which were intended to restore competition that the court believed had been harmed by the merger. The decree:

1. enjoined Ford for 10 years from manufacturing spark plugs,
2. ordered Ford for five years to purchase one-half of its total annual requirements of spark plugs from the divested plant under the “Autolite” name,
3. prohibited Ford for the same period from using its own trade names on spark plugs, and
4. required Ford for 10 years to continue its policy of selling spark plugs to its dealers at prices no less than its prevailing minimum suggested jobbers’ selling price.

The last provision, designed to assemble an adequate distribution system for the aftermarket by permitting service stations and independent jobbers to compete with franchised car dealers, was not challenged before the Supreme Court. The first three provisions were challenged but were sustained by a divided Court. The majority opinion reasoned: “The ancillary measures ordered by the District Court are designed to allow Autolite to re-establish itself in the OE and replacement markets and to maintain it as a viable competitor until such time as forces within the market place weaken the OE tie.” Ford argued that the 10–year prohibition on its manufacture of spark plugs would lessen competition because it would remove a potential competitor from the marketplace. Recalling the 5–to–8 years estimated as required for Ford to establish a spark plug division internally, the Court observed:

The five-year prohibition on the use of its own name and the 10–year limitation on its own manufacturing mesh neatly to allow Ford to establish itself in the aftermarket prior to becoming a manufacturer. . . . Thus, the District Court’s decree delays for only two to five years the date on which Ford may become a manufacturer with an established share of the aftermarket. Given the normal five-to-eight year lead time on entry through internal expansion, the District Court’s decree does not significantly lessen Ford’s moderating influence as a potential entrant on the edge of the market.


Vertical Mergers

Antitrust has been concerned about the effects of vertical mergers upon competition for over sixty years, but it has never evolved a satisfactory theory of the ways in which such integration could be harmful. The predominant fear has been that the acquisition of a customer or supplier would “foreclose” a market or source of supply to rivals and thereby fence out competition. That theory appeared in the 1911 American Tobacco decision, which supposed that the acquisition of suppliers was a means of gaining or maintaining monopoly in tobacco manufacture.

Antitrust’s concern with vertical mergers is mistaken. Vertical mergers are means of creating efficiency, not of injuring competition. There is a faint theoretical case, hardly worth mentioning, that vertical mergers can be used by very large firms for purposes of predation under exceptional circumstances, but it is highly doubtful that that narrow possibility has any application to reality. In any event, the vertical mergers attacked by the law do not contain even that possibility. The vertical mergers the law currently outlaws have no effect other than the creation of efficiency.

It is conventional and useful to say, as Morris Adelman does, that vertical integration exists when a firm “transmits from one of its departments to another a good or service which could, without major adaptation, be sold in a market.” This definition calls attention to the choice of the firm to bypass a market transaction in favor of
internal control. But the definition may lead us to overlook the ubiquity of such integration in our economy. Often there is no outside market for a good or service transmitted within a firm precisely because the efficiencies of vertical integration are so great that no firm would think of selling or buying at that stage. Every firm in the economy is vertically integrated in the sense that goods and services are transmitted within it and not offered on any market. This fact is important because it shows the vertical integration is indispensable to the realization of productive efficiencies. One can imagine the chaos and costs that would arise if the law were logically to extend its aversion to vertical integration by requiring, for example, an open market transaction every time goods moved from one worker or department to another or, indeed, by forbidding individuals to perform more than one task in the productive chain before selling. This is entirely fanciful, of course, but it is worth stressing that all economic activity displays vertical integration, because that tends to remove some of the sinister coloration this essential form of integration has undeservedly acquired.

The word “integration” means only that administrative direction rather than a market transaction organizes the cooperation of two or more persons engaged in a productive or distributive activity. The firm chooses between modes of organization according to their relative costs. On this basis, it chooses to perform particular tasks itself, to subtract them to others, or to sell a finished or semifinished product to other firms which perform further functions in bringing a finished product to the final market. The firm itself is best defined for purposes of economic analysis as the area of operations within which administration, rather than market processes, coordinates work.

What antitrust law perceives as vertical merger, and therefore as a suspect and probably traumatic event, is merely an instance of replacing a market transaction with administrative direction because the latter is believed to be a more efficient method of coordination. Vertical mergers may cut sales and distribution costs, facilitate the flow of information between levels of the industry (for example, marketing possibilities may be transmitted more effectively from the retail to the manufacturing level, new product possibilities may be transmitted in the other direction, better inventory control may be attained, and better planning of production runs may be achieved), create economies of scale in management, and so on. When such possibilities become apparent throughout an industry, a trend toward vertical integration will develop, as it did in shoe manufacturing and retailing, and as it has done in many other industries. Such trends are merely the responses of businessmen to changing circumstances. They are essentially no different from, and certainly no more cause for alarm than, countless other trends in product styles, types of outlets, automation, prices, and the like. What is incipient in any such trend is not the lessening of competition but the attainment of new efficiency, and it is the latter result at which amended Section 7 of the Clayton Act is actually striking in vertical merger cases.

It is thoroughly naive of the law to suppose that vertical merger affects resource allocation adversely while vertical growth affects it not at all. The only difference between vertical merger and vertical growth is that in a specific situation at a particular moment one or the other will be the lower-cost way of achieving the efficiencies of integration. In fact, the sole difference between vertical merger and existing vertical integration within all firms is historical. In the latter case the efficiencies of integration have been present, recognized, and realized in firm structures for some time, while in the case of merger the efficiencies are either just becoming possible or are just being recognized, and firms are seeking to realize them through structural change.

Vertical integration is often believed somehow to cause or permit a firm to behave differently than it would in the absence of integration. Aside from the efficiency effect, however, it is clear that vertical integration does not affect the firm’s pricing and output policies. If, for example, a firm operates at both the manufacturing and retailing levels of an industry, it maximizes overall profit by setting the output at each level as though the units were independent of one another. The firm will not, as is frequently suggested, sell to its own retail subsidiary for less than it sells to outsiders, unless the efficiencies of integration lower the cost of selling to its own retail unit.
The reasons for this are obvious. It is impossible for a firm actually to sell to itself for less than it sells to outside firms because the real cost of any transfer from the manufacturing unit to the retailing unit includes the return that could have been made on a sale to an outsider. No matter what the bookkeeper writes down as the transfer price, the real cost is always the opportunity foregone. (If a garment manufacturer spends $50 to make a dress, could sell it for $100, but chooses to give it to his wife, the cost to him is $100, not $50, and the fact cannot be altered by any number he chooses to put in his books.) Nor would there be any point in the firm’s subsidizing its retail level by transfers at artificially low prices. Such a policy would merely entail the sacrifice of return at the manufacturing level, and the self-deception as to true costs would cause the retailing subsidiary to operate at an uneconomical rate. If the marginal costs of retailing are rising—as they certainly are, unless the retailer is a natural monopolist—the artificially low price would result in an increased output at higher costs. The integrated firm would be paying more for the performance of the retailing function than it would if it recognized real costs and operated at a smaller scale on the retail level.

These principles may usefully be applied to varying industry structures. Where the firm is competitive at both levels, it maximizes by equating marginal cost and price at each level, and each level makes a competitive rate of return. Should the firm enjoy a monopoly at the manufacturing level but face competition in retailing, it will of course exact a monopoly profit in manufacturing; but, for the reasons discussed, it will sell to the retail level at the same monopoly price it asks of independent retailers.

If the integrated firm has monopoly positions in both manufacturing and retailing, however, the levels will not maximize independently. This is true because vertically related monopolies can take only one monopoly profit. If each level tries to maximize by restricting output, the result will be a price higher than the monopoly price and an output smaller, the result being less than a full monopoly return. The reason for this is easily seen. Suppose the firm starts as a manufacturing monopoly selling to a competitive retail level. The manufacturer would set his output and price so that the appropriate monopoly price would be charged consumers after retailers had added their costs, including a competitive return. The monopolist must allow the retailers a competitive return, and he will not want to allow them more than that. If he allowed them less, the level of investment and operation in retailing would decline to the manufacturer’s detriment. If he allowed them more, the level of investment and operation would rise above the optimal, and the manufacturer would be paying for retailing services he did not want.

We may suppose that the manufacturer purchases all of the retailers, converting that level of the industry to a second monopoly held by him. This will not change his price and output decisions at all. Though he now holds both manufacturing and retailing, the monopolist is still facing the same consumer demand and the same costs at both levels. The maximizing price to consumers, therefore, remains the same. The new retail subsidiary will not be permitted to act independently and restrict output further than the manufacturing level had already restricted it, since that would result in an output lower and a price higher than the maximizing level.

The case under discussion is, in any event, a very rare one: the acquisition by a monopolist of a second vertically-related monopoly. Much of the theoretical case against vertical integration begins by trying to establish some possibility of competitive hard from the joining of two vertically related monopolies, and then proceeds on the unstated assumption that a case has been made which is applicable to all vertical mergers. The point here is that no case has been made against the vertical acquisition by a monopolist of a second monopoly; moreover, even if such a case could be made, it would be largely an academic exercise and would have no force in the broader context of the vertical mergers the law is actually preventing.

The argument so far holds, of course, whether vertical integration is created by growth or merger. Vertical merger does not create or increase the firm’s power to restrict output. The ability to restrict output depends upon the share of the market occupied by the firm. Horizontal mergers increase market share, but vertical mergers do not.
These observations indicate that vertical mergers are merely one means of creating a valuable form of integration and that there is no reason for the law to oppose such mergers. Adherence to an economic fallacy almost as old as antitrust policy, however, has caused the law to take an entirely different course.

“Foreclosure”: The Law’s Objection to Vertical Merger

The law developed under amended Section 7 of the Clayton Act assumes that vertical mergers may sometimes be beneficial or neutral but that their dominant effect is so heavily deleterious as to merit the prohibition of almost all such integrations. The law’s current theory of the way in which vertical mergers injure competition is contained in the concept of “foreclosure.” It is supposed that, for instance, a manufacturer may acquire a retailer, force the retail subsidiary to sell the manufacturer parent’s products, and thus “foreclose” rival manufacturers from the market represented by the captive retailer. This thought to be a means by which the competitive process may be injured.

In analyzing the Brown Shoe case we have seen the extremes to which this theory can be carried, but once an erroneous idea is let loose in antitrust it tends to run riot. Even before Brown Shoe the Federal Trade Commission had ingeniously devised what was, apparently, a doctrine of reciprocal foreclosure. This theory, whose sole merit is that it establishes a new high in preposterousness, is illustrated by the Commission’s refusal to permit the acquisition by A.G. Spalding & Bros. of another full-line sporting goods company, Rawling Manufacturing Co. The case was decided primarily as a horizontal merger, but the Commission objected to possible vertical foreclosure as well.

A fair sample of the Spalding opinion’s foreclosure reasoning runs this way: before the merger Spalding did not manufacture baseball gloves but bought its requirements from others. Rawlings, on the other hand, made gloves and sold them to others. The merger might therefore wreak havoc on competition at both manufacturing and selling levels, for as the Commission saw it “by acquiring Rawlings, Spalding can not only prevent competitors from purchasing [baseball gloves] from Rawlings but can also foreclose manufacturers of [gloves] from access to Spalding as a purchaser thereof.”

A two-edge sword indeed! The Commission’s opinion does not inform us why the people who formerly made gloves for Spalding could not sell them to the people who formerly bought gloves from Rawlings. Instead, we are left to imagine eager suppliers and hungry customers, unable to find each other, forever foreclosed and left to languish. It would appear the Commission could have cured this aspect of the situation by throwing an industry social mixer.

M.H. Riordan & S.C. Salop, Evaluating Vertical Mergers: A Post-Chicago Approach


The Post-Chicago Analysis of Vertical Mergers

The permissive policy toward vertical mergers, derived from the Chicago School, is premised on a simple economic model. In contrast, the post-Chicago approach relies on more realistic and complex economic analysis that facilitates the identification of anticompetitive concerns that have less importance in the Chicago School approach.

A. The Chicago School Critique of 1960s Vertical Merger Law

The Chicago School critique . . . is based on two main tenets. First, the mere fact that a vertical merger forecloses rival firms’ access to the supply of inputs produced by one input supplier does not mean that the net supply of inputs available to those rival firms has been reduced. When the rivals lose access to the input supplies produced by one firm, they are likely to gain access to the input suppliers that previously supplied the merging supplier’s downstream merger partner. In that case, according to Chicago
School theory, the vertical merger does not reduce the net supply available to rivals. Instead, it merely realigns purchase patterns among competing firms.16

Second, the Chicago School utilizes an oversimplified microeconomic model to conclude that vertical mergers carried out by a monopolist cannot enhance monopoly power. The idea is that there is only a “single monopoly profit” that can be earned by the monopolist, whether or not the monopolist is vertically integrated.α Instead of enhancing monopoly power, the only economic motive for vertical merger is to reduce costs by achieving synergies.

Post–Chicago industrial organization economics accepts, as a starting point, these criticisms of pre-Chicago foreclosure theory. However, it has extended the economic models to more realistic assumptions that reach a more refined understanding of foreclosure. The modern industrial organization literature has formulated models of vertical integration in which vertical mergers lead to real foreclosure in which the net supply of inputs available to rivals is decreased. Models have been formulated in which monopoly power may be created or enhanced—and monopoly profits thereby increased—by vertical mergers that have little or no efficiency benefits. In these post-Chicago models, some vertical mergers can be anticompetitive, although others are procompetitive.

Post–Chicago analysis also relaxes the restrictive assumptions upon which the single monopoly profit theory is based. In particular, the single monopoly profit theory relies on the following four assumptions:18

(1) there is a monopoly input supplier, whose monopoly is protected by prohibitive barriers to entry;
(2) the monopoly is unregulated;
(3) there is perfect competition in the downstream output market; and
(4) the technology for producing output involves usage of all inputs in fixed proportions.

In the absence of these four assumptions, the single monopoly profit result no longer holds. Instead, vertical mergers may be motivated by either monopoly power, economic efficiency concerns, or both.

When the input market is not a monopoly, the analysis of vertical mergers is altered. Vertical mergers in these circumstances can have anticompetitive or procompetitive effects through a number of mechanisms. A vertical merger can create barriers to entry or expansion by foreclosing or disadvantaging unintegrated rivals. A vertical merger also can facilitate tacit or express pricing coordination among the competing input suppliers. In either case, a vertical merger may lead to a reduction in net input supply to rivals, not just a supply realignment.

Further, even if there is an input monopolist but that monopolist’s price is regulated, a vertical merger can be used to evade price control regulations. A vertical merger also can be used to facilitate price discrimination, where price discrimination by an unintegrated monopolist would be constrained by regulation or a competitive output market.

By contrast, when there is not perfect competition in the output market, a vertical merger has the potential to reduce costs and increase efficiency by eliminating a double monopoly markup on input costs. When the output technology is not in fixed proportions,

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16 As Bork points out, the cure for such naive allegations of foreclosure could be “an industry social mixer” to facilitate the realignment, see p. ___ supra.

α Ed. The “single monopoly profit” theory traces most notably to the scholarship of Robert Bork: “... vertically related monopolies can take only one monopoly profit. . . .”

18 An analogous version would center the monopoly in the output market and perfect competition in the input market. Relaxing those assumptions alters the results analogously to the results discussed in the text below.
a vertical merger also has the potential to reduce costs by eliminating distortions in efficient input usage that arise from noncompetitive input prices.

Although the original Chicago School commentators focused primarily on the efficiency benefits of vertical mergers, they did identify some competitive concerns. For example, they paid close attention to the potential for collusion and recognized evasion of regulation as a potential concern. Nevertheless, the original Chicago School approach placed little credence in the harm from foreclosure. This rejection of foreclosure as a competitive concern has two sources in addition to those identified earlier. First, the Chicago School approach is based on an assumption that barriers to entry generally are low. Second, the Chicago approach pre-dated the recent interest among economists in game theory and strategic behavior. Along with other advances in economic theory, the game theoretic analysis of strategic behavior forms the core of what has been termed the post-Chicago approach. The strategic behavior models study the decisions of firms that take rivals’ likely reactions to their conduct into account when making their decisions. These involve models of strategic oligopoly conduct rather than the models of simple monopoly and perfect competition that form the foundations of the traditional Chicago School approach.

These more realistic models of competitive behavior form the basis for a richer analysis of vertical mergers and their potential anticompetitive or procompetitive effects. In such a light, vertical mergers should be neither universally condemned nor universally applauded.

**FEDERAL ENFORCEMENT AGAINST VERTICAL Mergers in the 1990s**

During the 1980s and early 1990s, influenced by conservative scholarship like the excerpt from Robert Bork, there was no enforcement against vertical mergers at the federal level. In addition, there was widespread rejection of the views expressed by the Supreme Court in *Brown Shoe* that made vertical mergers between relatively small firms, with low barriers to entry, a violation of revised Section 7. The enforcement situation changed in the 1990s when a series of vertical mergers were either blocked or substantially restructured as a condition of government approval. Enforcement activity that was exclusively or primarily addressed to vertical aspects of a merger occurred for the most part at the Federal Trade Commission. Two examples are described below:


Silicon Graphics ("SGI"), the dominant provider of entertainment graphics workstations with a 90% market share, proposed to acquire Alias and Wavefront, two of the three dominant developers of entertainment graphics and animation software. The workstation and software created 3-D computer graphics special effects used in film and video, television and interactive computer games. The Commission indicated concern about vertical foreclosure in both directions. Workstation manufacturers that were rivals to SGI would not be able to compete effectively if Alias and Wavefront were to design their software to be compatible only with SGI, and rival graphic software manufacturers would be foreclosed from 90% of the market if SGI were to close its previously open software interface so that only Alias and Wavefront would be able to design compatible software. On the other hand, there were very strong indications that the combination of SGI, Alias and Wavefront’s complementary capacities would lead to important innovation. To allow the merger to proceed, SGI signed a consent order providing that SGI would use best efforts to ensure optimal interoperation of Alias’ leading software programs with competitor workstations and that SGI would maintain

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an open architecture and publish its application programming interface for its workstations so that it did not discriminate against software rivals of Alias and Wavefront.

2. In *Time Warner–Turner*, 5 Trade Reg. Rep. ¶ 24,104 (1996), the Commission examined the potential competitive effects of a merger of Time Warner, a dominant programmer in movies, magazines, music, and network broadcasting (and also the second largest cable company in the U.S.) with Turner, another major television programmer. Concern was expressed with respect to both upstream and downstream foreclosure effects. Programming competitors of Turner feared that they would be denied equal access to Time Warner cable as a result of the merger, and competitors of Time Warner cable (including particularly companies delivering programming through satellite systems) feared that they would be denied equal access to Turner's valuable news, sports and movie programming. The merger was allowed to proceed pursuant to a consent order that imposed an elaborate set of restrictions on the companies intended to preserve access to competitors and to ban unjustified discrimination.

The blockbuster sequel to *Time Warner–Turner* was *AOL–Time Warner*, a merger that involved both horizontal and vertical effects. Again, the merger was allowed to proceed, but only after acceptance of some unusually regulatory provisions designed to keep access open to new broadband technology and thereby allow programming competitors of Time Warner and internet service provider competitors of AOL to compete effectively after the merger. See *In re Am. Online, Inc. and Time Warner Inc.*, Docket No. C-3989, Decision and Order (F.T.C. Apr. 17, 2001), available at https://www.ftc.gov/sites/default/files/documents/cases/2001/04/aoltwdo.pdf.

3. *Barnes & Noble–Ingram*. In 1999, Barnes & Noble, the largest retail bookseller in the United States with 34% of national sales, proposed to acquire Ingram, the largest book wholesaler in the United States with 23% of national sales. The Commission investigated primarily on the theory that smaller bookstores competing with Barnes & Noble would not after the merger receive from the Ingram subsidiary comparable discounts, terms of sale, delivery dates, or marketing specials. Another theory, explored but not emphasized, is that new entrants into the market for sale of books on the internet would be denied a source of supply and might need to become their own wholesalers in order to enter internet retailing. After the Commission staff indicated its intention to recommend that the Commission challenge the deal, the merger was abandoned. See Labaton, “Book Chain Gives In; Barnes and Noble Won’t Seek $600 Million Deal,” N.Y. Times, June 3, 1999.

4. In 2011, the Department of Justice and the Federal Communications Commission challenged Comcast’s acquisition of NBC Universal from General Electric. The matter was settled by a consent decree and described in the Competitive Impact Statement reprinted below.

**United States and States of California, Florida, Missouri, Texas, and Washington v. Comcast Corp., General Electric Co., and NBC Universal, Inc.**


Competitive Impact Statement, 1:11-cv-00106.

The United States of America ("United States"), acting under the direction of the Attorney General of the United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA" or "Tunney Act"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment (attached hereto as Exhibit A) submitted for entry in this civil antitrust proceeding.

I. Nature and Purpose of the Proceeding

On December 3, 2009, Comcast Corporation ("Comcast"), General Electric Company ("GE"), NBC Universal, Inc. ("NBCU"), and Navy, LLC ("Newco"), announced plans to form a new Joint Venture ("JV") to which Comcast and GE will contribute broadcast and cable network assets. As a result of the transaction, Comcast – the nation's largest cable
company — will have majority control of a JV holding highly valued video programming needed by Comcast’s video distribution rivals to compete effectively.

The United States filed a civil antitrust Complaint on January 18, 2011, seeking to enjoin the proposed transaction because its likely effect would be to lessen competition substantially in the market for timely distribution of professional, full-length video programming to residential customers ("video programming distribution") in major portions of the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The transaction would allow Comcast to disadvantage its traditional competitors (direct broadcast satellite ("DBS") and telephone companies ("telcos") that provide video services), as well as competing emerging online video distributors ("OVDs"). This loss of current and future competition likely would result in lower-quality services, fewer choices, and higher prices for consumers, as well as reduced investment and less innovation in this dynamic industry.

On January 18, 2011, the Federal Communications Commission ("FCC") adopted a Memorandum Opinion and Order relating to the foregoing transaction.¹ The FCC’s Order approved the transaction subject to certain conditions. Under the proposed Final Judgment filed by the United States Department of Justice simultaneously with this Competitive Impact Statement and explained more fully below, Defendants will be required, among other things, to license the JV’s programming to Comcast’s emerging OVD competitors in certain circumstances. When Defendants and OVDs cannot reach agreement on the terms and conditions of the license, the aggrieved OVD may apply to the Department for permission to submit its dispute to commercial arbitration under the proposed Final Judgment. The FCC Order contains a similar provision. For so long as commercial arbitration is available for the resolution of such disputes in a timely manner under the FCC’s rules and orders, the Department will ordinarily defer to the FCC’s commercial arbitration process to resolve such disputes. However, the Department reserves the right, in its sole discretion, to permit arbitration under the proposed Final Judgment to advance the Final Judgment’s competitive objectives. In addition, the Department may seek relief from the Court to address violations of any provisions of the proposed Final Judgment. The proposed Final Judgment also contains provisions to prevent Defendants from interfering with an OVD’s ability to obtain content or deliver its services over the Internet.

The proposed Final Judgment will provide a prompt, certain, and effective remedy for consumers by diminishing Comcast’s ability to use the JV’s programming to harm competition. The United States and Defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment, and to punish and remedy violations thereof.

II. Description of Events Giving Rise to the Alleged Violation

A. Defendants, the Proposed Transaction, and the Department’s Investigation

1. Comcast

Comcast is a Pennsylvania corporation headquartered in Philadelphia, Pennsylvania. It is the largest cable company in the nation, with approximately 23 million video subscribers. Comcast is also the largest Internet service provider ("ISP"), with over 16 million subscribers. Comcast also wholly owns national cable programming networks, including E! Entertainment, G4, Golf, Style, and Versus, and has partial ownership interests in Current Media, MLB Network, NHL Network, PBS KIDS Sprout,

¹ Memorandum Opinion and Order, In re Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees, FCC MB Docket No. 10-56 (adopted Jan. 18, 2011). Under the Communications Act, the FCC has jurisdiction to determine whether mergers involving the transfer of a telecommunications license are in the “public interest, convenience, and necessity.” 47 U.S.C. § 310(d).
Retirement Living Television, and TV One. In addition, Comcast has controlling and partial interests in regional sports networks ("RSNs"). Comcast also owns digital properties such as DailyCandy.com, Fandango.com, and Fancast, its online video website. In 2009, Comcast reported total revenues of $36 billion. Over 94 percent of Comcast's revenues, or $34 billion, were derived from its cable business, including $19 billion from video services, $8 billion from high-speed Internet services, and $1.4 billion from local advertising on Comcast's cable systems. In contrast, Comcast's cable programming networks earned only about $1.5 billion in revenues from advertising and fees collected from video programming distributors.

2. GE and NBCU

GE is a New York corporation with its principal place of business in Fairfield, Connecticut. GE is a global infrastructure, finance, and media company. GE owns 88 percent of NBCU, a Delaware corporation, headquartered in New York, New York. NBCU is principally involved in the production, packaging, and marketing of news, sports, and entertainment programming.

NBCU wholly owns the NBC and Telemundo broadcast networks, as well as ten local NBC owned and operated television stations ("O&Os"), 16 Telemundo O&Os, and one independent Spanish language television station. In addition, NBCU wholly owns national cable programming networks – Bravo, Chiller, CNBC, CNBC World, MSNBC, mun2, Oxygen, Sleuth, SyFy, and USA Network – and partially owns A&E Television Networks (including the Biography, History, and Lifetime cable networks), The Weather Channel, and ShopNBC.

NBCU also owns Universal Pictures, Focus Films, and Universal Studios, which produce films for theatrical and digital video disk ("DVD") release, as well as content for NBCU's and other companies' broadcast and cable programming networks. NBCU produces approximately three-quarters of the original primetime programming shown on the NBC broadcast network and the USA cable network, NBCU's two highest-rated networks. In addition to its programming assets, NBCU owns several theme parks and digital assets, such as iVillage.com. In 2009, NBCU had total revenues of $15.4 billion.

NBCU also is a founding partner and 32 percent owner of Hulu, LLC, currently one of the most successful OVDs. Hulu is a joint venture between NBCU, News Corp., The Walt Disney Company, and a private equity investor. Each of the media partners has representation on the Hulu Board, possesses management rights, and licenses content for Hulu to deliver over the Internet.

3. The Proposed Transaction

On December 3, 2009, Comcast, GE, NBCU, and Newco, entered into a Master Agreement ("Agreement"), whereby Comcast agreed to pay $6.5 billion in cash to GE, and Comcast and GE each agreed to contribute certain assets to the JV. Specifically, GE agreed to contribute all of the assets of NBCU, including its interest in Hulu, and the 12 percent interest in NBCU that GE does not own but has agreed to purchase from Vivendi SA. Comcast agreed to contribute all its cable programming assets, including its national programming networks, its RSNs, and some digital properties, but not its cable systems or its Internet video service, Fancast. As a result of the content contributions and cash payment by Comcast, Comcast will own 51 percent of the JV, and GE will retain a 49 percent interest. The JV will be managed by a separate Board of Directors consisting initially of three Comcast-designated directors and two GE-designated directors. Board decisions will be made by majority vote.

The Agreement precludes Comcast from transferring its interest in the JV for a four-year period, and prohibits GE from transferring its interest for three and one-half years. Thereafter, either party may sell its respective interest in the JV, subject to Comcast's right to purchase at fair market value any interest that GE proposes to sell.
Additionally, three and one-half years after closing, GE will have the right to require the JV to redeem 50 percent of GE’s interest and, after seven years, GE will have the right to require the JV to redeem all of its remaining interest. If GE elects to exercise its first right of redemption, Comcast will have the contemporaneous right to purchase the remainder of GE’s ownership interest once a purchase price is determined. If GE does not exercise its first redemption right, Comcast will have the right to buy 50 percent of GE's initial ownership interest five years after closing and all of GE's remaining ownership interest eight years after closing. It is expected that Comcast ultimately will own 100 percent of the JV.

4. The Department’s Investigation

The Department opened an investigation soon after the JV was announced and conducted a thorough and comprehensive review of the video programming distribution industry and the potential implications of the transaction. The Department interviewed more than 125 companies and individuals involved in the industry, obtained testimony from Defendants’ officers, required Defendants to provide the Department with responses to numerous questions, reviewed over one million business documents from Defendants’ officers and employees, obtained and reviewed tens of thousands of third-party documents, obtained and extensively analyzed large volumes of industry financial and economic data, consulted with industry and economic experts, organized product demonstrations, and conducted independent industry research. The Department also consulted extensively with the FCC to ensure that the agencies conducted their reviews in a coordinated and complementary fashion and created remedies that were both comprehensive and consistent.

B. The Video Programming Industry

NBCU and Comcast are participants in the video programming industry, in which content is produced and distributed to viewers through their television sets or, increasingly, through Internet-connected devices. Historically, the video programming industry has had three different levels: content production, content aggregation or networks, and distribution.

1. Content Production

Television production studios produce television shows and coordinate how, when, and where their content is licensed in order to maximize revenues. They usually license to broadcast and cable networks the right to show a program first (i.e., the first-run rights). Content producers also license their content for subsequent “windows” such as syndication (e.g., licensing series to broadcast and cable networks after the first run of the programming), as well as for DVD distribution, video on demand (“VOD”), and pay per view (“PPV”) services. For example, the television show House is produced by NBCU, licensed for its first run on the FOX broadcast network and then rerun on the USA Network, a cable network owned by NBCU. These content licenses often include ancillary rights such as the right to offer some programming on demand.

Historically, first-run licenses were reserved for one of the four major broadcast networks (ABC, CBS, NBC, and FOX), followed by broadcast syndication and, ultimately, cable syndication. Over the past several years, however, content owners have begun to license their content for first run on cable networks and distribution over the Internet on either a catch-up (e.g., next day) or syndicated (e.g., next season) basis.

In addition to producing content for television and cable networks, NBCU produces and distributes first-run movies through Universal Pictures, Universal Studios, and Focus Films. Typically, producers distribute movies to theaters before releasing them on DVD, then license them to VOD/PPV providers, then to premium cable channels (e.g., Home Box Office (“HBO”)), then to regular cable channels, and finally to broadcast networks. As with television distribution, studios have experimented with different windows for film distribution over the past several years.

2. Programming Networks
Networks aggregate content to provide a 24-hour service that is attractive to consumers. The most popular networks, by far, are the four broadcast networks. However, cable networks have grown in popularity and number, and at the end of 2009 there were an estimated 600 national, plus another 100 regional, cable programming networks.

a. Broadcast Networks

Owners of broadcast network programming or broadcasters like NBCU license their broadcast networks either to third-party television stations affiliated with that network ("network affiliates"), or to their owned and operated television stations ("O&Os"). The network affiliates and O&Os distribute the broadcast network feeds over the air ("OTA") to the public and also retransmit them to video programming distributors, such as cable companies and DBS providers, which in turn distribute the feeds to their subscribers.

Under the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"), Pub. L. No. 102-385, 106 Stat. 1460 (1992), broadcast television stations, whether network affiliates or O&Os, may elect to obtain "retransmission consent" from a programming distributor, in which case a distributor negotiates with a station for the right to carry the station's programming for agreed-upon terms. Alternatively, stations may elect "must carry" status and demand carriage but without compensation. Stations affiliated with the four major broadcast networks and the networks' O&Os have elected retransmission consent. Historically, these stations negotiated for non-monetary compensation (e.g., carriage of new cable channels owned by the broadcaster) in exchange for retransmission consent. Today, most broadcast stations seek retransmission consent fees based on the number of subscribers to the cable, DBS, or telco service distributing their content. Less popular broadcast networks generally elect must carry status, although recently they also have begun to negotiate retransmission payments. Despite these retransmission payments, broadcast stations earn the majority of their revenues from local advertising sales. The broadcast networks earn most of their revenues from national advertising sales.

b. Cable Networks

Popular cable networks include ESPN, USA, MTV, CNN, and Bravo. Cable networks typically derive roughly one half of their revenues from licensing fees paid by video programming distributors and the other half from advertising fees. Generally, a distributor pays an owner of cable networks a monthly per-subscriber fee that may vary based upon the number of subscribers served by the distributor, the programming packages in which the program is included, the percentage of the distributor's subscribers receiving the programming, and other factors. Typically, the popularity or ratings of a network's programming affects the ability of a content owner to negotiate higher license fees. In addition to the right to carry the network, a distributor of the cable network often receives two to three minutes of advertising time per hour on the network for sale to local businesses (e.g., car dealers). A distributor also may receive marketing payments or discounts to encourage wider distribution of the programming. In the case of a completely new cable network, a programmer may pay a distributor to carry the network or offer other discounts.

3. Video Programming Distribution

Video programming distributors acquire the rights to transmit professional (as opposed to user-generated videos such as those typically seen on YouTube), full-length

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4 In the past, NBCU negotiated the retransmission rights only for its O&Os, but recently it has made efforts to obtain the rights from its network affiliates to negotiate retransmission consent agreements on their behalf. NBCU also may seek to renegotiate its agreements with its affiliates to obtain a share of any retransmission consent fees the affiliates are able to command.
(as opposed to clips) broadcast and cable programming networks or individual programs or movies, aggregate the content, and distribute it to their subscribers or users. This content includes live programming, sports, and general entertainment programming from a variety of broadcast and cable networks and from movie studios, and can be viewed either on demand or as scheduled in a broadcast or cable network’s linear stream. Video programming distributors offer various packages of content (e.g., basic, expanded basic, digital) with different quality levels (e.g., standard definition, HD, 3D), and employ different business models (e.g., ad-supported, subscription).

\textit{a. Multichannel Video Programming Distributors}

Traditional video programming distributors include incumbent cable companies, DBS providers, cable overbuilders, also known as broadband service providers ("BSPs," such as RCN), and telcos. These distributors are referred to as multichannel video programming distributors ("MVPDs"), and typically offer hundreds of channels of professional video programming to residential customers for a fee.

\textit{b. Online Video Programming Distributors}

OVDs are relatively recent entrants into the video programming distribution market. They deliver a variety of on-demand professional, full-length video programming over the Internet, whether streamed to Internet-connected televisions or other devices, or downloaded for later viewing. Hulu, Netflix, Amazon, and Apple are examples of OVDs, although the content delivered and business model used varies greatly among them.

Unlike MVPDs, OVDs do not own distribution facilities and are dependent upon ISPs for the delivery of their content to viewers. Therefore, the future growth of OVDs depends, in part, on how quickly ISPs expand and upgrade their broadband facilities and the preservation of their incentives to innovate and invest.\footnote{See discussion infra Section II.C.2.b.} The higher the bandwidth available from the ISP, the greater the speed and the better the quality of the picture delivered to an OVD’s users.

ISPs' management and pricing of broadband services may also affect OVDs. In particular, OVDs would be harmed competitively if ISPs that are also MVPDs (e.g., cable companies, telcos) were to impair or delay the delivery of video because OVDs pose a threat to those MVPDs' traditional video programming distribution businesses. Because Comcast is the country’s largest ISP, an inherent conflict exists between Comcast’s provision of broadband services to its customers, who may use this service to view video programming provided by OVDs, and its desire to continue to sell them MVPD services.

Growth of OVDs also will depend, in part, on their ability to acquire programming from content producers. Some cable companies, such as Comcast and Cablevision Corp., have purchased or launched their own cable networks. This vertical integration of content and distribution was one reason for the passage of Section 19 of the 1992 Cable Act, 47 U.S.C. § 548. Pursuant to the Act, Congress directed the FCC to promulgate rules that place restrictions on how cable programmers affiliated with a cable company deal with unaffiliated distributors. These "program access rules" were designed to prevent vertically integrated cable companies from refusing to provide popular programming to their competitors. The rules prohibit both the cable company and a cable network owned by it from engaging in unfair acts and practices, including: (1) entering into exclusive agreements to distribute the cable network; (2) selling the cable network to the cable company’s competitors on discriminatory terms and conditions; and (3) unduly influencing the cable network in deciding to whom, and on what terms and conditions, to sell its programming.\footnote{47 C.F.R. §§ 76.1001-76.1002. The prohibition on exclusivity sunsets in October 2012, unless extended by the FCC pursuant to a rulemaking. Id. § 76.1002 (c)(6).} The FCC program access rules do not apply to online distribution or to retransmission of broadcast station content.

\textit{C. The Market for Video Programming Distribution in the United States}
The relevant product market affected by this transaction is the market for timely distribution of professional, full-length video programming to residential customers ("video programming distribution"). Professionally produced content is video programming that is created or produced by media and entertainment companies using professional equipment, talent, and production crews, and for which those companies hold or maintain distribution and syndication rights. Video programming distribution is characterized by the aggregation of professionally produced content consisting of entire episodes of shows and movies, rather than short clips. The market for video programming distribution includes both MVPDs and OVDs.

1. Traditional Video Programming Distribution

Cable companies first began operating in the 1940s and initially were granted exclusive franchises to serve local communities. Although they now face competition, the incumbent cable companies continue to serve a dominant share of subscribers in most areas. In the mid-1990s, DirecTV and DISH Network began to offer competing services using small satellite dishes installed on consumers' homes. Around the same time, cable overbuilders began building their own wireline networks in order to compete with the incumbent cable operator and offer video, high-speed Internet, and telephony services – the "triple-play." More recently, Verizon and AT&T entered the market with their own video distribution services, also offering the triple-play. Competition from these video programming distributors encouraged incumbent cable operators across the country to upgrade their systems and offer many more video programming channels, as well as the triple-play. Further innovations have included digital video recorders ("DVRs") that allow consumers to record programming and view it later, and VOD services that enable viewers to watch broadcast or cable network programming or movies on demand at the consumer's convenience for a limited time.

A consumer purchasing video programming distribution services selects from those distributors offering such services directly to that consumer's home. The DBS operators – DirecTV and DISH – can reach almost any consumer who lives in the continental United States and has an unobstructed line of sight to the DBS operators' satellites. However, wireline cable distributors, such as Comcast and Verizon, generally must obtain a franchise from local or state authorities to construct and operate a wireline network in a specific area, and can build lines only to the homes in that area. A consumer cannot purchase video programming distribution services from a wireline distributor operating outside its area because that firm does not have the facilities to reach the consumer's home. Consequently, although the set of video programming distributors able to offer service to individual consumers' residences generally is the same within each local community, that set differs from one local community to another and can even vary within a local community. The markets for video programming distribution therefore are local.

The geographic markets relevant to this transaction are the numerous local markets throughout the United States where Comcast is the incumbent cable operator and where Comcast through the JV will be able to withhold NBCU programming from, or raise programming costs to, Comcast's rival distributors. Comcast service areas cover 50 million U.S. television households or about 45 percent of households nationwide, with nearly half of those households (23 million) subscribing to at least one Comcast service. Competitive effects also may be felt in other areas because Comcast's competitors serve territories outside its cable footprint. If Comcast can disadvantage these rivals, for example by raising their costs, competition will be reduced everywhere these competitors provide service reflecting these higher costs. Thus, the potential anticompetitive effects of the transaction could extend to almost all Americans.

The incumbent cable companies often dominate any particular market and typically hold well over 50 percent market shares within their franchise areas. For example, Comcast has market shares of 64 percent in Philadelphia, 62 percent in Chicago, 60 percent in Miami, and 58 percent in San Francisco (based on MVPD subscribers). Combined, the DBS providers account for approximately 31 percent of video programming subscribers nationwide, although their shares vary and may be lower in any particular local market. Although AT&T and Verizon have had great success and
achieved penetration (i.e., the percentage of households to which a provider's service is available that actually buys its service) as high as 40 percent in the selected communities they have entered, they currently have limited expansion plans. Overbuilders serve an even smaller portion of the United States.

2. Competition from OVDs

OVDs are relatively recent entrants into the video programming distribution market. Their services are available to any consumer with high-speed Internet service sufficient to receive video of an acceptable quality. OVDs have increased substantially the amount of full-length professional content they distribute online. Viewership of video content distributed over the Internet has grown enormously and is expected to continue to grow. The number of adult Internet users who watch full-length television shows online is expected to increase from 41.1 million in 2008 to 72.2 million in 2011. The total number of unique U.S. viewers of video who watch full-length television shows online grew 21 percent from 2008 to 2009. OVD revenues also have increased dramatically. Revenue associated with video content delivered over the Internet to televisions is expected to grow from $2 billion in 2009 to over $17 billion in 2014.

One reason for the dramatic growth of online distribution is the increased consumer interest in on-demand viewing, especially among younger viewers who have grown up with the Internet, and are accustomed to viewing video at a time and on a device of their choosing. In response to competition by OVDs, MVPDs increasingly are offering more on-demand choices.

a. OVD Business Models and Participants

Recognizing the enormous potential of OVDs, dozens of companies are innovating and experimenting with products and services that either distribute online video programming or facilitate such distribution. New developments, products, and models are announced on almost a daily basis by companies seeking to satisfy consumer demand. A number of companies are committing significant resources to this industry.

OVDs provide content using a variety of different business models. Some offer content on an ad-supported basis pursuant to which consumers pay nothing. One firm using this model is Hulu, which aggregates primarily current-season broadcast content from NBC, FOX, ABC, and others. Hulu has experienced substantial growth since its launch in 2008, reaching 39 million unique viewers by February 2010.

Netflix has pursued a different business model. It initially offered DVDs delivered by mail and then added unlimited streaming of a limited library of content over the Internet for a monthly subscription fee. Netflix has expanded its online library and introduced an Internet-only subscription service. Netflix content primarily consists of relatively recent movies, older movies, and past-season television shows. Netflix recently announced a deal with premium cable network EPIX for access to more movie content.

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8 Id.


10 See R. Thomas Umstead, Younger Viewers Watching More TV on the Web, Multichannel News (Apr. 12, 2010), http://www.multichannel.com/article/451375-Younger_Viewers_Watching_More_Television_On_The_Web.php (survey of more than 1,000 people shows 23 percent under the age of 25 watch most of their television online).

that it will distribute over the Internet.\(^\text{12}\) Netflix also has grown substantially in the last several years, from 7.5 million subscribers at the end of 2007 to 16.9 million in the third quarter of 2010.\(^\text{13}\)

Apple also is experimenting with different business models for video programming distribution. For several years it has offered content on an electronic sell-through (“EST”) basis through its Apple iTunes Store. Customers pay a per-transaction fee to buy television shows and movies and download them onto various electronic devices (e.g., iPod). Apple recently announced a service that allows consumers to rent television content on a per-transaction basis (e.g., $0.99 per show) and view it for a limited time. Other major companies are offering or planning to offer OVD services.\(^\text{14}\)

b. The Impact of OVDs

Some of these OVD products and services undoubtedly will be viewed by consumers as closer substitutes for MVPD services than others. The extent to which an OVD service has the potential to become a better substitute for MVPD service will depend on a number of factors, such as the OVD’s ability to obtain popular content, its ability to protect the licensed content from piracy, its financial strength, and its technical capabilities to deliver high-quality content. Moreover, as noted previously, OVDs’ future competitive significance depends, in part, on robust broadband capacity. Accordingly, the competitive significance of OVDs is fostered by protecting broadband providers’ economic incentives to upgrade and improve their broadband infrastructure, and obtain fair returns on that investment.

Today, some consumers regard OVDs as acceptable substitutes for at least a portion of their traditional video programming distribution services. These consumers buy smaller content packages from traditional distributors, decline to take certain premium channels, or purchase fewer VOD offerings, and instead watch that content online, a practice known as "cord-shaving." A small but growing number of MVPD customers are also "cutting the cable cord" completely in favor of OVDs. These customers may rely on an individual OVD or may view video content from a number of OVDs (e.g., Hulu ad-supported service, Netflix subscription service, Apple EST service) as a replacement for their MVPD service.

When measured by the number of customers who are cord-shaving or cord-cutting, OVDs currently have a de minimis share of the video programming distribution market. Their current market share, however, greatly understates their potential competitive significance in this market. Whether viewers buy individual or a combination of OVD services, OVDs are likely to continue to develop into better substitutes for MVPD video services. Evolving consumer demand, improving technology (e.g., higher Internet access speeds, better compression technologies to improve picture quality, improved digital


\(^{14}\) For example, Google recently launched GoogleTV, a device that enables viewers simultaneously to search the Internet and their MVPD service for content, and to switch back and forth on their televisions between content delivered over the Internet and content delivered by their MVPD. Press Release, Google, Industry Leaders Announce Open Platform to Bring Web to TV (May 20, 2010), http://www.google.com/intl/en/press/pressrel/20100520_googletv.html. Walmart recently acquired VUDU, an OVD service, and is making content available for EST and rental to VUDU-enabled devices. Press Release, Walmart Announces Acquisition of Digital Entertainment Provider, VUDU (Feb. 22, 2010), http://www.walmartstores.com/pressroom/news/9661.aspx. Amazon is reportedly developing an OVD service that allows Amazon service subscribers to stream television and movie content over the Internet. Nick Wingfield & Sam Schechner, No Longer Tiny, Netflix Gets Respect—and Creates Fear, Wall St. J. (Dec. 6, 2010), http://online.wsj.com/article/SB10001424052748704493004576001781352962132.html. Sears and Kmart recently announced the launch of an online video store, called Alphaline, which sells and rents movies and television shows. Paul Bond, Sears, Kmart launch Alphaline online video store, Reuters (Dec. 30, 2010), http://www.reuters.com/article/idUSTRE6BT03C20101230.
rights management to combat piracy), the increased choice of viewing devices, and advertisers' increasing willingness to place their ads on the Internet likely will make OVDs stronger competitors to MVPDs for an increasing number of viewers.\footnote{Historically, OTA distribution of broadcast network content has not served as a significant competitive constraint on MVPDs because of the limited number of channels offered. In addition, OTA distribution likely will not expand in the future because no new broadcast networks are likely to be licensed for distribution. Thus, OTA is unlikely to become a more significant video programming distributor. By contrast, OVDs are expanding rapidly and have the potential to provide increased and more innovative viewing options in the future.}

The development of the video programming distribution market – and in particular the success of OVDs – may influence any future analysis of consolidation in this market. Such analysis would follow standard merger evaluation principles and consider not only the role of OVDs, but also factors such as the extent to which the merging firms' offerings are close substitutes and compete directly. In this case, Defendants' own assessments - as reflected in numerous internal documents and their executives' testimony - of the importance of OVDs and their potential to alter dramatically the existing competitive landscape are particularly important to determining the relevant product market.

c. Comcast's and Other MVPDs' Reactions to the Growth of OVDs

Comcast and other MVPDs recognize the threat posed to their video distribution business from the growth of OVDs. Many internal documents reflect Comcast's assessment that OVDs are growing quickly and pose a competitive threat to traditional forms of video programming distribution. In response to this threat, Comcast has taken significant steps to improve the quality of Fancast, its own Internet video service. Among other things, Comcast has attempted to obtain additional – and at times exclusive – content from programmers, and has made Fancast's user interface easier to navigate. Comcast also has increased the quality and quantity of the VOD content it offers as an adjunct to its traditional cable service.

In addition, Comcast has created and implemented an "authentication" system that enables its existing cable subscribers to view some video content over the Internet if the subscriber already pays for and receives the same content from Comcast through its traditional cable service. Internal documents expressly acknowledge that "authentication" is Comcast's and other MVPDs' attempt to counter the perceived threat posed by OVDs.

Comcast's and other MVPDs' reactions to the emergence of OVDs demonstrate that they view OVDs as a future competitive threat and are adjusting their investment decisions today in response to that threat. Because OVDs today affect MVPDs' decisions, they are appropriately treated as participants in the market. Market definition considers future substitution patterns, and the investment decisions of MVPDs are strong evidence of market participants' view of the increased likelihood of consumer substitution between MVPD and OVD services.\footnote{Cf. U.S. Dept of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.2 (Aug. 19, 2010), available at http://www.justice.gov/atr/public/guidelines/hmg-2010.html (“However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. The Agencies consider reasonably predictable effects or ongoing changes in market conditions when calculating and interpreting market share data.”).}

This effect on investment is significant and could be diminished or even lost altogether if Comcast, through the JV, acquires the ability to delay or deter the development of OVDs.

D. The Anticompetitive Effects of the Proposed Transaction

Antitrust law, including Section 7 of the Clayton Act, protects consumers from anticompetitive conduct, such as firms' acquisition of the ability to raise prices above levels that would prevail in a competitive market. It also ensures that firms do not acquire the ability to stifle innovation. Vertical mergers are those that occur between firms at different stages of the chain of production and distribution. Vertical mergers have the potential to harm competition by changing the merged firm's ability or incentives to deal with upstream or downstream rivals. For example, the merger may
give the vertically integrated entity the ability to establish or protect market power in a
downstream market by denying or raising the price of an input to downstream rivals
that a stand-alone upstream firm otherwise would sell to those downstream firms. The
merged firm may find it profitable to forego the benefits of dealing with its rivals in
order to hobble them as competitors to its own downstream operations.

A merged firm can more readily harm competition when its rivals offer new
products or technologies whose competitive potential is evolving. Nascent competitors
may be relatively easy to quash. For example, denying an important input, such as a
popular television show, to a nascent competitor with a small customer base is much less
costly in terms of foregone revenues than denying that same show to a more established
rival with a larger customer base. Even if a vertical merger only delays nascent
competition, an increase in the duration of a firm's market power can result in
significant competitive harm. The application and enforcement of antitrust law is
appropriate in such situations because promoting innovation is one of its important
goals.\footnote{[e on competition, not only to reduce costs but also to innovate new products and processes.]} \footnote{Herbert Hovenkamp, Restraints on Innovation, 29 Cardozo L. Rev. 247, 253-54, 260 (2007) ("[N]o one doubts
[the] basic conclusion that innovation and technological progress very likely contribute much more to economic
growth than policy pressures that drive investment and output toward the competitive level."); see also 4B Phillip E.
Areeda et al., Antitrust Law, ¶ 407a (3d ed. 2007); Willow A. Sheremata, Barriers to innovation: a monopoly,
network externalities, and the speed of innovation, 42 Antitrust Bull. 937, 938 (1997) ("[I]n the long run it is
dynamic performance that counts. The speed of innovation is important to social welfare." (quoting F.M. Scherer &
David Ross, Industrial Market Structure & Economic Performance 613 (3d ed. 1990))).}

\footnote{See Sheremata, supra note 18, at 944 ("When owners of current technology raise artificial barriers to entry of
new technology, opportunities for innovation decline to the detriment of consumers.").}

17. The Importance of Access to NBCU Content

Generally, programmers want to distribute their content in multiple ways to
maximize viewers' exposure to the content and the impact of any advertising revenues.
Likewise, distributors must be able to license a sufficient quantity and quality of content
to create a compelling video programming service. A distributor also must gain access to
a sufficient variety of content from different sources. This "aggregation" of a variety of
content is important to a distributor's ability to succeed.

NBCU content is extremely valuable to video programming distributors. NBC is one
of the original three broadcast networks and has decades of history and brand name
recognition. It carries general interest content that appeals to a wide variety of viewers.
Surveys routinely rank the NBC network as one of the top four of all broadcast and cable
networks. Similarly, NBCU's USA Network is highly valued and has been rated the top
cable network for four of the past five years. Many of NBCU's other networks – Bravo,
CNBC, MSNBC, SyFy – also are highly rated and valued by their audiences.

The proposed transaction would give Comcast, through the JV, control of an
important portfolio of current and library content. The ratings of each NBCU network
are based on the popularity of the particular slate of shows currently on that network
and can increase or decrease significantly from one television season to the next based
on the gain or loss of hit shows. NBCU also has the ability to switch programming from
one network to another, or otherwise make popular content from one network available
to another. Through the JV, Comcast would gain the ability to impair emerging OVD
competition by withholding or raising the prices of individual NBCU shows, or of linear
feeds of one or more NBCU cable or broadcast networks. It is reasonable to examine the
competitive impact of withholding NBCU content in the aggregate, rather than
analyzing the value of any individual show or network to a competitor, because an
aggregate withholding strategy would have the greatest impact on Comcast’s downstream rivals.

2. The Proposed Transaction Increases the JV’s Incentive and Ability to Harm Competitors

   a. Ability and Incentive to Harm Rival MVPDs

   If the proposed transaction is approved, Comcast through the JV will gain control of NBCU's content, including a substantial amount of valuable broadcast and cable programming. Competing MVPDs will be forced to obtain licenses for NBCU content from their rival, Comcast. Unlike a stand-alone programmer, Comcast's pricing and distribution decisions will take into account the impact of those decisions on the competitiveness of rival MVPDs. As a result, Comcast will have a strong incentive to disadvantage its competitors by denying them access to valuable programming or raising their licensing fees above what a stand-alone NBCU would have found it profitable to charge.

   A stand-alone programmer typically attempts to maximize the combined license fee and advertising revenues from its programming by making its content available in multiple ways. The JV would continue to value widespread distribution of NBCU content, but it also would likely consider how access to that content makes Comcast's MVPD rivals better competitors. This could lead the JV to withhold content altogether or, more likely, to insist on higher fees for the NBCU content from Comcast's MVPD competitors. Whether Comcast's rival MVPDs refuse to purchase the programming or agree to pay the higher fees, Comcast would benefit from weakening its MVPD rivals. Likewise, high licensing fees charged to other MVPDs and OVDs will also induce customers to switch to (or stay with) Comcast. These higher licensing fees will be reflected either in higher subscriber fees or, in the case of MVPDs building alternative cable distribution infrastructures, a smaller level of investment and, consequently, a smaller coverage area for the MVPD competing with Comcast. In either case, higher licensing fees will reduce pricing pressure on Comcast's MVPD business and increase its ability to raise prices to its subscribers.

   By disadvantaging competitors in this manner, Comcast through the JV will cause some of its rivals’ customers to seek an alternative MVPD provider. Many of these dissatisfied customers likely will become Comcast subscribers, making it profitable for Comcast and the JV to increase licensing fees above the stand-alone NBCU levels. Those increased fees likely will lead to higher prices for subscribers of other MVPDs and perhaps further migration by those subscribers to Comcast.

   Licensing disputes in which a major broadcast network has pulled a network signal from an MVPD have resulted in the MVPD’s loss of significant numbers of subscribers to its competitors. Through the formation of the JV, Comcast gains the rights to negotiate on behalf of the seven O&Os that operate in areas where it is the dominant cable company. It also becomes the owner of the NBC network, which may give it leverage to seek the rights to negotiate on behalf of NBCU’s NBC network affiliate television stations, or at least the ability to influence affiliate negotiations, for retransmission consent rights in other areas of the United States. Comcast, through the JV, can withhold or raise the price of the NBC network to its rivals, thereby causing customers to shift away from the rival. Other NBCU programming also is important to consumers, and similar switching behavior could result if the JV were to withhold it from Comcast’s rival MVPDs.

   Comcast has engaged in such strategies in the past. For example, Comcast has withheld its RSN in Philadelphia in order to discriminate against, and thereby disadvantage, DBS providers against which Comcast competes in that city. The DBS providers' market shares are lower and Comcast’s subscription fees are higher in Philadelphia than in comparable markets. This appears to have been a profitable strategy for Comcast because the overall benefit to its cable business of retaining subscribers seems to have outweighed the substantial losses associated with failing to earn licensing fees for the withheld RSN from DBS companies.
Post-transaction, Comcast's rival MVPDs would realize that, unlike the stand-alone NBCU, the JV will set higher licensing fees for NBCU that take into consideration Comcast's business profits. Some MVPDs might find it unprofitable to carry the programming at the prices the JV could command. Other MVPDs might agree to the JV's increased prices for the NBCU content given the likelihood that they would lose a large number of their subscribers if they did not carry the NBCU content.

Lowering the profitability of Comcast's MVPD rivals also would weaken the incentives of some existing and future entrants to build out their systems, especially in areas Comcast currently serves, weakening the competitive constraints faced by Comcast. This weakened state of competition would allow Comcast, in turn, to decrease its investments and innovation to improve its own offerings. Higher subscription fees for Comcast services or decreased investment in improving their quality are less likely to induce customer switching to Comcast's MVPD rivals where those rivals are unable to match its programming or prices. As a result, Comcast could reinforce and even increase its dominant market share of video programming distribution in all areas of the country in which it operates.

b. Incentive and Ability to Harm OVDs

Comcast, through the JV, also could discriminate against competing OVDs in similar ways, thereby diminishing the competitive threat posed by individual OVDs and impeding the development of OVDs, generally. The JV could charge OVDs higher content fees than the stand-alone NBCU would have charged, or impose different terms for NBCU content than Comcast negotiates for itself. The JV also could withhold NBCU content completely, thereby diminishing OVDs' ability to compete for video programming distribution customers, again to Comcast's benefit. Either situation could delay significantly the development of OVDs as a competitive alternative to traditional video programming distribution services.

Over the last several years, NBCU has been one of the content providers most willing to experiment with different methods of online distribution. It was a driving force behind the creation and success of Hulu, and is now a partner in, and major content contributor to, the recently launched Hulu Plus, a subscription version of Hulu. Prior to the JV announcement, NBCU entered into several contracts with OVDs to distribute its content online through Apple iTunes and Amazon, and on a subscription basis through Netflix. Allowing the JV to proceed removes NBCU content from the control of a company that supported the development of OVDs and places it in the control of a company that views OVDs as a serious competitive threat.

Finally, Comcast, through the JV, would gain control of NBCU's governance rights and 32 percent ownership interest in Hulu, a current and future competitor to Comcast's MVPD services. Hulu has achieved significant success since its launch in early 2008.

Each of the media partners in Hulu, including NBCU, contributes content to Hulu and holds three seats on Hulu's Board of Directors. Significantly, any important or strategic decisions by Hulu require the unanimous approval of all members of the Board. Comcast's acquisition of NBCU's interest in Hulu would give it the ability to hamper Hulu's strategic and competitive development by refusing to agree to major actions by Hulu, or by blocking Hulu's access to NBCU content.

3. How the Formation of the JV Changes Comcast's Incentives and Abilities

Post-transaction, the JV would gain increased bargaining leverage sufficient to negotiate higher prices or withhold NBCU content from Comcast's MVPD competitors. Comcast's rival distributors would have to pay the increased prices or not carry the programming. In either case, the MVPDs likely would be less effective competitors to Comcast, and Comcast would be able to delay or otherwise substantially impede the development of OVDs as alternatives to MVPDs.

All of these activities could have a substantial anticompetitive effect on consumers and the market. Because Comcast would face less competition from other video programming distributors, it would be less constrained in its pricing decisions and have
a reduced incentive to innovate. As a result, consumers likely would be forced to pay higher prices to obtain their video content or receive fewer benefits of innovation. They also would have fewer choices in the types of content and providers to which they would have access, and there would be lower levels of investment, less experimentation with new models of delivering content, and less diversity in the types and range of product offerings.

4. Entry Is Unlikely to Reverse the Anticompetitive Effects of the JV

Over the last decade, Comcast and other traditional video distributors benefited from an industry with limited competition and increasing prices, in part because successful entry into the traditional video programming distribution business is difficult and requires an enormous investment to create a distribution infrastructure such as building out wireline facilities or obtaining spectrum and launching satellites. Accordingly, additional entry into wireline or DBS distribution is not likely in the foreseeable future. Telcos have been willing to incur some of the enormous costs to modify their existing telephone infrastructure to distribute video, but only in certain areas, and they have recently indicated that further expansion will be limited for the foreseeable future.

OVDs, therefore, represent the most likely prospect for successful competitive entry into the existing video programming distribution market. However, they face the difficulty of obtaining access to a sufficient amount of content to become viable distribution businesses. In addition, OVDs rely upon the infrastructure of others, including Comcast, to deliver service to their customers. After the JV is formed, Comcast will control some of the most significant content needed by OVDs to successfully position themselves as a replacement for traditional video distribution providers.

5. Any Efficiencies Arising from the Deal Are Negligible or Not Merger-Specific

The Department considers expected efficiencies in determining whether to challenge a vertical merger. The potential anticompetitive harms from a proposed transaction are balanced against the asserted efficiencies of the transaction. The evidence does not show substantial efficiencies from the transaction.

In particular, the JV is unlikely to achieve substantial savings from the elimination of double marginalization. Double marginalization occurs when two independent companies at different points in a product's supply chain each extract a profit margin above marginal cost. Because each firm in the supply chain treats the other firm's price (in lieu of its marginal cost) as a cost of producing the final good, each firm finds it profitable to produce a lower output than the firms would have produced had they accurately accounted for the social cost of producing the output. This ultimately results in a lower output (and a higher price to consumers) than would have occurred if the product had been produced by a combined firm. Despite a higher price, the lower output from double marginalization ultimately results in lower total profits for the entire supply chain.

Vertical mergers often are procompetitive because they enable the merged firm to properly account for costs when determining output and setting a final product price. The combined firm no longer treats the profit of the other firm as part of the cost of

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21 Similarly, it is unlikely that an entrant would attempt to provide a traditional MVPD service with wireless technology, particularly given the difficulty in acquiring spectrum and the costs and risks of constructing such a system. See generally U.S. Dep’t of Justice, Ex Parte Submission, In re Economic Issues in Broadband Competition, A National Broadband Plan for Our Future, FCC GN Docket No. 09-51, at 8-11 (filed Jan. 4, 2010), available at http://www.justice.gov/atr/public/comments/253393.htm.

production. Because the combined firm faces lower marginal costs, it may find it profitable to expand output and reduce the final product price. Lower marginal costs may result in better service, greater product quality or innovation, or other improvements.

In certain industries, however, including the one at issue here, vertical mergers are far less likely to reduce or eliminate double marginalization. Documents, data, and testimony obtained from Defendants and third parties demonstrate that much, if not all, of any potential double marginalization is reduced, if not completely eliminated, through the course of contract negotiations between programmers and distributors over quantity and penetration discounts, tiering requirements, and other explicit and verifiable conditions.

Other efficiencies claimed by Comcast are not specific to this transaction or not verifiable, or both. It is unlikely that the efficiencies associated with this transaction would be sufficient to undo the competitive harm that otherwise would result from the JV.

III. Explanation of the Proposed Final Judgment

The proposed Final Judgment ensures that Comcast, through the JV, will not impede the development of emerging online video distribution competition by denying access to the JV’s content to such competitors. The proposed Final Judgment also contains provisions that protect Comcast’s traditional video distribution competitors. The proposed Final Judgment thereby protects consumers by eliminating the likely anticompetitive effects of the proposed transaction.

A. The Proposed Final Judgment Protects Emerging Online Video Competition

1. The Proposed Final Judgment Ensures that OVDs have Access to the JV’s Video Programming

The proposed Final Judgment requires the JV to license its broadcast, cable, and film content to OVDs on terms comparable to those in similar licensing arrangements with MVPDs or OVDs. It provides two options through which an OVD will be able to obtain the JV’s content.

Under the first option, set forth in Section IV.A of the proposed Final Judgment, the JV must license linear feeds of video programming to any requesting OVD on terms that are economically equivalent to the terms on which the JV licenses that programming to MVPDs. Subject to some exceptions, the JV must make available to an OVD any channel or bundle of channels, and all quality levels and VOD rights, it provides to any MVPD with more than one million subscribers.

The terms of the JV’s license with the OVD need not match precisely any existing license between the JV and the MVPD, but it must reasonably approximate, in the aggregate, an existing licensing agreement. That approximation must account for factors, such as advertising revenues and any technical and economic limitations of the OVD seeking a license.

The first option ensures that the JV will not be able to use its control of content to impede competitive pressure exerted on traditional forms of video programming distribution from OVDs that choose to offer linear channels and associated VOD content. The proposed Final Judgment uses Defendants’ own contracts with MVPDs, including MVPDs that do not compete with Comcast, as proxies for the content and terms the JV would be willing to provide to distributors if it did not have the incentive or ability to disadvantage them in order to maintain customers in or drive customers to Comcast’s service.

Under the second option, set forth in Section IV.B, the proposed Final Judgment requires the JV to license to an OVD, broadcast, cable, or film content comparable in scope and quality to the content the OVD receives from one of the JV’s programming peers. For example, if an OVD receives each episode of five primetime television series from CBS for display in a subscription VOD service within 48 hours of the original airing, the JV must provide the OVD a comparable set of NBC broadcast television
programs, as measured by volume and economic value, for display during the same subscription VOD window. The requirement applies to all JV content, even non-NBCU content, in order to ensure that the JV cannot undermine the purposes of the proposed Final Judgment by shifting content from one network to another.

While the first option ensures that Comcast, through the JV, will not disadvantage OVD competitors in relation to MVPDs, the second option ensures that the programming licensed by the JV to OVDs will reflect the licensing trends of its peers as the industry evolves. Because the OVD industry is still developing, the contracts of the JV’s peers also provide an appropriate benchmark for determining the terms and conditions under which content should be licensed to OVDs. The programming peers include the owners of the three major non-NBC broadcast networks (CBS, FOX, and ABC), the largest cable network groups (including News Corporation, Time Warner, Inc., Viacom, and The Walt Disney Company), and the six largest production studios (including News Corporation, Viacom, Sony Corporation of America, Time Warner Inc., and The Walt Disney Company).

If an OVD and the JV are unable to reach an agreement for carriage of the JV’s programming under either of these options, an OVD may apply to the Department for permission to submit its dispute to commercial arbitration in accordance with Section VII of the proposed Final Judgment. The FCC Order requires the JV to license content on reasonable terms to OVDs and includes an arbitration mechanism for resolution of disputes over access to programming. The FCC is the expert communications industry agency, and the Department worked very closely with the FCC in designing effective relief in this case. For so long as commercial arbitration is available for resolution of disputes in a timely manner under the FCC’s rules and orders, the Department will ordinarily defer to the FCC’s commercial arbitration process to resolve such disputes. OVDs are nascent competitors, however, and consistent with the Department’s competition law enforcement mandate, the Department reserves the right, in its sole discretion, to permit arbitration pursuant to Section VII to advance the competitive objectives of the proposed Final Judgment. Although the Department may seek enforcement of the Final Judgment through traditional judicial process, the arbitration process will help ensure that OVDs can obtain content from the JV at a competitive price, without involving the Department or the Court in expensive and time-consuming litigation. To support the proposed Final Judgment’s requirement that the JV license its programming to OVDs and assist the Department’s oversight of this nascent competition, Comcast and NBCU are required, pursuant to Sections IV.M and IV.N, to maintain copies of agreements the JV has with any OVD as well as the identities of any OVD that has requested video programming from the JV.

2. The Proposed Final Judgment Prevents Comcast, through the JV, from Adversely Affecting Hulu

Section IV.D of the proposed Final Judgment requires Defendants to relinquish their voting and other governance rights in Hulu, and Section IV.E prohibits them from receiving confidential or competitively sensitive information concerning Hulu. As noted above, Hulu is one of the most successful OVDs to date. Comcast has an incentive to prevent Hulu from becoming an even more attractive avenue for viewing video programming because Hulu would then exert increased competitive pressure on Comcast’s cable business. If the proposed transaction were to be consummated without conditions, Defendants would hold seats on Hulu’s Board of Directors and could exercise their voting and other governance rights to compromise strategic and competitive

23 Under Section VI of the proposed Final Judgment, Defendants are required to license only video programming subject to their management or control or over which Defendants possess the power or authority to negotiate content licenses. NBCU has management rights in The Weather Channel, including the right to negotiate programming contracts on its behalf. NBCU currently is not exercising these rights. However, Section V.F provides that if the JV exercises them or otherwise influences The Weather Channel, this programming will be covered under the requirements of the proposed Final Judgment. Similarly, Section V.E exempts The Weather Channel, TV One, FearNet, the Pittsburgh Cable News Channel, and Hulu from the definitions of “Defendants” and other related terms unless the Defendants gain control over those channels or the ability to negotiate or influence carriage contracts for those channels.
initiatives Hulu may wish to pursue. Requiring Defendants to relinquish their voting and governance rights in Hulu, and barring access to competitively sensitive information, will prevent Comcast, through the JV, from interfering with Hulu's competitive and strategic plans.

At the same time, NBCU should not be permitted to abandon its commitments to provide Hulu video programming under agreements currently in place and deny Hulu customers the value of the JV's content. Therefore, Section IV.G of the proposed Final Judgment requires the JV to continue to supply Hulu with content commensurate with the supply of content provided to Hulu by its other media owners.

3. The Proposed Final Judgment Prohibits Defendants from Discriminating Against, Retaliating Against, or Punishing Video Programmers and OVDs

The proposed Final Judgment protects the development of OVDs by prohibiting Defendants from engaging in certain conduct that would deter video programmers and OVDs from contracting with each other. Section V.A of the proposed Final Judgment prohibits Defendants from discriminating against, retaliating against, or punishing any content provider for providing programming to any OVD. Section V.A also prohibits Defendants from discriminating against, retaliating against, or punishing any OVD for obtaining video programming, for invoking any provisions of the proposed Final Judgment or any FCC rule or order, or for furnishing information to the Department concerning Defendants’ compliance with the proposed Final Judgment.

4. The Proposed Final Judgment Prohibits Defendants from Limiting Distribution to OVDs through Restrictive Licensing Practices

The proposed Final Judgment further protects the development of OVDs by preventing Comcast from using its influence either as the nation's largest MVPD or as the licensor, through the JV, of important video programming to enter into agreements containing restrictive contracting terms. Video programming agreements often grant licensees preferred or exclusive access to the programming content for a particular time period. Such exclusivity provisions can be competitively neutral, but also can have either pro- or anticompetitive purposes or effects. Sections V.B and V.C of the proposed Final Judgment set forth broad prohibitions on restrictive contracting practices, including exclusives, but then delineate a narrowly tailored set of exceptions to those bans. These provisions ensure that Comcast, through the JV, cannot use restrictive contract terms to harm the development of OVDs and, at the same time, preserve the JV's incentives to produce and exploit quality programming.

The video programming distribution industry frequently uses exclusive contract terms that can be procompetitive. For instance, as discussed above, content producers often sequence the release of their content to various distribution platforms, a practice known as "windowing." These windows of exclusivity enable a content producer to maximize the revenues it earns on its content by separating customers based on their willingness to pay and effectively increasing the price charged to the customers that place a higher value on receiving content earlier. Exclusivity also encourages the various distributors, such as cable companies, to promote the content during a distribution window by assuring the distributor that the content will not be available through other distribution channels at a lower price. This ability to price discriminate across types of customers and increase promotion of the content increases the profitability of producing quality programming and encourages the production of more high-quality programming than otherwise would be the case. Exclusivity also may help a new competitor gain entry to a market by encouraging users to try a service they would not otherwise consider. For example, an OVD may desire a limited exclusivity window in order to market its exclusive access to certain programming provided by its service. This unique content makes the service more attractive to consumers and gives them a reason to replace their existing service or try something new.

However, exclusivity restrictions also can serve anticompetitive ends. As a cable company, Comcast has the incentive to seek exclusivity provisions that would prevent content producers from licensing their content to alternative distributors, such as OVDs, for a longer period than the content producer ordinarily would find economically
reasonable, in order to hinder OVD development. If Comcast could use exclusivity provisions to prevent the JV’s peers from licensing content to OVDs that otherwise would obtain the rights to offer the programming, other provisions of the proposed Final Judgment designed to preserve and foster OVD competition could be effectively nullified.

The proposed Final Judgment strikes a balance by allowing reasonable and customary exclusivity provisions that enhance competition while prohibiting those provisions that, without any offsetting procompetitive benefits, hinder the development of effective competition from OVDs. Section V.B of the proposed Final Judgment prohibits the JV from entering into any agreement containing terms that forbid, limit, or create economic incentives for the licensee to limit distribution of the JV’s video programming through OVDs, unless such terms are common and reasonable in the industry. Evidence of what is common and reasonable industry practice includes, among other things, Defendants’ contracting practices prior to the date that the JV was announced, as well as practices of the JV’s video programming peers. This provision allows the JV to employ those pricing and contractual strategies used by its peers to maximize the value of the content it produces, while limiting Comcast’s incentives, through the JV, to craft unusually restrictive contractual terms in the JV’s contracts with third parties, the purpose of which is to limit the access of OVDs to content produced by the JV. Section V.C of the proposed Final Judgment prohibits Comcast from entering into or enforcing agreements for carriage of video programming on its cable systems that forbid, limit, or create incentives that limit the provision of video programming to OVDs. Section V.C establishes three narrow exceptions to this broad prohibition. First, Comcast may obtain a 30-day exclusive from free online display if Comcast pays for the video programming. Second, Comcast may enter into an agreement in which the programmer provides content exclusively to Comcast, and to no other MVPD or OVD, for 14 days or less. Third, Comcast may condition carriage of programming on its cable system on terms which require it to be treated in material parity with other similarly situated MVPDs, except to the extent such terms would be inconsistent with the purpose of the proposed Final Judgment. These provisions are designed to ensure that Comcast, either alone or in conjunction with the JV, cannot use existing or new contracts to dictate the terms of the video programming agreements that the JV’s peers are able to offer OVDs, thereby hindering the development of OVDs.

5. The Proposed Final Judgment Prohibits Unreasonable Discrimination in Internet Broadband Access

Section V.G of the proposed Final Judgment requires Comcast to abide by certain restrictions on the operation and management of its Internet facilities. Without these restrictions Comcast would have the ability and the incentive to undermine the effectiveness of the proposed Final Judgment. Comcast is the dominant high-speed ISP in much of its footprint and therefore could disadvantage OVDs in ways that would prevent them from becoming better competitive alternatives to Comcast’s video programming distribution services. OVDs are dependent upon ISPs’ access networks to deliver video content to their subscribers. Without the protections secured in the proposed Final Judgment, Comcast would have the ability, for instance, to give priority to non-OVD traffic on its network, thus adversely affecting the quality of OVD services that compete with Comcast’s own MVPD or OVD services. Comcast also would be able to favor its own services by not subjecting them to the network management practices imposed on other services.

Section V.G.1 of the proposed Final Judgment prohibits Comcast from unreasonably discriminating in the transmission of lawful traffic over its Internet access service, with the proviso that reasonable network management practices do not constitute unreasonable discrimination. This provision requires Comcast to treat all Internet traffic the same and, in particular, to ensure that OVD traffic is treated no worse than any other traffic on Comcast’s Internet access service, including traffic from Comcast and NBCU sites. Similarly, Section V.G.2 prohibits Comcast from excluding their own services from any caps, tiers, metering, or other usage-based billing plans, and requires them to ensure that OVD traffic is counted in the same way as Comcast’s traffic, and that billing plans are not used to disadvantage an OVD in favor of Comcast. Many high-
speed Internet providers are evaluating usage-based billing plans. These plans may more efficiently apportion infrastructure costs across users, offer lower-cost service to low-volume subscribers, or divert high-volume usage to non-peak hours. However, these plans also have the potential to increase the cost of high-volume services, such as video distribution, that may compete with an MVPD's video services. Section V.G.2 addresses this concern by ensuring that under these plans Comcast must treat other OVD services just as it treats its own Internet-based video services.

Specialized Services are offered to consumers over the same last-mile facilities as Internet access services, but are separate from the public Internet. The potential benefits of Specialized Services include the facilitation of services that might not otherwise be technically or economically feasible on current networks and the development of new and innovative services, such as services that may compete directly with Comcast's own MVPD offerings. If Comcast were to offer online video services through Specialized Services, however, it could effectively avoid the prohibitions in Sections V.G.1 and V.G.2. Sections V.G.3 and V.G.4 recognize both the potential benefits and the risks of Specialized Services and strike a balance to protect the beneficial development of these services while preventing Comcast from using them anticompetitively to benefit its own content. Section V.G.3 prohibits Comcast from offering Specialized Services that are comprised substantially or entirely of the JV's content. Section V.G.4 requires Comcast to allow any OVD access to a Specialized Service if other OVDs, including Comcast, are being offered access. Together, these two provisions ensure that OVDs will have access to any Specialized Service Comcast may offer that includes comparable services.

Finally, Section V.G.5 ensures that Comcast will maintain its public Internet access service at a level that typically would allow any user on the network to download content from the public Internet at speeds of at least 12 megabits per second in markets where it has deployed DOCSIS 3.0. The requirement to maintain service at this speed may be adjusted by the Court upon a showing that other comparable high-speed Internet access providers offer higher or lower speeds. These speeds are sufficient to ensure that Comcast's Internet access services can support the development of OVDs as well as other services that are potentially competitive with Comcast's own offerings.

In interpreting Section V.G and the terms used therein, the Department will be informed by the FCC's Report and Order, In re Preserving the Open Internet Broadband Industry Practices, GN Docket No. 90-191 & WC Docket No. 07-52, adopted December 21, 2010.

B. The Proposed Final Judgment Preserves Traditional Video Competition

A number of FCC orders issued in prior mergers established a commercial arbitration process for resolution of disputes over access to broadcast network programming and regional sports networks. The FCC Order approving this transaction requires the JV to license all of its programming to MVPDs, including its cable networks, and includes an arbitration mechanism that contains several enhancements to its existing commercial arbitration process when licensing disputes between Defendants and other MVPDs arise. The Department believes that these enhancements, combined with the FCC's experience in MVPD arbitration disputes, should protect MVPDs' access to the JV's programming without need of another commercial arbitration mechanism for MVPDs under this proposed Final Judgment.

In addition to the protections contained in the FCC Order, the proposed Final Judgment, in Section V.A, prohibits Defendants from discriminating against, retaliating against, or punishing any MVPD for obtaining video programming, for furnishing any information to the United States about any noncompliance with the proposed Final Judgment, or for invoking the arbitration provisions of the FCC Order. Section V.D also

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24 For example, the FCC Order allows an MVPD claimant to demand arbitration of programming on a stand-alone basis in certain circumstances. It also allows a claimant whose contract with the JV has expired to continue to carry the JV's programming during the pendency of the dispute, subject to a true-up. The FCC Order also contains further modifications to the arbitration process relating to smaller MVPDs.
prevents Defendants from requiring or encouraging their local broadcast network affiliates to deny MVPDs the right to carry the local network signals. To aid the enforcement of this prohibition, pursuant to Sections IV.J and IV.K, Comcast and NBCU are required to maintain not only their network affiliate agreements, but also all documents discussing whether any of their affiliates has withheld or threatened to withhold retransmission consent from any MVPD.

C. Term of the Proposed Final Judgment

Section XI of the proposed Final Judgment provides that the Final Judgment will expire seven years from the date of entry unless extended by the Court. The FCC Order also lasts for seven years. The Department believes this time period is long enough to ensure that the JV cannot deny access to Comcast’s OVD competitors at a crucial point in their development but otherwise short enough to account for the rapidly evolving nature of the video distribution market.

VI. Alternatives to the Proposed Final Judgment

The United States considered, as an alternative to the proposed Final Judgment, seeking preliminary and permanent injunctions against Defendants’ transaction and proceeding to a full trial on the merits. The United States is satisfied, however, that the relief in the proposed Final Judgment will preserve competition for the provision of video programming distribution services in the United States. Thus, the proposed Final Judgment would protect competition as effectively as would any remedy available through litigation, but avoids the time, expense, and uncertainty of a full trial on the merits.

NOTES AND QUESTIONS

1. Harm to competition. The Justice Department’s investigation focused on two vertically-related markets—the Online Video Distributor (OVD) market and the Multichannel Video Programming Distributors (MVPDs)–and on the ability of a merged Comcast-NBC to protect its MVPD customers from OVD rivals. In particular, the Department suggested that a merged firm would have the incentive and ability to (1) withhold programming as part of a predatory strategy to exclude rival distributors; and (2) use its control over broadband platforms to undermine competition in the emerging over-the-top video marketplace. Which concern do you find more compelling?

2. The Role of the FCC. In the backdrop of this consent decree is the role of FCC regulation. At the time of the merger, the FCC was developing network neutrality regulation to ensure non-discriminatory access to broadband platforms and had already adopted program access regulation to ensure non-discriminatory access to cable networks owned by Multichannel Video Programming Distributors (MVPDs) like Comcast. If such regulations are in place, why does the Justice Department ask for additional remedial safeguards that can be enforced by the Department and at the FCC? Contrast the Department’s insistence on maintaining its role in this case with the rhetoric about deferring to a regulatory agency (the FCC) in the Trinko case, discussed in Chapter 8, which suggests that such deference is appropriate and might even be required.

3. Comcast and Time Warner. Comcast subsequently entered into an agreement to acquire Time Warner Cable. Comcast and Time Warner operated in different geographic areas and did not compete head-to-head. The acquisition would, however, have enlarged the footprint and the share of Comcast’s broadband customers across the US, bringing it to a reported 57% market share of nationwide broadband subscribers after the merger.28 The transaction was abandoned after the Justice Department expressed its concerns.

The Department expressed the concern, among others, that innovative entrants could be harmed on account of this merger. In particular, it stated:

A merged firm can more readily harm competition when its rivals offer new products or technologies whose competitive potential is evolving. Nascent competitors may be relatively easy to quash. For example, denying an important input, such as a popular television show, to a nascent competitor with a small customer base is much less costly in terms of foregone revenues than denying that same show to a more established rival with a larger customer base. Even if a vertical merger only delays nascent competition, an increase in the duration of a firm’s market power can result in significant competitive harm. The application and enforcement of antitrust law is appropriate in such situations because promoting innovation is one of its important goals.

How should antitrust law view nascent technological developments as a threat to entry (where that is a defense to a merger) and as a market threat to the merging firms (where that is a potential harm)? Should the level of skepticism, or proof, be comparable in both situations? Are there other ways that the merger might have harmed competition?

4. Innovation and Mergers. Two well-respected economists, Michael Katz & Howard Shelanski, have emphasized that “[m]erger-policy enforcers should recognize that innovation will depend more heavily on factual inquiries specific to a given case and less on systematic presumptions of the kind merger policy has long applied to static, product-market competition.” Howard A. Shelanski & Michael L. Katz, Mergers and Innovation, 74 ANTITRUST L.J. 1, 78 (2007). In some cases, they argue, enforcers will need to make “trade-offs between innovation and short-term product-market competition,” with no discernable principle for making such judgments. Id. As an example of cases in which such judgments must be made, they invoke the FTC’s decision in the Genzyme/Novazyme merger, where the FTC allowed a merger to monopoly because it believed that it would lead to more innovation. See Closing Letter, Investigation of Genzyme Corporation Acquisition of Novazyme Pharmaceuticals, Inc., FTC File No. 021 0026 (Jan. 13, 2004), available at http://www.ftc.gov/os/2004/01/040113genzyme.pdf.

5. Déjà vu All Over Again? As this book goes to press, the Department of Justice is considering the legality of a proposed merger between AT&T and Time Warner. AT&T, like Comcast, provides “multi-video channel programming” (through its DirecTV subsidiary), broadband, and wireless services. In seeking to acquire Time Warner, it proposes the very sort of vertical integration that happened in Comcast/NBC Universal. The controversy about the deal reflects, among other things, concerns about increasing consolidation, whether the conduct remedies in Comcast/NBC Universal were effective, and whether the merger could provide any benefits to consumers.

6. Beyond Bork? In connection with the AT&T/Time Warner merger, some commentators suggest that the Chicago School focus on economic impact and toleration for vertical integration should be rejected. Professor Tim Wu, for example, suggested that “there's an older tradition [than the Chicago School], embodied by Supreme Court Justice Louis Brandeis, that says a concentration of too much power in too few hands is bad for democracy and bad for consumers.” James Stewart, Why A Merger That Should Go Through Might Not, N.Y.Times (October 25, 2016), available at http://www.nytimes.com/2016/10/26/business/economy/why-a-media-merger-that-should-go-through-might-not.html?ref=business. How would a Brandeis theory operate in this case? What advantages or disadvantages do you see in developing one? Some argue that such concerns are especially applicable to media industries because of a heightened concern about restricting access to and distribution of ideas. See Maurice E. Stucke & Allen P. Grunes, Antitrust and the Marketplace of Ideas, 69 ANTITRUST L.J. 249, 256 (2001) (arguing that “the federal antitrust agencies should consider the implications of media mergers on the marketplace of ideas”). Do you find this persuasive?

7. Other Vertical Theories. The principal theory used to challenge vertical mergers, as in NBCU/Comcast, is that the merger will enable the merged firm to foreclose rivals’ access to competitively significant inputs. In an article suggesting that vertical mergers are more significant than generally appreciated, Steven C. Salop & Daniel P. Culley identify three other theories: (1) potential competition (see below); (2) misuse of competitors’ sensitive information when the merged firm does deal with competitors; and (3) collusive information
## CHAPTER 7

### COMPETITION LAW IN THE GLOBAL ECONOMY

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### 1. **International Commerce and US Antitrust Law**

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#### 2. **Competition Laws of Other Nations**

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1. INTERNATIONAL COMMERCE AND US ANTITRUST LAW

A. TERRITORIAL LIMITS ON U.S. LAW

SCOPE NOTE

From the day the Sherman Act was passed to the present time, it has been clear that the U.S. antitrust laws have some application to foreign trade and commerce. Sections 1 and 2 of the Sherman Act both refer explicitly to restraints or monopolization of “trade or commerce among the several States, or with foreign nations. . . .” On the other hand, it is equally clear that the United States did not, and cannot, legislate rules of market organization or behavior for the entire world. The questions of how far the U.S. antitrust laws reach beyond our borders, and how they interact with the competition laws that exist today in almost every other commercially significant country in the world, are of ever-increasing importance.

The expansion of global commerce, particularly since the end of World War II, is an economic development of surpassing importance not only for U.S. business, but also for consumers and producers around the world. As of the end of 2015, the U.S. Department of Commerce reported that the U.S. gross domestic product (GDP) was a seasonally adjusted $18,164.8 billion; of that figure, exports contributed $2,216.6 billion, and imports $2,730.9 billion.1 Taken together, international trade in goods amounted to about 22% of U.S. GDP.2 The Commerce Department reported that international trade in services for 2015 was just over 30% of total exports, and on the import side trade in services was about 15% of the total.3 The world-wide figures are even more impressive: the World Trade Organization estimates that the value of intra- and inter-regional merchandise trade in 2014 was $18,494 billion.4 Supplies of goods and services by United States affiliates established abroad in 2012 amounted to $1,739.0 billion to affiliated companies and $3,999.0 to unaffiliated companies.5 When we couple these facts with the

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1 U.S. Dept. of Commerce, Bureau of Economic Analysis, Nat’l Data, Table 1.1.5. Gross Domestic Product, http://bea.gov/iTable/iTable.cfm?ReqID=9&step=1#reqid=9&step=3&isuri=1&903=5.
2 According to the Bureau of Economic Analysis, in 2015, trade in goods totaled $3,829.2 billion—$1,517.5 billion in exports, and $2,311.7 billion in imports. Id.
3 Total seasonally adjusted exports for 2015 were $2,257.3 billion, as noted; exports of services were $739.8 billion (about 33%). Total seasonally adjusted imports were $2,808.9 billion, of which $497.2 billion were services (about 18%). Id.
5 Id., Table IV.4.
reality that more than 100 countries now have antitrust laws, the risk of conflict and the possibilities of cooperation among antitrust authorities become plain.

The materials that follow provide an introduction to the doctrines that address the twin problems of complex international commercial activity and multiplicity of regulating sovereigns. We begin with the scope of legislative jurisdiction under U.S. antitrust law to reach conduct that is in whole or in part located abroad—often referred to as the “extraterritoriality” question. Included in that inquiry is the role of comity and cooperation between U.S. and foreign systems. We conclude with a brief look at the competition law of the European Union, which applies within the Member States and has been copied widely around the world.

EARLY USE OF FOREIGN COMMERCE POWER

Until 1982, the question whether the federal antitrust laws applied to activities based either wholly or partly in foreign countries was governed exclusively by doctrines developed by the courts. Applying a presumption against extraterritorial application of U.S. law that would look familiar to modern eyes, see, e.g., RJR Nabisco, Inc. v. European Community, 136 S. Ct. 2090 (2016); Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659 (2013), the earliest cases turned down efforts to use U.S. law against foreign transactions. Thus, in American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909), Justice Holmes, writing for the Court, held that U.S. law could not be applied to a conspiracy to prevent competition among banana growers in Costa Rica that was designed to affect imports of bananas into the United States. The Court regarded that conclusion as unremarkable, writing that “[i]t is obvious that, however stated, the plaintiff’s case depends on several rather startling propositions. In the first place the acts causing the damage were done, so far as appears, outside the jurisdiction of the United States and within that of other states. It is surprising to hear it argued that they were governed by the [Sherman Act].” 213 U.S. at 355. It then announced that “the general and almost universal rule is that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done.” Id. at 356. United States v. American Tobacco Co., 221 U.S. 106 (1911).

The seemingly crisp rule of American Banana did not last for long. Two years after that decision, the Supreme Court found jurisdiction in a foreign commerce case, United States v. American Tobacco Co., 221 U.S. 106 (1911), without even discussing this issue in any detail and despite the fact that some of the contracts leading to the violation were executed in England. American Tobacco was followed by other decisions to the same effect. In all of them, at least some of the allegedly unlawful conduct took place in the United States.

These decisions lead us to the famous Alcoa decision of the Second Circuit, other parts of which you saw in Chapter 5, supra p. ___. Alcoa was a final, unappealable judgment even though it was not before the United States Supreme Court. Because a quorum of the Supreme Court could not be assembled, the case was certified to the Court of Appeals for the Second Circuit, which sat in place of the Supreme Court.

The case involved Alcoa’s alleged monopolization of the market for virgin aluminum ingot in violation of Sherman Act § 2. The government also claimed that Alcoa had entered into a conspiracy in restraint of commerce in aluminum, including in foreign commerce. Because much of the conduct took place outside the United States, and was undertaken by foreign companies, the Court had to
consider whether the Sherman Act even applied. Judge Hand’s discussion of that issue remains, more than sixty years later, a leading formulation of the jurisdictional reach of the U.S. antitrust laws.

We give below excerpts from the third part of the court’s opinion, in which it discussed whether a foreign company, Limited, was guilty of a conspiracy with foreign producers.

United States v. Aluminum Co. of America
United States Court of Appeals, Second Circuit, 1945.
148 F.2d 416.

L. HAND, CIRCUIT JUDGE. ... Limited was incorporated in Canada on May 31, 1928, to take over those properties of Alcoa which were outside the United States. ... [By the middle of 1931, ... formally at any rate, the separation between Limited and Alcoa] was complete. ...

[There was some evidence that Alcoa took part in the formation of the Alliance, a foreign cartel. Before 1928 Alcoa already had an understanding with foreigners on prices; the producers visited Canada in 1931 to set up the Alliance. Alcoa’s defense was that Limited had been organized for three reasons, none of which was related to controlling prices in the United States. First, it was designed to combat growing nationalism in the British Empire, by using a Canadian corporation (albeit one with U.S. shareholders). Second, it was a way of improving its management of its foreign properties. Finally, it was designed to provide for a smooth transition from old management to new.

The trial judge found that by 1935 Limited had become free from any connection with Alcoa, and that Alcoa had had no part in forming the Alliance or in limiting imports, fixing their price, or in intervening in pricefixing cartels in Europe (except some early ones that were not material). The Second Circuit concluded that Alcoa could not be held responsible for the Alliance’s actions solely by virtue of the fact that a majority (or controlling group) of Alcoa’s shareholders were also a majority (or controlling group) of Limited’s shareholders. It thus exonerated Alcoa itself from any violation of section 1 of the Act in foreign commerce. The court then turned to the question whether Limited had violated the Act.]

Whether Limited itself violated that section depends upon the character of the Alliance. It was a Swiss corporation, created in pursuance of an agreement entered into on July 3, 1931, the signatories to which were a French corporation, two German, one Swiss, a British, and Limited. The original agreement, or “cartel,” provided for the formation of a corporation in Switzerland which should issue shares, to be taken up by the signatories. This corporation was from time to time to fix a quota of production for each share, and each shareholder was to be limited to the quantity measured by the number of shares it held, but was free to sell at any price it chose. The corporation fixed a price every year at which it would take off any shareholder’s hands any part of its quota which it did not sell. No shareholder was to “buy, borrow, fabricate or sell” aluminum produced by anyone not a shareholder except with the consent of the board of governors, but that must not be “unreasonably withheld.” Nothing was said as to whether the arrangement extended to sales in the United States; but Article X, known as the “Conversion Clause,” provided that any shareholder might exceed his quota to the extent that he converted into aluminum in the United States or Canada any ores delivered to
him in either of those countries by persons situated in the United States. This was confessedly put in to allow Limited to receive bauxite or alumina from Alcoa, to smelt it into aluminum and to deliver the aluminum to Alcoa.

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Did either the agreement of 1931 [creating Limited and creating the quotas] or that of 1936 [substituting a system of royalties for the quotas] violate § 1 of the Act? The answer does not depend upon whether we shall recognize as a source of liability a liability imposed by another state. On the contrary we are concerned only with whether Congress chose to attach liability to the conduct outside the United States of persons not in allegiance to it. That being so, the only question open is whether Congress intended to impose the liability, and whether our own Constitution permitted it to do so: as a court of the United States, we cannot look beyond our own law. Nevertheless, it is quite true that we are not to read general words, such as those in this Act, without regard to the limitations customarily observed by nations upon the exercise of their powers; limitations which generally correspond to those fixed by the “Conflict of Laws.” We should not impute to Congress an intent to punish all whom its courts can catch, for conduct which has no consequences within the United States. American Banana Co. v. United Fruit Co., 213 U.S. 347, 357; … On the other hand, it is settled law … that any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize. …

It may be argued that this Act extends further. Two situations are possible. There may be agreements made beyond our borders not intended to affect imports, which do affect them, or which affect exports. Almost any limitation of the supply of goods in Europe, for example, or in South America, may have repercussions in the United States if there is trade between the two. Yet when one considers the international complications likely to arise from an effort in this country to treat such agreements as unlawful, it is safe to assume that Congress certainly did not intend the Act to cover them. Such agreements may on the other hand intend to include imports into the United States, and yet it may appear that they had no effect upon them. That situation might be thought to fall within the doctrine that intent may be a substitute for performance in the case of a contract made within the United States; or it might be thought to fall within the doctrine that a statute should not be interpreted to cover acts abroad which have no consequence here. We shall not choose between these alternatives; but for argument we shall assume that the Act does not cover agreements, even though intended to affect imports or exports, unless its performance is shown actually to have had some effect upon them. Where both conditions are satisfied, the situation certainly falls within such decisions as United States v. Pacific & Arctic R. & Navigation Co., 228 U.S. 87; Thomsen v. Cayser, 243 U.S. 66; and United States v. Sisal Sales Corp., 274 U.S. 268. … It is true that in those cases the persons held liable had sent agents into the United States to perform part of the agreement; but an agent is merely an animate means of executing his principal’s purposes, and, for the purposes of this case, he does not differ from an inanimate means; besides, only human agents can import and sell ingot.

Both agreements would clearly have been unlawful, had they been made within the United States; and it follows from what we have just said that both were unlawful, though made abroad, if they were intended to affect imports and did affect them. Since the shareholders almost at once agreed that the agreement
of 1931 should not cover imports, we may ignore it and confine our discussion to that of 1936: indeed that we should have to do anyway, since it superseded the earlier agreement. The judge found that it was not the purpose of the agreement to “suppress or restrain the exportation of aluminum to the United States for sale in competition with Alcoa.” By that we understand that he meant that the agreement was not specifically directed to Alcoa, because it only applied generally to the production of the shareholders. If he meant that it was not expected that the general restriction upon production would have an effect upon imports, we cannot agree, for the change made in 1936 was deliberate and was expressly made to accomplish just that. It would have been an idle gesture, unless the shareholders had supposed that it would, or at least might, have that effect. The first of the conditions which we mentioned was therefore satisfied; the intent was to set up a quota system for imports.

The judge also found that the 1936 agreement did not “materially affect the ... foreign trade or commerce of the United States”; apparently because the imported ingot was greater in 1936 and 1937 than in earlier years. We cannot accept this finding ... . It by no means follows from such an increase that the agreement did not restrict imports; and incidentally it so happens that in those years such inference as is possible at all, leads to the opposite conclusion. ... We do not mean to infer from this that the quota system of 1936 did in fact restrain imports, as these figures might suggest; but we do mean that nothing is to be inferred from the gross increase of imports. We shall dispose of the matter therefore upon the assumption that, although the shareholders intended to restrict imports, it does not appear whether in fact they did so. Upon our hypothesis the plaintiff would therefore fail, if it carried the burden of proof upon this issue as upon others. We think, however, that, after the intent to affect imports was proved, the burden of proof shifted to Limited. In the first place a depressant upon production which applies generally may be assumed, ceteris paribus, to distribute its effect evenly upon all markets. Again, when the parties took the trouble specifically to make the depressant apply to a given market, there is reason to suppose that they expected that it would have some effect, which it could have only by lessening what would otherwise have been imported. If the motive they introduced was over-balanced in all instances by motives which induced the shareholders to import, if the United States market became so attractive that the royalties did not count at all and their expectations were in fact defeated, they to whom the facts were more accessible than to the plaintiff ought to prove it, for a prima facie case had been made. Moreover, there is an especial propriety in demanding this of Limited, because it was Limited which procured the inclusion in the agreement of 1936 of imports in the quotas.

There remains only the question whether this assumed restriction had any influence upon prices ... .To that Socony–Vacuum Oil Co. v. United States, supra, 310 U.S. 150, is an entire answer. ... [A]n agreement to withdraw any substantial part of the supply from a market would, if carried out, have some effect upon prices, and was as unlawful as an agreement expressly to fix prices. The underlying doctrine was that all factors which contribute to determine prices, must be kept free to operate unhampered by agreements. For these reasons we think that the agreement of 1936 violated Sec. 1 of the Act. ...
NOTE AND QUESTIONS

1. *Sherman Act vis-à-vis public international law.* Justice Holmes considered the plaintiff’s claim that the Sherman Act covered the foreign conduct in question in *American Banana* at least “surprising,” if not “startling,” while Judge Hand in *Alcoa* thought it equally clear that “any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends.” Do their different views reflect a difference in views about international law limitations on the breadth of a country’s prescriptive jurisdiction? See generally ALI, Restatement (Third) of the Foreign Relations Law of the United States §§ 401–03 (1987). Do they reflect different views about Congress’ intent in the antitrust laws? Do they suggest that international law itself evolved between the opening years of the 20th century and the time immediately after World War II?

2. *International harmonization.* The Sherman Act, as applied abroad, creates the potential challenge of inconsistent standards. What should a company do if a practice banned as per se illegal in one country is tolerated in another one? Should U.S. courts ever adjust the scope of antitrust to accommodate international differences? To what extent, if at all, should or must the Sherman Act be construed to conform to norms of public international law? See *The Paquete Habana*, 175 U.S. 677 (1900); see also *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993) (dissenting opinion of Justice Scalia), infra p. ___.

3. *Antitrust and Statutory Interpretation.* In *Alcoa*, Judge Hand was undisturbed by the breaking with prior Supreme Court predecent. Given the “common law” nature of antitrust law (consider the overruling of *Schwinn* several years later in *GTE Sylvania*, discussed in Chapter 4), that might seem appropriate. But consider that, when the issue is construing a statutory provision, the Supreme Court has sometimes suggested that Congress should be the entity to correct a Supreme Court ruling. See *Flood v. Kuhn*, 407 U.S. 258 (1972) (declining to overrule ruling holding that Major League Baseball was not covered by the antitrust laws). Does that distinction make sense to you? Did Hand follow that principle in *Alcoa*?

B. THE FOREIGN TRADE ANTITRUST IMPROVEMENTS ACT

The FTAIA, which was enacted in 1982, amended both the Sherman Act and the Federal Trade Commission Act to clarify the meaning of the phrase “conduct involving trade or commerce with foreign nations” in the two statutes. Because there is no pertinent difference in the amendments of the two statutes, only the Sherman Act language is reproduced here:

Sections 1 to 7 of this title [Title 15, U.S.C.] shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—

(1) such conduct has a direct, substantial, and reasonably foreseeable effect—

(A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or
(B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and

(2) such effect gives rise to a claim under the provisions of sections 1 to 7 of this title, other than this section.

If sections 1 to 7 of this title apply to such conduct only because of the operation of paragraph (1)(B), then sections 1 to 7 of this title shall apply to such conduct only for injury to export business in the United States.


Although the statute may not be destined for inclusion in a manual of style, it essentially creates two categories of “foreign commerce” cases: those in which the effects of the conduct in question are felt in domestic or import commerce, and those in which the effects of the conduct are felt in the export trade of U.S. exporters.

NOTES AND QUESTIONS

1. Import commerce. Why do you think Congress so explicitly treated import trade or commerce differently from other “conduct involving trade or commerce with foreign nations”? Is there a difference between “import commerce” and activity “involving” import commerce?

2. Special antitrust standard. Is the formula “direct, substantial, and reasonably foreseeable effects” an appropriate one for import commerce cases, or should the courts use something more like the test in Summit Health, Ltd. v. Pinhas, 500 U.S. 322 (1991), which governs conventional jurisdictional analysis under the Sherman Act? Is there any reason to treat criminal cases differently? See United States v. Nippon Paper Indus., 109 F.3d 1 (1st Cir. 1997).

3. International comity. Congress specified when it passed the FTAIA that it was not taking a position one way or the other on the question whether the exercise of judicial power should be tempered by comity—that is to say, a concern about the impact a case might have on foreign relations. See Timberlane Lumber Co. v. Bank of America, N.T. & S.A., 549 F.2d 597 (9th Cir. 1976), discussed infra. Consider, after reading F. Hoffman-LaRoche, Ltd. v. Empagran S.A., 542 U.S. 155 (2004), infra, whether the Supreme Court has engrafted such a requirement on the statute.

4. Us v. Them. The FTAIA was passed as part of the Export Trading Company Act of 1982, Pub. L. 97-290, 96 Stat. 1233 (Oct. 8, 1982). As part of the findings and declaration of purpose of the Act, the statute provided that:

It is the purpose of this Act to increase United States exports of products and services by encouraging more efficient provisions of export trade services to United States producers and suppliers, in particular … by modifying the application of the antitrust laws to certain export trade.

What does that mean? Should we understand that to mean that the point of this law is to call off the application of the antitrust laws when goods are being exported from the United States? Put more directly, is the point to facilitate possible export cartels where the monopoly benefits of the cartel will be received in the United States and the reduced competition and the corresponding harms will be borne by foreign purchasers?

5. Post-FTAIA decisions. The next case, Hartford Fire, arose out of an elaborate alleged conspiracy in international insurance markets; it allegedly limited policies
written in the United States. Which theory of jurisdiction did the majority adopt? Which did the dissent advocate?

Hartford Fire Insurance Co. v. California
Supreme Court of the United States, 1993.
509 U.S. 764.

[Nineteen states and many private plaintiffs sued domestic insurance companies and domestic and foreign reinsurers alleging a conspiracy to restrict the coverage of commercial general liability (CGL) insurance available in the United States. Plaintiffs alleged conspiracies to curtail insurance coverage in several respects, the most important of which limited the insurer’s responsibility so that it had to pay only for claims made during the policy period, rather than for insurable events that occurred during the policy period, no matter when the claim was filed. Other conspiracies allegedly made pollution coverage unavailable or practically unavailable in the plaintiffs’ states.

The Supreme Court’s review of dismissal of the complaints focused on two issues: whether the alleged conduct was immune from the antitrust laws because it constituted “the business of insurance” within the meaning of the McCarran–Ferguson Act, and whether the action against several of the foreign defendants should be dismissed because the Sherman Act did not apply to the foreign conduct at issue.

The Court found that the McCarran–Ferguson Act was no bar to Sherman Act enforcement and then turned for the first time in many years to the question of the extraterritorial reach of the Sherman Act. The majority opinion of Justice Souter and the dissenting opinion of Justice Scalia follow.]

SOUTER, J. … Finally, we take up the question ... whether certain claims against the London reinsurers should have been dismissed as improper applications of the Sherman Act to foreign conduct. The Fifth Claim for Relief of the California Complaint alleges a violation of § 1 of the Sherman Act by certain London reinsurers who conspired to coerce primary insurers in the United States to offer CGL coverage on a claims-made basis, thereby making “occurrence CGL coverage ... unavailable in the State of California for many risks.” The Sixth Claim for Relief of the California Complaint alleges that the London reinsurers violated § 1 by a conspiracy to limit coverage of pollution risks in North America, thereby rendering “pollution liability coverage ... almost entirely unavailable for the vast majority of casualty insurance purchasers in the State of California.”

At the outset, we note that the District Court undoubtedly had jurisdiction of these Sherman Act claims, as the London reinsurers apparently concede. (“Our position is not that the Sherman Act does not apply in the sense that a minimal basis for the exercise of jurisdiction doesn’t exist here. Our position is that there are certain circumstances, and that this is one of them, in which the interests of another State are sufficient that the exercise of that jurisdiction should be restrained”). Although the proposition was perhaps not always free from doubt, see American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909), it is well

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6 One of the London reinsurers, Sturge Reinsurance Syndicate Management Limited, argues that the Sherman Act does not apply to its conduct in attending a single meeting at which it allegedly agreed to exclude all pollution coverage from its reinsurance contracts. … Sturge may have attended only one meeting, but the allegations, which we are bound to credit, remain that it participated in conduct that was intended to and did in fact produce a substantial effect on the American insurance market.
established by now that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States. See Matsushita Elec. Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 582, n. 6 (1986); United States v. Aluminum Co. of America, 148 F.2d 416, 444 (CA2 1945) (L. Hand, J.); Restatement (Third) of Foreign Relations Law of the United States § 415, and Reporters’ Note 3 (1987) (hereinafter Restatement (Third) Foreign Relations Law). ... Such is the conduct alleged here: that the London reinsurers engaged in unlawful conspiracies to affect the market for insurance in the United States and that their conduct in fact produced substantial effect.8

According to the London reinsurers, the District Court should have declined to exercise such jurisdiction under the principle of international comity.9 The Court of Appeals agreed that courts should look to that principle in deciding whether to exercise jurisdiction under the Sherman Act. This availed the London reinsurers nothing, however. To be sure, the Court of Appeals believed that “application of [American] antitrust laws to the London reinsurance market ‘would lead to significant conflict with English law and policy,’ ” and that “such a conflict, unless outweighed by other factors, would by itself be reason to decline exercise of jurisdiction.” But other factors, in the court’s view, including the London reinsurers’ express purpose to affect United States commerce and the substantial nature of the effect produced, outweighed the supposed conflict and require the exercise of jurisdiction in this case.

When it enacted the [FTAIA], Congress expressed no view on the question whether a court with Sherman Act jurisdiction should ever decline to exercise such jurisdiction on grounds of international comity. See H.R. Rep. No. 97–686, p. 13 (1982) (“If a court determines that the requirements for subject matter jurisdiction are met, [the FTAIA] would have no effect on the court[s] ability to employ notions of comity ... or otherwise to take account of the international character of the

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7 Justice Scalia believes that what is at issue in this case is prescriptive, as opposed to subject-matter, jurisdiction. The parties do not question prescriptive jurisdiction, however, and for good reason: it is well established that Congress had exercised such jurisdiction under the Sherman Act. ...

8 Under [the FTAIA], the Sherman Act does not apply to conduct involving foreign trade or commerce, other than import trade or import commerce, unless “such conduct has a direct, substantial, and reasonably foreseeable effect” on domestic or import commerce. 15 U.S.C. § 6a(1)(A). The FTAIA was intended to exempt from the Sherman Act export transactions that did not injure the United States economy, see H.R.Rep. No. 97–686, pp. 2–3, 9–10 (1982); P. Areeda & H. Hovenkamp, Antitrust Law ¶ 236'a, pp. 296–297 (Supp.1992), and it is unclear how it might apply to the conduct alleged here. Also unclear is whether the Act’s “direct, substantial, and reasonably foreseeable effect” standard amends existing law or merely codifies it. See id., ¶ 236’a, p. 297. We need not address these questions here. Assuming that the FTAIA’s standard affects this case, and assuming further that the standard differs from the prior law, the conduct alleged plainly meets its requirements.

9 Justice Scalia contends that comity concerns figure into the prior analysis whether jurisdiction exists under the Sherman Act. This contention is inconsistent with the general understanding that the Sherman Act covers foreign conduct producing a substantial intended effect in the United States, and that concerns of comity come into play, if at all, only after a court has determined that the acts complained of are subject to Sherman Act jurisdiction. See United States v. Aluminum Co. of America, 148 F.2d 416, 444 (CA2 1945) (“it follows from what we have ... said that [the agreements at issue] were unlawful [under the Sherman Act], though made abroad, if they were intended to affect imports and did affect them”); Mannington Mills, Inc. v. Congoleum Corp., 585 F.2d 1287, 1294 (CA3 1979) (once court determines that jurisdiction exists under the Sherman Act, question remains whether comity precludes its exercise); H.R.Rep. No. 97–686, p. 13 (1982). But cf. Timberlane Lumber Co. v. Bank of America, N.T. & S.A., 549 F.2d 597, 613 (CA9 1976); 1 J. Atwood & K. Brewster, Antitrust and American Business Abroad 166 (1981). In any event, the parties conceded jurisdiction at oral argument, and we see no need to address this contention here.
transaction”) (citing *Timberlane*). We need not decide that question here, however, for even assuming that in a proper case a court may decline to exercise Sherman Act jurisdiction over foreign conduct (or, as Justice Scalia would put it, may conclude by the employment of comity analysis in the first instance that there is no jurisdiction), international comity would not counsel against exercising jurisdiction in the circumstances alleged here.

The only substantial question in this case is whether “there is in fact a true conflict between domestic and foreign law.” *Société Nationale Industrielle Aerospatiale v. United States District Court*, 482 U.S. 522, 555 (1987) (Blackmun, J., concurring in part and dissenting in part). The London reinsurers contend that applying the Act to their conduct would conflict significantly with British law, and the British Government, appearing before us as amicus curiae, concurs. They assert that Parliament has established a comprehensive regulatory regime over the London reinsurance market and that the conduct alleged here was perfectly consistent with British law and policy. But this is not to state a conflict. “[T]he fact that conduct is lawful in the state in which it took place will not, of itself, bar application of the United States antitrust laws,” even where the foreign state has a strong policy to permit or encourage such conduct. Restatement (Third) Foreign Relations Law § 415, Comment j; see *Continental Ore Co.* , supra, at 706–707. No conflict exists, for these purposes, “where a person subject to regulation by two states can comply with the laws of both.” Restatement (Third) Foreign Relations Law § 403, Comment e.10 Since the London reinsurers do not argue that British law requires them to act in some fashion prohibited by the law of the United States, or claim that their compliance with the laws of both countries is otherwise impossible, we see no conflict with British law. See Restatement (Third) Foreign Relations Law § 403, Comment e, § 415, Comment j. We have no need in this case to address other considerations that might inform a decision to refrain from the exercise of jurisdiction on grounds of international comity.

SCALIA, J., dissenting [in part]. … The petitioners,... various British corporations and other British subjects, argue that certain of the claims against them constitute an inappropriate extraterritorial application of the Sherman Act. It is important to distinguish two distinct questions raised by this petition: whether the District Court had jurisdiction, and whether the Sherman Act reaches the extraterritorial conduct alleged here. On the first question, I believe that the District Court had subject-matter jurisdiction over the Sherman Act claims against all the defendants (personal jurisdiction is not contested). The respondents asserted nonfrivolous claims under the Sherman Act, and 28 U.S.C. § 1331 vests district courts with subject-matter jurisdiction over cases “arising under” federal statutes. As precedents such as *Lauritzen v. Larsen*, 345 U.S. 571 (1953), make clear, that is sufficient to establish the District Court’s jurisdiction over these claims. *Lauritzen* involved a Jones Act claim brought by a foreign sailor against a foreign shipowner. The shipowner contested the District Court’s jurisdiction apparently on the grounds that the Jones Act did not govern the dispute between the foreign parties to the action. Though ultimately agreeing with the shipowner that the Jones Act did not apply, see discussion infra, the Court held that the District Court had jurisdiction.

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10 Justice Scalia says that we put the cart before the horse in citing this authority, for he argues it may be apposite only after a determination that jurisdiction over the foreign acts is reasonable. But whatever the order of cart and horse, conflict in this sense is the only substantial issue before the Court.
As frequently happens, a contention that there is some barrier to granting plaintiff’s claim is cast in terms of an exception to jurisdiction of subject matter. A cause of action under our law was asserted here, and the court had power to determine whether it was or was not founded in law and in fact. 345 U.S., at 575. ...

The second question—the extraterritorial reach of the Sherman Act—has nothing to do with the jurisdiction of the courts. It is a question of substantive law turning on whether, in enacting the Sherman Act, Congress asserted regulatory power over the challenged conduct. See EEOC v. Arabian American Oil Co., 499 U.S. 244 (1991) (“It is our task to determine whether Congress intended the protections of Title VII to apply to United States citizens employed by American employers outside of the United States”). If a plaintiff fails to prevail on this issue, the court does not dismiss the claim for want of subject-matter jurisdiction—want of power to adjudicate; rather, it decides the claim, ruling on the merits that the plaintiff has failed to state a cause of action under the relevant statute. See Romero, supra, at 384 (holding no claim available under the Jones Act); American Banana Co. v. United Fruit Co., 213 U.S. 347, 359 (1909) (holding that complaint based upon foreign conduct “alleges no case under the [Sherman Act]”).

There is, however, a type of “jurisdiction” relevant to determining the extraterritorial reach of a statute; it is known as “legislative jurisdiction,” Aramco, supra at 253, Restatement (First) Conflict of Laws § 60 (1934), or “jurisdiction to prescribe,” 1 Restatement (Third) of Foreign Relations Law of the United States 235 (1987) (hereinafter Restatement (Third)). This refers to “the authority of a state to make its law applicable to persons or activities,” and is quite a separate matter from “jurisdiction to adjudicate.” There is no doubt, of course, that Congress possesses legislative jurisdiction over the acts alleged in this complaint: Congress has broad power under Article I, § 8, cl. 3 “[t]o regulate Commerce with foreign Nations,” and this Court has repeatedly upheld its power to make laws applicable to persons or activities beyond our territorial boundaries where United States interests are affected. See Ford v. United States, 273 U.S. 593, 621–623 (1927); United States v. Bowman, 260 U.S. 94, 98–99 (1922); American Banana, supra, at 356. But the question in this case is whether, and to what extent, Congress has exercised that undoubted legislative jurisdiction in enacting the Sherman Act.

Two canons of statutory construction are relevant in this inquiry. The first is the “long-standing principle of American law ‘that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’ ” Aramco, supra. ... Applying that canon in Aramco, we held that the version of Title VII of the Civil Rights Act of 1964 then in force, 42 U.S.C. §§ 2000e–2000e–17 (1988 ed.), did not extend outside the territory of the United States even though the statute contained broad provisions extending its prohibitions to, for example, “‘any activity, business, or industry in commerce.’ ” We held such “boilerplate language” to be an insufficient indication to override the presumption against extraterritoriality. The Sherman Act contains similar “boilerplate language,” and if the question were not governed by precedent, it would be worth considering whether that presumption controls the outcome here. We have, however, found the presumption to be overcome with respect to our antitrust laws; it is now well established that the Sherman Act applies extraterritorially. See Matsushita Elec. Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 582 n. 6 (1986); Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 704 (1962); see also United States v. Aluminum Co. of America, 148 F.2d 416 (CA2 1945).
But if the presumption against extraterritoriality has been overcome or is otherwise inapplicable, a second canon of statutory construction becomes relevant: “[A]n act of congress ought never to be construed to violate the law of nations if any other possible construction remains.” Murray v. Schooner Charming Betsy, 6 U.S. 64 (1804) (Marshall, C.J.). This canon is “wholly independent” of the presumption against extraterritoriality. [citation omitted] It is relevant to determining the substantive reach of a statute because “the law of nations,” or customary international law, includes limitations on a nation’s exercise of its jurisdiction to prescribe. See Restatement (Third) §§ 401–416. Though it clearly has constitutional authority to do so, Congress is generally presumed not to have exceeded those customary international-law limits on jurisdiction to prescribe.

Consistent with that presumption, this and other courts have frequently recognized that, even where the presumption against extraterritoriality does not apply, statutes should not be interpreted to regulate foreign persons or conduct if that regulation would conflict with principles of international law. …

... [W]e have recognized the principle that the scope of generally worded statutes must be construed in light of international law in other areas [in addition to maritime cases] as well. See, e.g., Sale v. Haitian Centers Council, Inc., 509 U.S. 155, 178, n. 35 (1993); Weinberger v. Rossi, 456 U.S. 25, 32 (1982). More specifically, the principle was expressed in United States v. Aluminum Co. of America, 148 F.2d 416 (C.A.2 1945), the decision that established the extraterritorial reach of the Sherman Act. In his opinion for the court, Judge Learned Hand cautioned “we are not to read general words, such as those in [the Sherman] Act, without regard to the limitations customarily observed by nations upon the exercise of their powers; limitations which generally correspond to those fixed by the ‘Conflict of Laws.’ ” Id., at 443.

More recent lower court precedent has also tempered the extraterritorial application of the Sherman Act with considerations of “international comity.” … The “comity” they refer to is not the comity of courts, whereby judges decline to exercise jurisdiction over matters more appropriately adjudged elsewhere, but rather what might be termed “prescriptive comity”: the respect sovereign nations afford each other by limiting the reach of their laws. That comity is exercised by legislatures when they enact laws, and courts assume it has been exercised when they come to interpreting the scope of laws their legislatures have enacted. It is a traditional component of choice-of-law theory. See J. Story, Commentaries on the Conflict of Laws § 38 (1834) (distinguishing between the “comity of the courts” and the “comity of nations,” and defining the latter as “the true foundation and extent of the obligation of the laws of one nation within the territories of another”). Comity in this sense includes the choice-of-law principles that, “in the absence of contrary congressional direction,” are assumed to be incorporated into our substantive laws having extraterritorial reach. Romero, supra, at 382–383; see also Lauritzen, supra, at 578–579; Hilton v. Guyot, 159 U.S. 113, 162–166 (1895). Considering comity in this way is just part of determining whether the Sherman Act prohibits the conduct at issue.11

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11 Some antitrust courts, including the Court of Appeals in the present case, have mistaken the comity at issue for the “comity of courts,” which has led them to characterize the question presented as one of “abstention,” that is, whether they should “exercise or decline jurisdiction.” Mannington Mills, Inc. v. Congoleum Corp., 595 F.2d 1287, 1294, 1296 (CA3 1979); see also In re Insurance Antitrust Litigation, 938 F.2d 919, 932 (CA9 1991). As I shall discuss, that seems to be the error the Court has fallen into today.
In sum, the practice of using international law to limit the extraterritorial reach of statutes is firmly established in our jurisprudence. In proceeding to apply that practice to the present case, I shall rely on the Restatement (Third) of Foreign Relations Law for the relevant principles of international law. Its standards appear fairly supported in the decisions of this Court construing international choice-of-law principles (*Lauritzen*, *Romero*, and *McCulloch*) and in the decisions of other federal courts, especially *Timberlane*. Whether the Restatement precisely reflects international law in every detail matters little here, as I believe this case would be resolved the same way under virtually any conceivable test that takes account of foreign regulatory interests.

Under the Restatement, a nation having some “basis” for jurisdiction to prescribe law should nonetheless refrain from exercising that jurisdiction “with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable.” Restatement (Third) § 403(1). The “reasonableness” inquiry turns on a number of factors including, but not limited to: “the extent to which the activity takes place within the territory [of the regulating state],” *id.*, § 403(2)(a); “the connections, such as nationality, residence, or economic activity, between the regulating state and the person principally responsible for the activity to be regulated,” *id.*, § 403(2)(b); “the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted,” *id.*, § 403(2)(c); “the extent to which another state may have an interest in regulating the activity,” *id.*, § 403(2)(g); and “the likelihood of conflict with regulation by another state,” *id.*, § 403(2)(h). Rarely would these factors point more clearly against application of United States law. The activity relevant to the counts at issue here took place primarily in the United Kingdom, and the defendants in these counts are British corporations and British subjects having their principal place of business or residence outside the United States. 12 Great Britain has established a comprehensive regulatory scheme governing the London reinsurance markets, and clearly has a heavy “interest in regulating the activity,” *id.*, § 403(2)(g). See 935 F.2d, at 932–933; *In re Insurance Antitrust Litigation*, 723 F.Supp. 464, 487–488 (N.D.Cal.1989); see also J. Butler & R. Merkin, Reinsurance Law A.1.1–02 (1992). Finally, § 2(b) of the McCarran–Ferguson Act allows state regulatory statutes to override the Sherman Act in the insurance field, subject only to the narrow “boycott” exception set forth in § 3(b)—suggesting that “the importance of regulation to the [United States],” *id.*, § 403(2)(c), is slight. Considering these factors, I think it unimaginable that an assertion of legislative jurisdiction by the United States would be considered reasonable, and therefore it is inappropriate to assume, in the absence of statutory indication to the contrary, that Congress had made such an assertion.

It is evident from what I have said that the Court’s comity analysis, which proceeds as though the issue is whether the courts should “decline to exercise … jurisdiction,” rather than whether the Sherman Act covers this conduct, is simply

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12 Some of the British corporations are subsidiaries of American corporations, and the Court of Appeals held that “[t]he interests of Britain are at least diminished where the parties are subsidiaries of American corporations.” 938 F.2d, at 933. In effect, the Court of Appeals pierced the corporate veil in weighing the interests at stake. I do not think that was proper.
misdirected. I do not at all agree, moreover, with the Court’s conclusion that the issue of the substantive scope of the Sherman Act is not in the case. To be sure, the parties did not make a clear distinction between adjudicative jurisdiction and the scope of the statute. Parties often do not, as we have observed (and have declined to punish with procedural default) before. See the excerpt from *Lauritzen* quoted *supra*, at 14; see also *Romero*, 358 U.S. 359. It is not realistic, and also not helpful, to pretend that the only really relevant issue in this case is not before us. In any event, if one erroneously chooses, as the Court does, to make adjudicative jurisdiction (or more precisely, abstention) the vehicle for taking account of the needs of prescriptive comity, the Court still gets it wrong. It concludes that no “true conflict” counseling nonapplication of United States law (or rather, as it thinks, United States judicial jurisdiction) exists unless compliance with United States law would constitute a violation of another country’s law. That breathtakingly broad proposition, which contradicts the many cases discussed earlier, will bring the Sherman Act and other laws into sharp and unnecessary conflict with the legitimate interests of other countries—particularly our closest trading partners.

In the sense in which the term “conflic[t]” was used in *Lauritzen*, 345 U.S., at 582, 592, and is generally understood in the field of conflicts of laws, there is clearly a conflict in this case. The petitioners here, like the defendant in *Lauritzen*, were not compelled by any foreign law to take their allegedly wrongful actions, but that no more precludes a conflict-of-laws analysis here than it did there. See *id.*, at 575–576 (detailing the differences between foreign and United States law). Where applicable foreign and domestic law provide different substantive rules of decision to govern the parties’ dispute, a conflict-of-laws analysis is necessary. See generally R. Weintraub, Commentary on Conflict of Laws 2–3 (1980); Restatement (First) of Conflict of Laws § 1, Comment c and Illustrations (1934).

Literally the only support that the Court adduces for its position is § 403 of the Restatement (Third) of Foreign Relations Law—or more precisely Comment e to that provision, which states:

“Subsection (3) [which says that a state should defer to another state if that state’s interest is clearly greater] applies only when one state requires what another prohibits, or where compliance with the regulations of two states exercising jurisdiction consistently with this section is otherwise impossible. It does not apply where a person subject to regulation by two states can comply with the laws of both. . . .”

The Court has completely misinterpreted this provision. Subsection (3) of § 403 (requiring one State to defer to another in the limited circumstances just described) comes into play only after subsection (1) of § 403 has been complied with—*i.e.*, after it has been determined that the exercise of jurisdiction by both of the two states is not “unreasonable.” That prior question is answered by applying the factors (inter alia) set forth in subsection (2) of § 403, that is, precisely the factors that I have discussed in text and that the Court rejects.  

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13 The Court skips directly to subsection (3) of § 403, apparently on the authority of Comment j to § 415 of the Restatement (Third). But the preceding commentary to § 415 makes clear that “any exercise of [legislative] jurisdiction under this section is subject to [a] the requirement of reasonableness” set forth in § 403(2). Restatement (Third) § 415, Comment a. Comment j refers back to the conflict analysis set forth in § 403(3) which, as noted above, comes after the reasonableness analysis of § 403(2).
I would reverse the judgment of the Court of Appeals on this issue, and remand to the District Court with instructions to dismiss for failure to state a claim on the three counts at issue in No. 91–1128.

NOTES AND QUESTIONS

1. Conflict with foreign law. In Hartford Fire, it was possible for the defendants to comply with both U.S. law and U.K. law? The U.K. law did not require the defendants to engage in the conduct that violated U.S. law. The majority concluded that there was therefore no “true conflict” between U.S. and U.K. law. But what if U.K law embodied a deliberate policy decision to leave these decisions unregulated and thus to permit the conduct that violated U.S. law? Should that be regarded as a conflict?

2. Comity. Does Hartford Fire mean that a conflict with foreign law is the only basis to forebear from applying U.S. law to foreign conduct that has a sufficient effect on U.S. commerce? Does “comity” have any other role to play? Should it?

3. Jurisdiction or substance. Did the result urged by Justice Scalia in dissent depend on whether the extraterritorial reach of the Sherman Act is a matter of jurisdiction or substantive law?

4. Them vs. Us. We noted before that the FTAIA was passed as part of the Export Trading Company Act of 1982 and that the statute’s express purpose, at least in part, seemed to be to take U.S. law out of the picture for U.S.-based export cartels that might inflict antitrust injury on people outside the United States. For better or worse, countries tend to protect their own. But this isn’t an issue that arises only in the United States. In Hartford Fire, the London reinsurance markets have consequences throughout the world. What incentives does the local British antitrust agency (now the Competition and Markets Authority, or CMA) have to police London cartels where most of the harmful consequences of those cartels are felt outside the country? How does the answer to that question influence how we should think about whether the Sherman Act should apply extraterritorially?

5. Bases for extraterritoriality. The FTAIA authorizes the application of U.S. antitrust laws to conduct that takes place outside the United States if that conduct had the requisite harmful effect within the United States. Different laws, however, may use different tests for whether, or to what extent, they have extraterritorial reach. For example, the Foreign Corrupt Practices Act applies to conduct outside the United States if the defendant is an issuer of securities in the United States, 15 U.S.C. § 78dd-1; the prohibition on employment discrimination found in Title VII of the Civil Rights Act of 1964 (as amended) applies to conduct outside the United States if the victim is a U.S. citizen and the employer is controlled by a U.S. person, see 42 U.S.C. § 2000e(f) and 2000e-1; and the antifraud provisions of the U.S. securities law apply if a substantial part of the conduct took place in the United States or the victims were located in the United States, see section 929P(b) of the 2010 Dodd-Frank Act, codified at 15 U.S.C. §§ 77v(c); 78aa(b); 80b-14(b). Criteria such as the location of conduct or harm and the nationality of the victim or the defendant are used in international law to justify the application of a nation’s law. See Restatement (Third) of Foreign Relations Law §§ 402, 403. Why do you think that the extraterritorial application of U.S. antitrust law was limited to cases in which the harm occurred within the United States, and was not extended to cases in which U.S. citizens are harmed outside the country or themselves committed acts prohibited by U.S. law from outside the country? Recall in this connection that antitrust laws can affect economic actors in several ways:
they can constrain the behavior of the actor; they can constrain the behavior of the actor’s competitors; and they can protect victims of unlawful conduct.

6. Provoking conflict. Intuitively, it would seem that adverse effects in the regulating nation provide the most legitimate basis for extraterritorial application of the nation’s laws. The argument that State A should stand aside and let others regulate the conduct seems stronger where the conduct did not cause harm in State A. But consider this: in a world with increasing global and multinational transactions and markets, antitrust violations often have harmful effects in many nations. In the case of a global price-fixing cartel, for example, dozens of nations could be harmed. If all of them applied their laws to conduct, no matter where it occurred, that had a harmful effect within their borders, the likelihood of a conflict among nations seeking to regulate the conduct could increase exponentially. How serious a problem is this? Does it cause you to reconsider the wisdom of effects-based jurisdiction? Would it be better to restrict extraterritorial application of each country’s antitrust laws to only those cases where the defendant is a resident or citizen of the regulating country?

7. Other implications of effects-based extraterritoriality. Even if widespread adoption of effects-based extraterritoriality did not generate direct conflicts among nations (or regulating authorities such as the EU Commission), it would still be the case that the competition laws of many nations would often apply to the same conduct, and those laws would undoubtedly not be identical. This could make compliance by businesses difficult, and thus increase transaction costs, as more and more jurisdictions review the same underlying behavior. This would also create opportunities for firms to seek governmental intervention in order to handicap their competitors. And even if the laws were substantively identical, multiple investigations increase the risk of false positives (i.e. incorrect findings of violations) because, while a mistaken failure to find a violation can be corrected by a later investigation, a mistaken finding of a violation cannot be corrected by a second (or Nth) investigation by a different agency. Is this a big enough problem to justify a cautious approach to extraterritoriality? What can be done to minimize this risk while maintaining the ability to reach international anticompetitive arrangements?

F. Hoffman–La Roche, Ltd. v. Empagran S.A.
Supreme Court of the United States, 2004.
542 U.S. 155.

BREYER, J., The Foreign Trade Antitrust Improvements Act of 1982 (FTAIA) excludes from the Sherman Act’s reach much anticompetitive conduct that causes only foreign injury. It does so by setting forth a general rule stating that the Sherman Act “shall not apply to conduct involving trade or commerce ... with foreign nations.” It then creates exceptions to the general rule, applicable where (roughly speaking) that conduct significantly harms imports, domestic commerce, or American exporters.

We here focus upon anticompetitive price-fixing activity that is in significant part foreign, that causes some domestic antitrust injury, and that independently causes separate foreign injury. We ask two questions about the price-fixing conduct and the foreign injury that it causes. First, does that conduct fall within the FTAIA’s general rule excluding the Sherman Act’s application? That is to say, does the price-fixing activity constitute “conduct involving trade or commerce ... with foreign nations”? We conclude that it does.
Second, we ask whether the conduct nonetheless falls within a domestic-injury exception to the general rule, an exception that applies (and makes the Sherman Act nonetheless applicable) where the conduct (1) has a “direct, substantial, and reasonably foreseeable effect” on domestic commerce, and (2) “such effect gives rise to a [Sherman Act] claim.” §§ 6a(1)(A), (2). We conclude that the exception does not apply where the plaintiff’s claim rests solely on the independent foreign harm.

To clarify: The issue before us concerns (1) significant foreign anticompetitive conduct with (2) an adverse domestic effect and (3) an independent foreign effect giving rise to the claim. In more concrete terms, this case involves vitamin sellers around the world that agreed to fix prices, leading to higher vitamin prices in the United States and independently leading to higher vitamin prices in other countries such as Ecuador. We conclude that, in this scenario, a purchaser in the United States could bring a Sherman Act claim under FTAIA based on domestic injury, but a purchaser in Ecuador could not bring a Sherman Act claim based on foreign harm.

The plaintiffs in this case originally filed a class-action suit on behalf of foreign and domestic purchasers of vitamins under, inter alia, § 1 of the Sherman Act … and §§ 4 and 16 of the Clayton Act. … Their complaint alleged that petitioners, foreign and domestic vitamin manufacturers and distributors, had engaged in a price-fixing conspiracy, raising the price of vitamin products to customers in the United States and to customers in foreign countries.

As relevant there, petitioners moved to dismiss the suit as to the foreign purchasers (the respondents here), five foreign vitamin distributors located in Ukraine, Australia, Ecuador, and Panama, each of which bought vitamins from petitioners for delivery outside the United States describing the relevant transactions as “wholly foreign”). Respondents have never asserted that they purchased any vitamins in the United States or in transactions in United States commerce, and the question presented assumes that the relevant “transactions occur[ed] entirely outside U.S. commerce.” The District Court dismissed their claims. It applied the FTAIA and found none of the exceptions applicable. Thereafter, the domestic purchasers transferred their claims to another pending suit and did not take part in the subsequent appeal.

A divided panel of the Court of Appeals reversed. The panel concluded that the FTAIA’s general exclusionary rule applied to the case, but that its domestic-injury exception also applied. It basically read the plaintiffs’ complaint to allege that the vitamin manufacturers’ price-fixing conspiracy (1) had “a direct, substantial, and reasonably foreseeable effect” on ordinary domestic trade or commerce, i.e., the conspiracy brought about higher domestic vitamin prices, and (2) “such effect” gave “rise to a [Sherman Act] claim,” i.e., an injured domestic customer could have brought a Sherman Act suit, 15 U.S.C. §§ 6a(1), (2). Those allegations, the court held, are sufficient to meet the exception’s requirements.

The court assumed that the foreign effect, i.e., higher prices in Ukraine, Panama, Australia, and Ecuador, was independent of the domestic effect, i.e., higher domestic prices. But it concluded that, in light of the FTAIA’s text, legislative history, and the policy goal of deterring harmful price-fixing activity, this lack of connection does not matter. …

We granted certiorari to resolve a split among the Courts of Appeals about the exception’s application. Compare Den Norske Stats Oljeselskap As v. HeereMac Vof, 241 F.3d 420, 427 (C.A.5 2001) (exception does not apply where foreign injury independent of domestic harm), with Kruman v. Christie’s Int’l PLC, 284 F.3d 384,
The FTAIA seeks to make clear to American exporters (and to firms doing business abroad) that the Sherman Act does not prevent them from entering into business arrangements (say, joint-selling arrangements), however anticompetitive, as long as those arrangements adversely affect only foreign markets. See H.R. Rep. No. 97–686, pp. 1–3, 9–10 (1982) (hereinafter House Report). It does so by removing from the Sherman Act’s reach, (1) export activities and (2) other commercial activities taking place abroad, unless those activities adversely affect domestic commerce, imports to the United States, or exporting activities of one engaged in such activities within the United States.

This technical language initially lays down a general rule placing all (non-import) activity involving foreign commerce outside the Sherman Act’s reach. It then brings such conduct back within the Sherman Act’s reach provided that the conduct both (1) sufficiently affects American commerce, i.e., it has a “direct, substantial, and reasonably foreseeable effect” on American domestic, import, or (certain) export commerce, and (2) has an effect of a kind that antitrust law considers harmful, i.e., the “effect” must “give[e] rise to a [Sherman Act] claim.” §§ 6a(1), (2).

We ask here how this language applies to price-fixing activity that is in significant part foreign, that has the requisite domestic effect, and that also has independent foreign effects giving rise to the plaintiffs claim.

Respondents make a threshold argument. They say that the transactions here at issue fall outside the FTAIA because the FTAIA’s general exclusionary rule applies only to conduct involving exports. The rule says that the Sherman Act “shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations.” § 6a (emphasis added). The word “with” means between the United States and foreign nations. And, they contend, commerce between the United States and foreign nations that is not import commerce must consist of export commerce—a kind of commerce irrelevant to the case at hand.

The difficulty with respondents’ argument is that the FTAIA originated in a bill that initially referred only to “export trade or export commerce.” H.R. 5235, 97th Cong., 1st Sess., § 1 (1981). But the House Judiciary Committee subsequently changed that language to “trade or commerce (other than import trade or import commerce).” 15 U.S.C. § 6a. And it did so deliberately to include commerce that did not involve American exports but which was wholly foreign.

The House Report says in relevant part:

The Subcommittee’s ‘export’ commerce limitation appeared to make the amendments inapplicable to transactions that were neither import nor export, i.e., transactions within, between, or among other nations. . . . Such foreign transactions should, for the purposes of this legislation, be treated in the same manner as export transactions—that is, there should be no American antitrust jurisdiction absent a direct, substantial and reasonably foreseeable effect on domestic commerce or a domestic competitor. The Committee Amendment therefore deletes references to ‘export’ trade, and substitutes phrases such as ‘other than import’ trade. It is thus clear that wholly foreign transactions as well as export
transactions are covered by the amendment, but that import transactions are not.

House Report 9–10 (emphases added).

For those who find legislative history useful, the House Report’s account should end the matter. Others, by considering carefully the amendment itself and the lack of any other plausible purpose, may reach the same conclusion, namely that the FTAIA’s general rule applies where the anticompetitive conduct at issue is foreign.

We turn now to the basic question presented, that of the exception’s application. Because the underlying antitrust action is complex, potentially raising questions not directly at issue here, we reemphasize that we base our decision upon the following: The price-fixing conduct significantly and adversely affects both customers outside the United States and customers within the United States, but the adverse foreign effect is independent of any adverse domestic effect. In these circumstances, we find that the FTAIA exception does not apply (and thus the Sherman Act does not apply) for two main reasons.


This rule of statutory construction cautions courts to assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws. It thereby helps the potentially conflicting laws of different nations work together in harmony—a harmony particularly needed in today’s highly interdependent commercial world.

No one denies that America’s antitrust laws, when applied to foreign conduct, can interfere with a foreign nation’s ability independently to regulate its own commercial affairs. But our courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused. See *United States v. Aluminum Co. of America*, 148 F.2d 416, 443–444 (C.A.2 1945) (L. Hand, J.); 1 P. Areeda & D. Turner, Antitrust Law ¶ 236 (1978).

But why is it reasonable to apply those laws to foreign conduct insofar as that conduct causes independent foreign harm and that foreign harm alone gives rise to the plaintiff’s claim? Like the former case, application of those laws creates a
serious risk of interference with a foreign nation’s ability independently to regulate its own commercial affairs. But, unlike the former case, the justification for that interference seems insubstantial. See Restatement § 403(2) (determining reasonableness on basis of such factors as connections with regulating nation, harm to that nation’s interests, extent to which other nations regulate, and the potential for conflict). Why should American law supplant, for example, Canada’s or Great Britain’s or Japan’s own determination about how best to protect Canadian or British or Japanese customers from anticompetitive conduct engaged in significant part by Canadian or British or Japanese or other foreign companies?

We recognize that principles of comity provide Congress greater leeway when it seeks to control through legislation the actions of American companies, see Restatement § 402; and some of the anticompetitive price-fixing conduct alleged here took place in America. But the higher foreign prices of which the foreign plaintiffs here complain are not the consequence of any domestic anti-competitive conduct that Congress sought to forbid, for Congress did not seek to forbid any such conduct insofar as it is here relevant, i.e., insofar as it is intertwined with foreign conduct that causes independent foreign harm. Rather Congress sought to release domestic (and foreign) anticompetitive conduct from Sherman Act constraints when that conduct causes foreign harm. Congress, of course, did make an exception where that conduct also causes domestic harm. See House Report 13 (concerns about American firms’ participation in international cartels addressed through “domestic injury” exception). But any independent domestic harm the foreign conduct causes here has, by definition, little or nothing to do with the matter.

We thus repeat the basic question: Why is it reasonable to apply this law to conduct that is significantly foreign insofar as that conduct causes independent foreign harm and that foreign harm alone gives rise to the plaintiff’s claim? We can find no good answer to the question.

The Areeda and Hovenkamp treatise notes that under the Court of Appeals’ interpretation of the statute

... a Malaysian customer could ... maintain an action under United States law in a United States court against its own Malaysian supplier, another cartel member, simply by noting that unnamed third parties injured [in the United States] by the American [cartel member’s] conduct would also have a cause of action.

Effectively, the United States courts would provide worldwide subject-matter jurisdiction to any foreign suitor wishing to sue its own local supplier, but unhappy with its own sovereign’s provisions for private antitrust enforcement, provided that a different plaintiff had a cause of action against a different firm for injuries that were within U.S. [other-than-import] commerce. It does not seem excessively rigid to infer that Congress would not have intended that result.


We agree with the comment. We can find no convincing justification for the extension of the Sherman Act’s scope that it describes.

Respondents reply that many nations have adopted antitrust laws similar to our own, to the point where the practical likelihood of interference with the relevant interests of other nations is minimal. Leaving price fixing to the side, however, this Court has found to the contrary. See, e.g., Hartford Fire, 509 U.S. at 797–799 (noting that the alleged conduct in the London reinsurance market, while
illegal under United States antitrust laws, was assumed to be perfectly consistent with British law and policy; see also, e.g., 2 W. Fugate, Foreign Commerce and the Antitrust Laws § 16.6 (5th ed. 1996) (noting differences between European Union and United States law on vertical restraints).

Regardless, even where nations agree about primary conduct, say price fixing, they disagree dramatically about appropriate remedies. The application, for example, of American private treble-damages remedies to anticompetitive conduct taking place abroad has generated considerable controversy. ... And several foreign nations have filed briefs here arguing that to apply our remedies would unjustifyably permit their citizens to bypass their own less generous remedial schemes, thereby upsetting a balance of competing considerations that their own domestic antitrust laws embody. [Citing amicus briefs from the governments of Germany, Canada, and Japan.]

These briefs add that a decision permitting independently injured foreign plaintiffs to pursue private treble-damages remedies would undermine foreign nations' own antitrust enforcement policies by diminishing foreign firms' incentive to cooperate with antitrust authorities in return for prosecutorial amnesty. [Citing amicus briefs from the governments of Germany, Canada, and the United States.]

Respondents alternatively argue that comity does not demand an interpretation of the FTAIA that would exclude independent foreign injury cases across the board. Rather, courts can take (and sometimes have taken) account of comity considerations case by case, abstaining where comity considerations so dictate. Cf., e.g., Hartford Fire, supra, at 797, n. 24; United States v. Nippon Paper Industries Co., 109 F.3d 1, 8 (C.A.1 1997); Mannington Mills, Inc. v. Congoleum Corp., 595 F.2d 1287, 1294–1295 (C.A.3 1979).

In our view, however, this approach is too complex to prove workable. The Sherman Act covers many different kinds of anticompetitive agreements. Courts would have to examine how foreign law, compared with American law, treats not only price fixing but also, say, information-sharing agreements, patent-licensing price conditions, territorial product resale limitations, and various forms of joint venture, in respect to both primary conduct and remedy. The legally and economically technical nature of that enterprise means lengthier proceedings, appeals, and more proceedings—to the point where procedural costs and delays could themselves threaten interference with a foreign nation’s ability to maintain the integrity of its own antitrust enforcement system. Even in this relatively simple price-fixing case, for example, competing briefs tell us (1) that potential treble-damage liability would help enforce widespread anti-price-fixing norms (through added deterrence) and (2) the opposite, namely that such liability would hinder antitrust enforcement (by reducing incentives to enter amnesty programs). ... How could a court seriously interested in resolving so empirical a matter—a matter potentially related to impact on foreign interests—do so simply and expeditiously?

We conclude that principles of prescriptive comity counsel against the Court of Appeals’ interpretation of the FTAIA. Where foreign anticompetitive conduct plays a significant role and where foreign injury is independent of domestic effects, Congress might have hoped that America’s antitrust laws, so fundamental a component of our own economic system, would commend themselves to other nations as well. But, if America’s antitrust policies could not win their own way in the international marketplace for such ideas, Congress, we must assume, would
not have tried to impose them, in an act of legal imperialism, through legislative fiat.

Second, the FTAIA’s language and history suggest that Congress designed the FTAIA to clarify, perhaps to limit, but not to expand in any significant way, the Sherman Act’s scope as applied, to foreign commerce. See House Report 2–3. And we have found no significant indication that at the time Congress wrote this statute courts would have thought the Sherman Act applicable in these circumstances.

The Solicitor General and petitioners tell us that they have found no case in which any court applied the Sherman Act to redress foreign injury in such circumstances. ... See also [Den Norske Stats Oljeselskap As v. HeereMac Vof, 241 F.3d 420, 429 (5th Cir. 2001)] (“[W]e have found no case in which jurisdiction was found in a case like this—where a foreign plaintiff is injured in a foreign market with no injuries arising from the anticompetitive effect on a United States market”). And respondents themselves apparently conceded as much at a May 23, 2001, hearing before the District Court below.

Nevertheless, respondents now have called to our attention six cases, three decided by this Court and three decided by lower courts. In the first three cases the defendants included both American companies and foreign companies jointly engaged in anticompetitive behavior having both foreign and domestic effects. See Timken Roller Bearing Co. v. United States, 341 U.S. 593, 595 (1951) (agreements among American, British, and French corporations to eliminate competition in the manufacture and sale of anti-friction bearings in world, including United States, markets); United States v. National Lead Co., 332 U.S. 319, 325–328 (1947) (international cartels with American and foreign members, restraining international commerce, including United States commerce, in titanium pigments); United States v. American Tobacco Co., 221 U.S. 106, 171–172 (1911) (American tobacco corporations agreed in England with British company to divide world markets). In all three cases the plaintiff sought relief, including relief that might have helped to protect those injured abroad.

In all three cases, however, the plaintiff was the Government of the United States. A Government plaintiff, unlike a private plaintiff, must seek to obtain the relief necessary to protect the public from further anticompetitive conduct and to redress anticompetitive harm. And a Government plaintiff has legal authority broad enough to allow it to carry out this mission. 15 U.S.C. § 25; see also, e.g., United States v. E. I. du Pont de Nemours & Co., 366 U.S. 316, 334 (1961) (“[I]t is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor”). Private plaintiffs, by way of contrast, are far less likely to be able to secure broad relief. See California v. American Stores Co., 495 U.S. 271, 295 (1990) (“Our conclusion that a district court has the power to order divestiture in appropriate cases brought [by private plaintiffs] does not, of course, mean that such power should be exercised in every situation in which the Government would be entitled to such relief”); 2 P. Areeda & H. Hovenkamp, Antitrust Law §§ 303d–303e, pp. 40–45 (2d ed. 2000) (distinguishing between private and government suits in terms of availability, public interest motives, and remedial scope); Griffin, Extraterritoriality in U.S. and EU Antitrust Enforcement, 67 Antitrust L. J. 159, 194 (1999) (“[P]rivate plaintiffs often are unwilling to exercise the degree of self-restraint and consideration of foreign governmental sensibilities generally exercised by the U.S. Government”). This difference means that the Government’s
ability, in these three cases, to obtain relief helpful to those injured abroad tells us little or nothing about whether this Court would have awarded similar relief at the request of private plaintiffs.

Neither did the Court focus explicitly in its opinions on a claim that the remedies sought to cure only independently caused foreign harm. Thus the three cases tell us even less about whether this Court then thought that foreign private plaintiffs could have obtained foreign relief based solely upon such independently caused foreign injury.

Respondents also refer to three lower court cases brought by private plaintiffs. In the first, *Industria Siciliana Asfalti, Bitumi, S. p. A. v. Exxon Research & Engineering Co.*, 1977 WL 1353 (S.D.N.Y. 1977), a District Court permitted an Italian firm to proceed against an American firm with a Sherman Act claim based upon a purely foreign injury, i.e., an injury suffered in Italy. The court made clear, however, that the foreign injury was “inextricably bound up with … domestic restraints of trade,” and that the plaintiff “was injured … by reason of an alleged restraint of our domestic trade,” id., at *11, *12 (emphasis added), i.e., the foreign injury was dependent upon, not independent of, domestic harm. See Part VI, infra.

In the second case, *Dominicus Americana Bohio v. Gulf & Western Industries, Inc.*, 473 F. Supp. 680 (S.D.N.Y. 1979), a District Court permitted Dominican and American firms to proceed against a competing American firm and the Dominican Tourist Information Center with a Sherman Act claim based upon injury apparently suffered in the Dominican Republic. The court, in finding the Sherman Act applicable, weighed several different factors, including the participation of American firms in the unlawful conduct, the partly domestic nature of both conduct and harm (to American tourists, a kind of “export”), and the fact that the domestic harm depended in part upon the foreign injury. Id., at 688. The court did not separately analyze the legal problem before it in terms of independently caused foreign injury. Its opinion simply does not discuss the matter. It consequently cannot be taken as significant support for application of the Sherman Act here.

The third case, *Hunt v. Mobil Oil Corp.*, 550 F.2d 68, 72 (C.A.2 1977), involved a claim by Hunt, an independent oil producer with reserves in Libya, that other major oil producers in Libya and the Persian Gulf (the “seven majors”) had conspired in New York and elsewhere to make it more difficult for Hunt to reach agreement with the Libyan government on production terms and thereby eliminate him as a competitor. The case can be seen as involving a primarily foreign conspiracy designed to bring about foreign injury in Libya. But, as in *Dominicus*, the court nowhere considered the problem of independently caused foreign harm. Rather, the case was about the “act of state” doctrine, and the sole discussion of Sherman Act applicability—one brief paragraph—refers to other matters. 550 F.2d, at 72, and n. 2. We do not see how Congress could have taken this case as significant support for the proposition that the Sherman Act applies in present circumstances.

The upshot is that no pre–1982 case provides significant authority for application of the Sherman Act in the circumstances we here assume. Indeed, a leading contemporaneous lower court case contains language suggesting the contrary. See *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 613 (C.A.9 1976) (insisting that the foreign conduct’s domestic effect be “sufficiently large to present a cognizable injury to the plaintiffs” (emphasis added)).

Taken together, these two sets of considerations, the one derived from comity and the other reflecting history, convince us that Congress would not have
intended the FTAIA’s exception to bring independently caused foreign injury within the Sherman Act’s reach.

Respondents point to several considerations that point the other way. For one thing, the FTAIA’s language speaks in terms of the Sherman Act’s applicability to certain kinds of conduct. The FTAIA says that the Sherman Act applies to foreign “conduct” with a certain kind of harmful domestic effect. Why isn’t that the end of the matter? How can the Sherman Act both apply to the conduct when one person sues but not apply to the same conduct when another person sues? The question of who can or cannot sue is a matter for other statutes (namely, the Clayton Act) to determine.

Moreover, the exception says that it applies if the conduct’s domestic effect gives rise to “a claim,” not to “the plaintiff’s claim” or “the claim at issue.” 15 U.S.C. § 6a(2) (emphasis added). The alleged conduct here did have domestic effects, and those effects were harmful enough to give rise to “a” claim. Respondents concede that this claim is not their own claim; it is someone else’s claim. But, linguistically speaking, they say, that is beside the point. Nor did Congress place the relevant words “gives rise to a claim” in the FTAIA to suggest any geographical limitation; rather it did so for a more neutral reason, namely, in order to make clear that the domestic effect must be an adverse (as opposed to a beneficial) effect. See House Report 11 (citing National Bank of Canada v. Interbank Card Assn., 666 F.2d 6, 8 (C.A.2 1981)).

Despite their linguistic logic, these arguments are not convincing. Linguistically speaking, a statute can apply and not apply to the same conduct, depending upon other circumstances; and those other circumstances may include the nature of the lawsuit (or of the related underlying harm). It also makes linguistic sense to read the words “a claim” as if they refer to the “plaintiffs claim” or “the claim at issue.”

At most, respondents’ linguistic arguments might show that respondents’ reading is the more natural reading of the statutory language. But those arguments do not show that we must accept that reading. And that is the critical point. The considerations previously mentioned—those of comity and history—make clear that the respondents’ reading is not consistent with the FTAIA’s basic intent. If the statute’s language reasonably permits an interpretation consistent with that intent, we should adopt it. And, for the reasons stated, we believe that the statute’s language permits the reading that we give it.

Finally, respondents point to policy considerations that we have previously discussed, supra ... namely, that application of the Sherman Act in present circumstances will (through increased deterrence) help protect Americans against foreign-caused anticompetitive injury. As we have explained, however, the plaintiffs and supporting enforcement-agency amici have made important experience-backed arguments (based upon amnesty-seeking incentives) to the contrary. We cannot say whether, on balance, respondents’ side of this empirically based argument or the enforcement agencies’ side is correct. But we can say that the answer to the dispute is neither clear enough, nor of such likely empirical significance, that it could overcome the considerations we have previously discussed and change our conclusion.
For these reasons, we conclude that petitioners’ reading of the statute’s language is correct. That reading furthers the statute’s basic purposes, it properly reflects considerations of comity, and it is consistent with Sherman Act history.

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We have assumed that the anticompetitive conduct here independently caused foreign injury; that is, the conduct’s domestic effects did not help to bring about that foreign injury. Respondents argue, in the alternative, that the foreign injury was not independent. Rather, they say, the anticompetitive conduct’s domestic effects were linked to that foreign harm. Respondents contend that, because vitamins are fungible and readily transportable, without an adverse domestic effect (i.e., higher prices in the United States), the sellers could not have maintained their international price-fixing arrangement and respondents would not have suffered their foreign injury. They add that this “but for” condition is sufficient to bring the price-fixing conduct within the scope of the FTAIA’s exception.

The Court of Appeals, however, did not address this argument, ... and, for that reason, neither shall we. Respondents remain free to ask the Court of Appeals to consider the claim. The Court of Appeals may determine whether respondents properly preserved the argument, and, if so, it may consider it and decide the related claim.

For these reasons, the judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

■ O'CONNER, J. took no part in the consideration or decision of this case.

■ SCALIA, J., with whom THOMAS, J., joins, concurring in the judgment.

I concur in the judgment of the Court because the language of the statute is readily susceptible of the interpretation the Court provides and because only that interpretation is consistent with the principle that statutes should be read in accord with the customary deference to the application of foreign countries' laws within their own territories.

NOTES AND QUESTIONS

1. Remand. The Supreme Court’s Empagran decision left one significant issue unresolved: whether the foreign injuries alleged were independent of the domestic effects of the conduct at issue or whether, because vitamins are fungible and readily transportable, the sellers could not have maintained their international price-fixing arrangements and thus injured foreign buyers without higher prices in the United States. On remand, the D.C. Circuit concluded that the linkage idea the Supreme Court had identified was not supported by the record. See Empagran S.A. v. F. Hoffman-LaRoche, Ltd., 417 F.3d 1267 (D.C. Cir. 2005).

2. Foreign and domestic effects linked. A high threshold for proving linkage would be consistent with the Court’s general message of restraint in the remainder of the Empagran decision; conversely, if linkage could be proven easily, because of factors like fungibility, ease of transport, and world-market pricing, then the linkage idea in the opinion might have taken back with the left hand much of what the right hand gave. In the years following Empagran, the lower courts have generally imposed a stringent test for plaintiffs trying to bring foreign conduct within the reach of the U.S. antitrust laws.
The Second Circuit was the first to address the issue, in a case involving a conspiracy by foreign banks to fix the exchange rates for the Euro. *Sniado v. Bank Austria*, 378 F.3d 210 (2d Cir. 2004). There, the plaintiff alleged in his complaint that the “domestic component of the conspiracy was necessary ... for the conspiracy’s overall success.” *Sniado*, 378 F.3d at 213. Notably, the plaintiff refrained from asserting “that currency exchange fees in the United States reached supra-competitive levels, [or] that but for the European conspiracy’s effect on United States commerce, he would not have been injured in Europe.” The Second Circuit concluded that the allegation of a “necessary” link was too conclusory, and thus found that the conduct was outside the reach of the U.S. antitrust laws. *Id.* at 213.

The global marketplace theory also failed in three other cases involving fungible commodities. In a magnesium oxide case, the court declared that allowing the theory would “effectively nullify the Supreme Court’s ruling in *Empagran*.” *eMAG Solutions LLC v. Toda Kogyo Corp.*, No. C 02–1611 PJH, 2005 WL 1712084, at *8 (N.D. Cal. July 20, 2005). Plaintiffs claiming that the adverse effects on U.S. commerce were “necessary for the success of [a food additive price-fixing] conspiracy” were told that their theory had been “explicitly rejected in *Sniado*.” *Latino Quimica–Amtex v. Akzo Nobel Chemicals B.V.*, No. 03–Civ–10312 (HBDF), 2005 WL 2207017, at *11 (S.D.N.Y. Sept. 8, 2005). Finally, in a case alleging global price fixing of DRAM chips, the court dismissed the claims, stating “[t]here is simply no persuasive authority that plaintiff can muster to support an argument that ... [a] global price-fixing conspiracy sufficiently alleges causation ... post *Empagran I* and II.” *In re Dynamic Random Access Memory Antitrust Litig.*, Nos. C 02–1486 PJH & C 05–3026 PJH, 2006 WL 515629, at *5 (N.D. Cal. March 1, 2006.)

3. “Gives Rise to a Claim.” Once we put to one side the cases involving import commerce (and those touching only on domestic commerce), we are left with two requirements under the FTAIA: (1) the conduct must have a “direct, substantial, and reasonably foreseeable effect” on either U.S. domestic, foreign, or specified export commerce; and (2) it must otherwise give rise to a claim under U.S. antitrust law excluding the FTAIA itself. The next case examines the latter requirement in detail.

**Motorola Mobility LLC v. AU Optronics Corp.**

*United States Court of Appeals, Seventh Circuit, 2015.* 775 F.3d 816.

■POSNER, CIRCUIT JUDGE. ... Motorola, the plaintiff-appellant, and its ten foreign subsidiaries, buy liquid-crystal display (LCD) panels and incorporate them into cellphones manufactured by Motorola or the subsidiaries. The suit accuses foreign manufacturers of the panels of having violated section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing with each other on the prices they would charge for the panels. Those manufacturers are the defendants-appellees.

The appeal does not concern all the allegedly price-fixed LCD panels. (We’ll drop “allegedly” and “alleged,” for simplicity, and assume that the panels were indeed price-fixed—a plausible assumption since defendant AU Optronics has been convicted of participating in a criminal conspiracy to fix the price of panel components of the cellphones manufactured by Motorola’s foreign subsidiaries. *United States v. Hsiung*, 758 F.3d 1074 (9th Cir.2014).) About 1 percent of the panels sold by the defendants to Motorola and its subsidiaries were bought by, and delivered to, Motorola in the United States for assembly here into cellphones; to the extent that the prices of the panels sold to Motorola had been elevated by collusive pricing by the manufacturers, Motorola has a solid claim under section 1
of the Sherman Act. The other 99 percent of the cartelized components, however, were bought and paid for by, and delivered to, foreign subsidiaries (mainly Chinese and Singaporean) of Motorola. Forty-two percent of the panels were bought by the subsidiaries and incorporated by them into cellphones that the subsidiaries then sold to and shipped to Motorola for resale in the United States. Motorola did none of the manufacturing or assembly of these phones. The sale of the panels to these subsidiaries is the focus of this appeal.

Another 57 percent of the panels, also bought by Motorola’s foreign subsidiaries, were incorporated into cellphones abroad and sold abroad. As neither those cellphones nor their panel components entered the United States, they never became a part of domestic U.S. commerce, see 15 U.S.C. § 6a, and so, as we’re about to see, can’t possibly support a Sherman Act claim.

Motorola says that it “purchased over $5 billion worth of LCD panels from cartel members [i.e., the defendants] for use in its mobile devices.” That’s a critical misstatement. All but 1 percent of the purchases were made by Motorola’s foreign subsidiaries. The subsidiaries are not Motorola; they are owned by Motorola. Motorola and its subsidiaries do not, as it argues in its opening brief, function “as a ‘single enterprise.’ ” And from this we can begin to see the oddity of this case. If a firm is injured by unlawful acts of other firms, the firm may have a cause of action against the injurers but the firm’s owner does not. The victims of the price fixing of LCD panels were Motorola’s foreign subsidiaries. Motorola itself, along with U.S. purchasers of cellphones incorporating those panels, were at most derivative victims.

The district judge ruled that Motorola’s suit, insofar as it relates to the 99 percent of panels purchased by the foreign subsidiaries, is barred by 15 U.S.C. §§ 6a(1)(A), (2), which are sections of the Foreign Trade Antitrust Improvements Act, 15 U.S.C. § 6a. That act has been interpreted, for reasons of international comity (that is, good relations among nations), to limit the extraterritorial application of U.S. antitrust law. Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 273c2 (3d ed.2006). Sections 6a(1)(A) and (2) provide that the Sherman Act “shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless ... such conduct has a direct, substantial, and reasonably foreseeable effect ... on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations,” and also, in either case, unless the “effect [on import trade or domestic commerce] gives rise to a claim” under federal antitrust law. See, e.g., F. Hoffmann–La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 161–62, (2004); Minn–Chem, Inc. v. Agrium, Inc., 683 F.3d 845, 853–54 (7th Cir. 2012) (en banc).

It is essential to understand that these are two requirements. There must be a direct, substantial, and reasonably foreseeable effect on U.S. domestic commerce—the domestic American economy, in other words—and the effect must give rise to a federal antitrust claim. The first requirement, if proved, establishes that there is an antitrust violation; the second determines who may bring a suit based on it.

Had the defendants conspired to sell LCD panels to Motorola in the United States at inflated prices, they would be subject to the Sherman Act because of the exception in the Foreign Trade Antitrust Improvements Act for importing. That is the 1 percent, which is not involved in the appeal. Regarding the 42 percent, Motorola is wrong to argue that it is import commerce. It was Motorola, rather
than the defendants, that imported these panels into the United States, as components of the cellphones that its foreign subsidiaries manufactured abroad and sold and shipped to it. So it first must show that the defendants’ price fixing of the panels that they sold abroad and that became components of cellphones also made abroad but imported by Motorola into the United States had “a direct, substantial, and reasonably foreseeable effect” on commerce within the United States. The panels—57 percent of the total—that never entered the United States neither affected domestic U.S. commerce nor gave rise to a cause of action under the Sherman Act.

If the prices of the components were indeed fixed, there would be an effect on domestic U.S. commerce. And that effect would be foreseeable (because the defendants knew that Motorola’s foreign subsidiaries intended to incorporate some of the panels into products that Motorola would resell in the United States), could be substantial, and might well be direct rather than “remote,” the word we used in Minn–Chem, Inc. v. Agrium, Inc., supra, 683 F.3d at 856–57, to denote effects that the statutory requirement of directness excludes.

The price fixers had, it is true, been selling the panels not in the United States but abroad, to foreign companies (the Motorola subsidiaries) that incorporated them into cell-phones that the foreign companies then exported to the United States for resale by the parent company, Motorola. The effect of fixing the price of a component on the price of the final product was therefore less direct than the conduct in Minn–Chem, where “foreign sellers allegedly created a cartel, took steps outside the United States to drive the price up of a product that is wanted in the United States, and then (after succeeding in doing so) sold that product to U.S. customers.” Id. at 860 (emphasis added). But at the same time the facts of this case are not equivalent to what we said in Minn–Chem would definitely block liability under the Sherman Act: the “situation in which action in a foreign country filters through many layers and finally causes a few ripples in the United States.” Id. In this case components were sold by their manufacturers to the foreign subsidiaries, which incorporated them into the finished product and sold the finished product to Motorola for resale in the United States. This doesn’t seem like “many layers,” resulting in just “a few ripples” in the United States cellphone market, though, as we’ll see, the ripple effect probably was modest. We’ll assume that the requirement of a direct, substantial, and reasonably foreseeable effect on domestic commerce has been satisfied, as in Minn–Chem and Lotes Co. v. Hon Hai Precision Industry Co., 753 F.3d 395, 409–13 (2d Cir. 2014).

What trips up Motorola’s suit is the statutory requirement that the effect of anticompetitive conduct on domestic U.S. commerce give rise to an antitrust cause of action. 15 U.S.C. § 6a(2). The conduct increased the cost to Motorola of the cellphones that it bought from its foreign subsidiaries, but the cartel-engendered price increase in the components and in the price of cellphones that incorporated them occurred entirely in foreign commerce.

We have both direct purchasers—Motorola’s foreign subsidiaries—from the price fixers, and two tiers of indirect purchasers: Motorola, insofar as the foreign subsidiaries passed on some or all of the increased cost of components to Motorola, and Motorola’s cellphone customers, insofar as Motorola raised the resale price of its cellphones in an attempt to offload the damage to it from the price fixing to its customers. According to Motorola’s damages expert, B. Douglas Bernheim, the company raised the price of its cellphones in the United States by more than the increased price charged to it by its foreign subsidiaries. We have no information
about whether Motorola lost customers as a result—it may not have, if other cellphone sellers raised their prices as well. Perhaps because Motorola may actually have profited from the price fixing of the LCD panels, it has waived any claim that the price fixing affected the price that Motorola’s foreign subsidiaries charged, or were told by Motorola to charge, for the cellphones that they sold their parent. (We’ll come back to the issue of waiver.)

Whether or not Motorola was harmed indirectly, the immediate victims of the price fixing were its foreign subsidiaries, see *F. Hoffmann–La Roche Ltd. v. Empagran S.A.*, *supra,* 542 U.S. at 173–75, and as we said in the *Minn–Chem* case “U.S. antitrust laws are not to be used for injury to foreign customers,” 683 F.3d at 858. Motorola’s subsidiaries are governed by the laws of the countries in which they are incorporated and operate; and “a corporation is not entitled to establish and use its affiliates’ separate legal existence for some purposes, yet have their separate corporate existence disregarded for its own benefit against third parties.” *Disenos Artisticos E Industriales, S.A. v. Costco Wholesale Corp.*, 97 F.3d 377, 380 (9th Cir. 1996). For example, although for antitrust purposes Motorola contends that it and its subsidiaries are one (the “it” we referred to earlier), for tax purposes its subsidiaries are distinct entities paying foreign rather than U.S. taxes.

Distinct in *uno*, distinct in *omnibus*. Having submitted to foreign law, the subsidiaries must seek relief for restraints of trade under the laws either of the countries in which they are incorporated or do business or the countries in which their victimizers are incorporated or do business. The parent has no right to seek relief on their behalf in the United States.

Motorola wants us to treat it and all of its foreign subsidiaries as a single integrated enterprise, as if its subsidiaries were divisions rather than foreign corporations. But American law does not collapse parents and subsidiaries (or sister corporations) in that way. Some foreign nations, it is true, treat multinational enterprises as integrated units. See, e.g., Binda Sahni, “The Interpretation of the Corporate Personality of Transnational Corporations,” 15 *Widener L.J.* 1 (2005). A number of countries (mainly in the Third World) persuaded the U.N. General Assembly in 1974 to issue a resolution entitled “Charter of Economic Rights and Duties of States” that could be understood to intimate that First World parents were responsible for the actions of their Third World subsidiaries. For chapter 2, Article 2(b), of the Charter provides that each state has the right “to regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, cooperate with other States in the exercise of the right set forth in this subparagraph.” But the United States and other developed countries refused to buy that theory. They insisted, and continue to insist, that corporate formalities should be respected unless one of the recognized justifications for piercing the veil, or otherwise deeming a parent and a subsidiary one, is present. See, e.g., *On Command Video Corp. v. Roti*, 705 F.3d 267 (7th Cir. 2013); Sahni, *supra*, at 822-23. None is present in this case.

This is thus a case of derivative injury, and derivative injury rarely gives rise to a claim under antitrust law, for example by an owner or employee of, or an investor in, a company that was the target of, and was injured by, an antitrust violation. *Mid–State Fertilizer Co. v. Exchange National Bank of Chicago*, 877 F.2d
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1333, 1335–36 (7th Cir. 1989); see generally Brunswick Corp. v. Pueblo Bowl–O–Mat, 429 U.S. 477 (1977). Those derivative victims are said to lack “antitrust standing.” Often, as in the example just given, their claims would be redundant, because if the direct victim received full compensation there would be no injury to the owner, employee, or investor—he or it would probably be as well off as if the antitrust violation had never occurred. If Motorola’s foreign subsidiaries have been injured by violations of the antitrust laws of the countries in which they are domiciled, they have remedies; if the remedies are inadequate, or if the countries don’t have or don’t enforce antitrust laws, these are consequences that Motorola committed to accept by deciding to create subsidiaries that would be governed by the laws of those countries. (An important, and highly relevant, application of the concept of “antitrust standing” is the indirect-purchaser doctrine of the Illinois Brick case, discussed below.)

No doubt Motorola thinks U.S. antitrust remedies more fearsome than those available to its foreign subsidiaries under foreign laws. But that’s just to say that Motorola is asserting a right to forum shop. Should some foreign country in which one of its subsidiaries operates have stronger antitrust remedies than the United States does, Motorola would tell that subsidiary to sue under the antitrust law of that country.

A related flaw in Motorola’s case is its collision with the indirect-purchaser doctrine of Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977), which forbids a customer of the purchaser who paid a cartel price to sue the cartelist, even if his seller—the direct purchaser from the cartelist—passed on to him some or even all of the cartel’s elevated price. Motorola’s subsidiaries were the direct purchasers of the price-fixed LCD panels, Motorola and its customers indirect purchasers of the panels. Confusingly, at the oral argument Motorola’s able counsel stated his approval of the Illinois Brick doctrine, yet Motorola’s briefs assert, albeit without any basis that we can see, that the Foreign Trade Antitrust Improvements Act, because it does not mention Illinois Brick (or the indirect-purchaser doctrine, announced in that case), is not subject to it.

Because it is difficult to assess the impact of a price increase at one level of distribution on prices and profits at a subsequent level, and thus to apportion damages between direct and indirect (i.e., subsequent) purchasers (here, between Motorola’s subsidiaries, Motorola the parent, and Motorola’s cellphone customers), the indirect-purchaser doctrine cuts off analysis at the first level. This may result in a windfall for the direct purchaser, but preserves the deterrent effect of antitrust damages liability while eliding complex issues of apportionment. In this case the first sale was to a foreign subsidiary of Motorola that could sue the price fixers under the law of the country of which the subsidiary was a citizen, or the law of the countries of which the price fixers were citizens (or a country of which a particular price fixer that the subsidiary decided to sue was a citizen). Motorola, the American parent, the harm to which from the price fixing would be so difficult to estimate, could not sue under federal antitrust law.

Speaking of the difficulty of estimating harm to Motorola, we point out that although this suit is more than five years old there is a remarkable dearth of evidence from which to infer actual harm to Motorola. Its briefs lack the numbers one would need to infer, let alone to quantify, such harm. But the report of Motorola’s expert witness on damages, B. Douglas Bernheim, provides a basis for informed speculation. Suppose hypothetically that a cellphone costs a Motorola foreign subsidiary $100 to manufacture, and the subsidiary sells it to Motorola for
$120 to cover the costs of assembling the components that go to make up the cellphone, and of shipment. Motorola in turn resells the cellphone to American consumers for $150. One of the components costs the subsidiary $10 (10 percent of the total cost of the cellphone—this appears to be an approximately accurate estimate for the LCD panels installed in the cellphones). The manufacturers of that component form a cartel and raise the price to $12, a 20 percent increase. Now the cost of making the cellphone is $102, and to reflect this cost increase Motorola could be expected to direct the subsidiary to raise its price to Motorola from $120 to, say, $122. What would Motorola do next? It would like to maintain its profit margin, and so we might expect it to raise its resale price—the price of its cellphones to the American consumer—from $150 to $152. That would be only a 1.33 percent increase. Would Motorola lose sales and therefore profits? Who knows? The price increase is tiny, and competitors might think it more profitable to match it than to undercut it; they might think their sales would not fall appreciably and that their profit margins would be slightly higher. This would be an example of tacit collusion, which is not an antitrust violation.

It is uncertainties like these that confirm the wisdom of the indirect-purchaser doctrine of *Illinois Brick*.

Motorola claims that it told the subsidiaries how much they could pay the cartel sellers for the panels—that its subsidiaries “issued purchase orders at the price and quantity determined by Motorola in the United States” and that therefore Motorola was the real buyer of the panels and so the panels were really imported directly into the United States rather than being sold abroad to the subsidiaries. In other words, Motorola is pretending that its foreign subsidiaries are divisions rather than subsidiaries. But Motorola can’t just ignore its corporate structure whenever it’s in its interests to do so. It can’t pick and choose from the benefits and burdens of United States corporate citizenship. It isn’t claiming that its foreign subsidiaries owe taxes to the United States instead of to the foreign countries in which they are incorporated, countries that may have lower tax rates, or be less efficient at tax collection. It isn’t claiming that its foreign subsidiaries are bound by the workplace safety or labor laws of the United States. Having chosen to conduct its LCD purchases through legally distinct entities organized under foreign law, it cannot now impute to itself the harm suffered by them.

Motorola insists that it was the “target” of the price fixers—that they “integrated themselves into the design of Motorola’s U.S. products, and intentionally manipulated Motorola’s price negotiations by illegally exchanging Motorola-specific information.” But this is just inflated rhetoric used to describe, what is obvious, that firms engaged in the price fixing of a component are critically interested in the market demand for the finished product—knowledge of that demand is essential to deciding on the optimal price of the component. If the price fixers are too greedy and fix a very high price for the component, this may result in so high a price for the finished product that the sales of that product will fall and with it the purchases of the component and quite possibly the profits of the price fixers.

Motorola’s “target” theory of antitrust liability would nullify the doctrine of *Illinois Brick*. For we’ve just seen that in deciding how much to charge the direct purchaser, a cartel would always want to estimate the price at which the direct purchaser would resell in order to capture some or all of the resale profits. There is nothing unusual about firms’ trying to pass on cost increases to their buyers; the buyers are hurt but as long as *Illinois Brick* is the law their hurt doesn’t give them
an antitrust case of action. Thus in asking us not to “ignore the injuries defendants knowingly caused to Motorola’s U.S. business through their deliveries abroad,” Motorola ignores the fact that a cartel almost always knowingly causes injury to indirect purchasers, yet those purchasers are barred from suit by *Illinois Brick* and the doctrine of antitrust standing that the rule of that case instantiates.

It’s true that the opinion in *Illinois Brick* states that a “situation in which market forces have been superseded and the pass-on defense might be permitted is where the direct purchaser is owned or controlled by its customer.” *Id.* at 736 n. 16. But “might be” is not “is,” and the distinction is significant in this case. Although Motorola, the “customer,” owns its foreign subsidiaries—the “direct purchasers” of the components—they are incorporated under and regulated by foreign law. What remedies they may have, if they overpay for inputs that they buy abroad, are determined not by U.S. antitrust law but by the law of the countries in which the subsidiaries are incorporated and of which they are therefore citizens of, or the law of the countries in which the price fixers they bought from operate, or of the countries in which the purchases were made. And that is quite apart from *Illinois Brick* or other sources of U.S. antitrust law.

But supposing this is wrong and Motorola is correct that it and its subsidiaries “are one,” there was no sale by the subsidiaries to Motorola. Instead the component manufacturers (the price fixers) sold components to “the one,” which assembled them into cellphones, and “the one” sold the cellphones to U.S. consumers. The sales to consumers would therefore have been the first sales in the United States—the first in domestic commerce, since “the one” bought the price-fixed components abroad. Remember that the Foreign Trade Antitrust Improvements Act requires that the effect of an anticompetitive practice on domestic U.S. commerce must, to be subject to the Sherman Act, give rise to an antitrust cause of action. “The one” (Motorola and its foreign subsidiaries conceived of as a single entity) would have been injured abroad when “it” purchased the price-fixed components.

Motorola makes a last attempt to wiggle out from under *Illinois Brick* by arguing that there should be an exception to the indirect-purchaser doctrine for any case in which applying the doctrine would prevent any American company from suing. But Motorola insists that it dictates the price at which it buys cellphones from its subsidiaries, and it would be odd to think that Motorola could obtain antitrust damages on the basis of its own pricing decisions.

In any event Motorola waived in the district court any argument that it could base damages on the effect of the cartel’s pricing of components on the cost to Motorola of cellphones incorporating those components. It argued only that its foreign subsidiaries overpaid for the LCD panels. How the overcharge may have affected Motorola’s cellphone business because of the component price fixing was a path that Motorola stepped off of after the pleadings. Its *complaint* alleged that it paid more for cellphones that it purchased from its subsidiaries, but it then dropped the point in favor of arguing (as it did for example in a brief opposing summary judgment) that “this ‘effect’—the approval of a single, artificially-inflated LCD panel price in the United States—proximately caused all of Motorola’s damages, because that same artificially-inflated price applied wherever and whenever a Motorola facility placed a purchase order and paid for a panel.” But Motorola’s damages expert, Bernheim, discussed only the damages that Motorola’s foreign subsidiaries incurred from having to overpay for LCD panels. He made no attempt to estimate the increase in the price paid by Motorola for finished cellphones. Motorola even refused to respond to one of the defendants’
requests for an admission by saying: “Motorola is not basing its claims on the purchase of finished LCD Products [i.e., cellphones].”

There is still more that is wrong with Motorola’s case. Nothing is more common nowadays than for products imported to the United States to include components that the producers bought from foreign manufacturers. ... Even Motorola acknowledges “that a substantial percentage of U.S. manufacturers utilize global supply chains and foreign subsidiaries to effectively compete in the global economy.” Some of those foreign manufacturers are located in countries that do not have or, more commonly, do not enforce antitrust laws consistently or uniformly, or whose antitrust laws are more lenient than ours, especially when it comes to remedies, notably punitive damages (such as the treble-damages antitrust remedy authorized by section 4 of the Clayton Act, 15 U.S.C. § 15). As a result, the prices of many products exported to the United States doubtless are elevated to some extent by price fixing or other anticompetitive acts that would be punished in proceedings under the Sherman Act if committed in the United States. Motorola argues that “the district court’s ruling would allow foreign cartels to come to the United States” and “unfairly overcharge U.S. manufacturers.” Not true; the defendants did not sell in the United States and, if they were overcharging, they were overcharging other foreign manufacturers—the Motorola subsidiaries.

The Supreme Court has warned that rampant extraterritorial application of U.S. law “creates a serious risk of interference with a foreign nation’s ability independently to regulate its own commercial affairs.” F. Hoffmann–La Roche Ltd. v. Empagran S.A., supra, 542 U.S. at 165. The Foreign Trade Antitrust Improvements Act has been interpreted to prevent such “unreasonable interference with the sovereign authority of other nations.” Id. at 164. The position for which Motorola contends would if adopted enormously increase the global reach of the Sherman Act, creating friction with many foreign countries and “resent[ment at] the apparent effort of the United States to act as the world’s competition police officer,” a primary concern motivating the Foreign Trade Antitrust Improvements Act. United Phosphorus, Ltd. v. Angus Chemical Co., 322 F.3d 942, 960–62 (7th Cir. 2003) (en banc) (dissenting opinion), overruled on other grounds by Minn–Chem, Inc. v. Agrium, Inc., supra. It is a concern to which Motorola is—albeit for understandable financial reasons—oblivious.

Motorola’s foreign subsidiaries were injured in foreign commerce—in dealings with other foreign companies—and to give Motorola rights to take the place of its foreign companies and sue on their behalf under U.S. antitrust law would be an unjustified interference with the right of foreign nations to regulate their own economies. The foreign subsidiaries can sue under foreign law—are we to presume the inadequacy of the antitrust laws of our foreign allies? Would such a presumption be consistent with international comity, or more concretely with good relations with allied nations in a world in turmoil? To quote from the Empagran opinion again, “Why should American law supplant, for example, Canada’s or Great Britain’s or Japan’s own determination about how best to protect Canadian or British or Japanese customers from anticompetitive conduct engaged in significant part by Canadian or British or Japanese or other foreign companies?” 542 U.S. at 165.

So Motorola’s suit has no merit, but it remains to note the amicus curiae brief filed by the Justice Department with endorsements by officials from the FTC, the State Department, and the Department of Commerce. Although an earlier such
brief had urged us to vacate our original decision (which we did), and we assumed the Department wanted us to reverse the district court’s grant of partial summary judgment in favor of the defendants, there is no such contention in its present brief. It asks us only to “hold that the conspiracy to fix the price of LCD panels had a direct, substantial, and reasonably foreseeable effect on U.S. import and domestic commerce in cellphones incorporating these panels.” The brief argues that the criminal and injunctive provisions of the Sherman Act, which of course are provisions that the Justice Department enforces, are applicable to the conduct of the defendants. The brief is less than sanguine on whether Motorola can obtain damages. The indirect-purchaser doctrine is applicable only to damages suits, and the brief disclaims taking any position on the applicability of the doctrine to this case. It goes so far as to say that “permitting Motorola to recover on all its claims because it purchased some panels in import commerce would allow recovery for independently caused foreign injuries on the basis of happenstance.”

All that the government wants from us is a disclaimer that a ruling against Motorola would interfere with criminal and injunctive remedies sought by the government against antitrust violations by foreign companies. The government’s concern relates to the requirement of the Foreign Trade Anti-trust Improvements Act that foreign anticompetitive conduct have a direct, substantial, and reasonably foreseeable effect on domestic U.S. commerce to be actionable under the Sherman Act. If price fixing by the component manufacturers had the requisite statutory effect on cellphone prices in the United States, the Act would not block the Department of Justice from seeking criminal or injunctive remedies. Indeed, we noted earlier that the Department successfully prosecuted AU Optronics for criminal price-fixing of the LCD panels sold to Motorola’s foreign subsidiaries. But the Department does not suggest that the defendants’ conduct gave rise to an antitrust damages remedy for Motorola.

Motorola has lost its best friend.

That’s something of a surprise but a bigger surprise, given that representatives of the State and Commerce Departments have signed on to the Justice Department’s brief, is the absence of any but glancing references to the concerns that our foreign allies have expressed with rampant extraterritorial enforcement of our antitrust laws. We asked the government’s lawyer at the oral argument about those concerns, and he replied that the Justice Department has worked out a modus vivendi with foreign countries regarding the Department’s antitrust proceedings against foreign companies. We have no reason to doubt this. Again private damages actions went unmentioned.

The United States has entered into bilateral cooperation agreements with the European Union, and with Canada and other countries. See U.S. Dept. of Justice, “Antitrust Cooperation Agreements,” www.justice.gov/atr/public/international/int-arrangements.html. Both the Justice Department and the Federal Trade Commission now work with their foreign counterparts in major antitrust cases. No longer is the United States “the world’s competition policeman,” as it used to be called, because other nations have stricter antitrust laws, in some respects, than ours. Motorola’s inability to mount the kind of private antitrust suit that it is attempting in this case does not foredoom the use of antitrust law to prevent and punish the kind of foreign cartelization harmful to Motorola’s subsidiaries. The Justice Department, at least, seems confident that effective governmental remedies remain—and, as mentioned, the Department was successful in its
criminal prosecution of AU Optronics for conduct that Motorola seeks, improperly as we believe, to recover damages for in this case.

Of course Motorola wants damages for its subsidiaries, rather than just a cessation of the cartel activities that are hurting them. And foreign antitrust laws rarely authorize private damages actions. But as we said earlier, that’s just to say that Motorola is asserting a right to forum shop; that if some foreign country in which one of its subsidiaries operates happened to provide a more generous private damages remedy than American antitrust law provides, Motorola would direct that subsidiary to seek that remedy in that country. ***

The district court’s grant of partial summary judgment in favor of the defendants is:

AFFIRMED.

NOTES AND QUESTIONS

1. Direct purchasers. Suppose Motorola’s Chinese and Singaporean subsidiaries had joined Motorola as plaintiffs in the case. In that case, direct purchasers of the price-fixed goods would be plaintiffs, rather than the indirect purchaser. Could such a case have gone forward under the FTAIA, or would it have run into problems under the Supreme Court’s decision in Empagran?

2. Local subsidiaries. Multinational enterprises frequently operate through locally incorporated affiliates, as Motorola did here. The court placed great weight on corporate formalities when it concluded that Motorola was not the party injured by the cartel. Does the FTAIA require courts to overlook the economic reality of the situation (here, the fact that Motorola its foreign subsidiaries were, in reality, one economic unit)? Is any antitrust purpose served by a principle that, if a corporation chooses to use local subsidiaries, it is stuck with the consequences?

3. The Copperweld standard. Why did the court not use the “economic reality” standard that the Supreme Court adopted in Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984), in which it treated a parent and a wholly owned subsidiary as a single entity for purposes of section 1 of the Sherman Act? Should it have used that standard? (We discuss Copperweld in Chapter xx.)

4. Government suit. Suppose the Department of Justice had brought the identical case that Motorola filed. Would such a suit have survived a motion to dismiss based on the FTAIA, on the asserted ground that the cartel occurred outside the United States and had its primary effects solely on foreign parties? See United States v. Hsiung, 758 F.3d 1074 (9th Cir. 2014) (criminal prosecution of same cartel).

5. Transacting around the decision. In this and all cases, it is useful to consider how affected entities might change their behavior to adapt to the legal principle at stake.

(a) Does the Seventh Circuit’s opinion create an incentive for companies to refrain from establishing foreign subsidiaries in order to take advantage of the protections offered by the antitrust laws, even where establishing foreign subsidiaries would otherwise be efficient? Would that result further any purpose of the FTAIA?

(b) Does the Seventh Circuit’s opinion offer a playbook for companies seeking to avoid U.S. antitrust liability by selling products destined for the U.S. only to foreign subsidiaries of U.S. companies rather than to the U.S. companies themselves? Is such a result required by the FTAIA?
6. **Simple resale or component.** The last question above proceeds from the premise that the Seventh Circuit’s logic would clearly imply the same result if the products had been bought abroad and resold to a U.S. affiliate, even if they were not components assembled abroad into a different product. Is this a correct reading of the opinion?

7. **Comity.** The competition laws of most other countries do not include a private right of action, and in the few laws that do, it is much more limited than the U.S. counterpart. Should that fact have influenced the court’s comity analysis? How?

8. **Passing on higher costs.** If Motorola had not waived in the district court the theory that it could base damages on the effect of the cartel’s pricing of components on the cost to it of cellphones incorporating those components, would that theory have satisfied the FTAIA?

9. **Injunctive relief.** The court relied heavily on *Illinois Brick*, which as the court noted was a damages action. (We discuss *Illinois Brick* in Chapter 10.) Would or should the result in *Motorola* have been different if the plaintiff had sought only injunctive relief?

**C. FTAIA: JURISDICTION OR MERITS?**

Finally, we consider whether the FTAIA imposes a limitation on the subject-matter jurisdiction of the federal courts or if, instead, it describes the substantive reach of the law. Initially, courts took the former view. See, e.g., *United Phosphorus, Ltd. v. Angus Chemical Co.*, 322 F.3d 942, 960-62 (7th Cir. 2003) (en banc). But as the Supreme Court began taking a stricter view about what actually touches the power of the court to hear a case, as opposed to other issues, that question was reconsidered. In the next case, the Seventh Circuit overruled *United Phosphorus* on that point and adopted the substantive reach approach. Go back and reconsider Justice Scalia’s dissenting opinion in *Hartford Fire*: Did he foresee this? Does the new approach undermine the remainder of the majority’s reasoning in that case? If you were representing a foreign company, which rule would you prefer?

**Minn–Chem, Inc. v. Agrium Inc.**


- **WOOD, CIRCUIT JUDGE.** Potash, a naturally occurring mineral used in agricultural fertilizers and other products, is produced and sold in a global market. In this case, the plaintiffs, U.S. companies that are direct and indirect purchasers of potash, accuse several global producers of price-fixing in violation of the U.S. antitrust laws. See 15 U.S.C. §§ 1 et seq. The district court denied the defendants’ motion to dismiss the complaint, but it certified its ruling for interlocutory appeal under 28 U.S.C. § 1292(b). We agreed with that court’s assessment of the importance of the issues presented and accepted the appeal. A panel of the court concluded that the complaint failed to meet the requirements of the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA), 15 U.S.C. § 6a, and it thus voted to reverse. *Minn–Chem, Inc. v. Agrium Inc.*, 657 F.3d 650 (7th Cir. 2011). We then decided to rehear the case *en banc*. We hold first that the FTAIA’s criteria relate to the merits of a claim, and not to the subject-matter jurisdiction of the court. We therefore overrule our earlier *en banc* decision in *United Phosphorus, Ltd. v. Angus Chem. Co.*, 322 F.3d 942 (7th Cir. 2003). We then address the applicable standards for antitrust cases involving import commerce and the restrictions imposed by the
FTAIA. We conclude that the district court correctly ruled that the complaint does state a claim under the federal antitrust laws.

I.

... The term “potash” refers to mineral and chemical salts that are rich in potassium. It is mined from naturally occurring ore deposits and its primary use is in agricultural fertilizers, but it is also used in the production of such varied products as glass, ceramics, soaps, and animal feed supplements. Importantly for our later antitrust analysis, potash is a homogeneous commodity: One manufacturer’s supply is interchangeable with another’s. As a result, buyers choose among suppliers based largely on price. Markets for this type of product are especially vulnerable to price-fixing.

We focus our analysis on the Direct Purchaser Amended Consolidated Class Action Complaint (referred to here simply as the Complaint), because the complaint filed by the indirect potash purchasers focuses primarily on state law remedies (since indirect purchasers are not entitled to sue for damages under the federal antitrust laws, see Illinois Brick Co. v. Illinois, 431 U.S. 720, 729 (1977)). The Complaint alleges that the world’s potash reserves are confined to a handful of areas, with over half of global capacity located in just two regions—Canada and the former Soviet Union (in particular, Russia and Belarus). Commercially, the industry has been dominated by a small group of companies that market, sell, and distribute potash. The key actors are:

- Potash Corporation of Saskatchewan (Canada) Inc. and its U.S. subsidiary Potash Sales (USA), Inc. (collectively PCS), the world’s largest producer of potash;
- Mosaic Company and Mosaic Crop Nutrition (Mosaic) a Delaware company headquartered in Minnesota, number three globally;
- Agrium Inc. and Agrium U.S. Inc. (Agrium), a Canadian corporation and its wholly owned U.S. subsidiary;
- Uralkali, a Russian joint venture headquartered in Moscow; fifth largest in the world and holder of a one-half interest in JSC Belarusian Potash Company (Belarusian Potash), which acts as the exclusive distributor of potash for Uralkali;
- Belaruskali, a Belarusian company and the owner of the other one-half interest in Belarusian Potash, which, as it is for Uralkali, is Belaruskali’s exclusive distributor;
- Silvinit, a Russian company that sells potash throughout the world, including the United States; and
- IPC, another Russian company, which is Silvinit’s exclusive distributor.

The Complaint alleges that as of 2008, these seven entities produced approximately 71% of the world’s potash.

In 2008, the United States consumed 6.2 million tons of potash. Of that total, 5.3 million tons were imports, and PCS, Mosaic, Agrium, and Belarusian Potash (acting for both Uralkali and Belaruskali, its equal and joint owners) were responsible for the lion’s share of those sales. Data for other years covered by the Complaint are comparable.
The total world market for potash, in which the United States is an important consumer (second only to China), is allegedly under the thumb of a global cartel consisting primarily of the companies listed above. This cartel restrained global output of potash in order to inflate prices. The cartel members used a rolling strategy: They would first negotiate prices in Brazil, India, and China, and then use those prices as benchmarks for sales to U.S. customers. For example, in May 2004, the cartel arranged for prices to increase by $20 per ton for some foreign customers; shortly thereafter, prices in the United States went up by precisely the same amount.

The cartel initiated a sustained and successful effort to drive prices up beginning in mid–2003; by 2008 potash prices had increased at least 600%. The plaintiffs assert that this increase cannot be explained by a significant uptick in demand, changes in the cost of production, or other changes in input costs. In fact, U.S. consumption of fertilizer, of which potash is a consistent part, remained relatively steady throughout the period covered by this case; demand declined somewhat in 2008 but then returned to normal levels in 2009. One might think that the decrease in demand in 2008 was because of the increase in price, but the slippage in demand did not build up over the entire Class Period and appears to have been only temporary, and is thus not correlated to potash price movements. Furthermore, the specific allegation in the Complaint that a $100 per ton increase in the price of potash adds only $0.03 to the production cost of a bushel of corn suggests that demand for potash is inelastic. Prices for potash rose and stayed high, increasing even while fertilizer prices declined. Based on World Bank statistics, average fertilizer price indices rose from 1.0 to 2.2, and then fell back to 1.0 in 2008, while potash price indices started in 2008 at 1.0 and rose to 3.5 by the end of the year. Earnings by cartel members reinforce this picture of financial gain even in the face of waning demand: PCS posted first-quarter income figures in 2008 that tripled its previous-year figure, while Mosaic’s earnings for that quarter were up more than tenfold over the year before.

The Complaint goes into detail about ways in which the defendants managed their collective output. (A cartel will always try to restrict output to the level where marginal cost equals marginal revenue, but in the real world, this normally requires constant adjustment.) For example, when global demand for potash declined in 2005, rather than decreasing its price, PCS announced that it was shutting down three of its mines in November and December 2005 for “inventory control purposes.” This action had the effect of removing 1.34 million tons of potash from the market. At the same time, rather than jumping into the gap this drastic cutback created, Mosaic announced that it too was implementing temporary cutbacks that would remove an additional 200,000 tons from the market. These (allegedly) coordinated and deep reductions continued into 2006. In the first three months of that year, PCS reduced output from 2.4 million tons to 1.3 million tons, removing yet another 1.1 million tons from the market, or the equivalent of 32 weeks of mining. Uralkali reduced its output by 200,000 tons, and Belaruskali cut its exports back by 50%, or 250,000 tons. In the second quarter of that year, Silvinit followed suit with mine stoppages that removed about 100,000 tons from the market. Collectively, these three companies removed over half a million tons of potash from the market in early 2006. Their compatriots applauded the “discipline” of the former Soviet Union producers, “noting that many years earlier when demand for potash declined those same producers had sought to maintain volume over price and flooded the market with excess supply.”
China was a particular target of the cartel’s efforts, given its importance as a consumer. The shortages created by Uralkali’s and PCS’s supply restrictions in the first half of 2006 induced China to accept an increase in the price of potash. Shortly thereafter, a similar price increase was implemented throughout the world. Comparable actions took place in 2007. The plaintiffs assert that a number of the defendants had excess capacity throughout the period between 2003 and mid–2009 (which represents the Class Period defined in ¶ 1 of the Complaint). PCS, for instance, had a utilization rate of only 54% to 69%, and Uralkali bragged in December 2007 that it had the “ability to add significant capacity on the cheapest basis vs. global peers.” This pattern of restrained output made it possible for the cartel to maintain its inflated prices, but the excess capacity inevitably gave its members an easy opportunity to cheat, and so the group had to coordinate to ensure that its price control efforts were not undermined.

The Complaint also points to several ways in which the cartel members had the opportunity to cooperate, to conspire on future actions, and to monitor one another’s actions for possible cheating. First, the major suppliers participated in joint ventures that facilitated coordination. PCS, Agrium, and Mosaic were joint venturers and equal shareholders in Canpotex Ltd., a Canadian company that sold, marketed, and distributed potash throughout the world excluding the United States. Through that vehicle, those three companies had access to one another’s sensitive production and pricing information. Canpotex in turn entered into cooperative marketing agreements with the Russian and Belarusian entities. As part of those deals, Canpotex agreed to market Uralkali potash outside North America and Europe. For their part, the former Soviet producers coordinated their sales and marketing through Belarusian Potash. That joint venture, formed between Uralkali and Belaruskali in 2005, supplied 34% of the market for potash by the following year. Silvinit has sought to join the venture, and one of its owners (with a 20% share) owns 60% of the stock of Uralkali.

Beyond the access created by these structural relations among the entities, there were other more immediate opportunities to collude. The defendants routinely held meetings during the Class Period and engaged in an exchange program through which senior executives from each visited the others’ plants. These meetings gave the defendants an opportunity to exchange sensitive information. Critically, one such meeting of the key players at PCS, Canpotex, Mosaic, Uralkali, Belaruskali, and Silvinit—mostly at the presidential level—took place in October 2005. As we described above, in the very next month, November 2005, PCS and Mosaic announced significant production cutbacks; the others followed suit with additional supply reductions through the beginning of 2006.

In addition, all of the defendants are members of the International Fertilizer Industry Association and the Fertilizer Institute, and they regularly attended those trade organizations’ conferences. During one such meeting in Turkey, in May 2007, the defendants announced an additional price increase.

The Complaint contains, in its 165 paragraphs, many more details, which we discuss as needed below. What we have said here, however, is enough to set the stage for the two legal issues before us: how the FTAIA should be interpreted, and whether the district court correctly allowed this case to go forward.

II.

Whether this case can be entertained by a court in the United States turns on the global reach of the antitrust laws, and to a significant degree on the Foreign
Trade Antitrust Improvements Act of 1982, 15 U.S.C. § 6a. Before delving into the FTAIA’s requirements, however, we take this opportunity to revisit the question whether that law affects the subject-matter jurisdiction of the district court or if, on the other hand, it relates to the scope of coverage of the antitrust laws. Nine years ago, in United Phosphorus v. Angus Chemical, the en banc court concluded that the former interpretation was correct. 322 F.3d 942, 952 (7th Cir. 2003). In so doing, we relied on the legislative history of the statute, the vocabulary used by a number of commentators, and a number of court decisions that used the word “jurisdiction” in describing the requirement that challenged conduct must affect interstate or import commerce in specified ways.

Since that decision, the Supreme Court has emphasized the need to draw a careful line between true jurisdictional limitations and other types of rules. Thus, in Morrison v. National Australia Bank Ltd., 561 U.S. 247 (2010), which dealt with the securities laws, the Court squarely rejected the notion that the extraterritorial reach of § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), raises a question of subject-matter jurisdiction. Id. at 2877. “[T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. Subject-matter jurisdiction, by contrast, refers to a tribunal’s power to hear a case.” Id. at 2877. “As a matter of subject-matter jurisdiction, a court can hear a case where the parties are not citizens of the same states, but the case is not a case in which subject-matter jurisdiction is presented by diversity of citizenship.” Id. (citing Union Pacific R. Co. v. Locomotive Eng’rs & Trainmen Gen. Comm. of Adjustment, 558 U.S. 67 (2009); Arbaugh v. Y & H Corp., 546 U.S. 500, 514 (2006); United States v. Cotton, 535 U.S. 625, 630 (2002)). Notably, what may have been thought a nascent idea at the time United Phosphorus was decided … has now become a firmly established principle of statutory construction.

The panel in the present case had no quarrel with the proposition that this recent string of decisions undermined the holding in United Phosphorus. 657 F.3d at 653. It commented that “[t]hese intervening developments suggest that United Phosphorus may be ripe for reconsideration,” but it was hesitant to take that step on its own. The panel also observed that the same issue had recently come before the Third Circuit, which held that the FTAIA does not impose a jurisdictional limit but instead establishes an element of a Sherman Act claim. Id. at 659 n. 3 (citing Animal Sci. Prods., Inc. v. China Minmetals Corp., 654 F.3d 462 (3d Cir. 2011)). Indeed, the Animal Science opinion expressly approved the position of the United Phosphorus dissenters. 654 F.3d at 469 n. 8. We agree with the panel that this issue is indeed ripe for reconsideration and ought to be settled now.

The Supreme Court’s decision in Morrison, we believe, provides all the guidance we need to conclude that, like § 10(b) of the Exchange Act, the FTAIA sets forth an element of an antitrust claim, not a jurisdictional limit on the power of the federal courts. As the Court put it, limitations on the extraterritorial reach of a statute describe what conduct the law purports to regulate and what lies outside its reach. The Supreme Court itself used much the same language with respect to the antitrust laws in its decision in F. Hoffmann–La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004), which dealt specifically with the FTAIA. The Court spoke, for example, of the FTAIA’s “removing from the Sherman Act’s reach” certain types of conduct, id. at 161, and whether it was reasonable under the facts presented there “to apply this law to conduct that is significantly foreign,” id. at 166. Even if one thought the language in Empagran to be less than dispositive, we can now see no way to distinguish this case from Morrison.

We add briefly that the interpretation we adopt today—that the FTAIA spells out an element of a claim—is the one that is both more consistent with the language of the statute and sounder from a procedural standpoint. When Congress
decides to strip the courts of subject-matter jurisdiction in a particular area, it speaks clearly. The FTAIA, however, never comes close to using the word “jurisdiction” or any commonly accepted synonym. Instead, it speaks of the “conduct” to which the Sherman Act (or the Federal Trade Commission Act) applies. This is the language of elements, not jurisdiction.

From a procedural standpoint, this means that a party who wishes to contest the propriety of an antitrust claim implicating foreign activities must, at the outset, use Federal Rule of Civil Procedure 12(b)(6), not Rule 12(b)(1). This is not a picky point that is of interest only to procedure buffs. Rather, this distinction affects how disputed facts are handled, and it determines when a party may raise the point. While “it is the burden of the party who seeks the exercise of jurisdiction in his favor clearly to allege facts demonstrating that he is a proper party to invoke judicial resolution,” *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 231 (1990) (citations and quotation marks omitted), we “accept as true all of the allegations contained in a complaint,” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007)) subject, of course, to the limitations articulated in those cases. Likewise, subject-matter jurisdiction must be secure at all times, regardless of whether the parties raise the issue, and no matter how much has been invested in a case. See, e.g., *Cotton*, 535 U.S. at 630 (citing *Louisville & Nashville R. Co. v. Mottley*, 211 U.S. 149 (1908)). By contrast, a motion to dismiss for failure to state a claim may only be brought as late as trial. FED.R.CIV.P. 12(h)(2). Although this is a significant difference, we note that foreign connections of the kind at issue here are unlikely to be difficult to detect, and so we are confident that parties who want to argue that a particular claim fails the requirements of the FTAIA will be able to do so within these generous time limits.

III.

Having established that the FTAIA relates to the merits of a claim, rather than the subject-matter jurisdiction of the court, we can now turn to the principal issues in this appeal. We consider first how the statute should be interpreted and then, on that understanding of the law, we decide whether the district court correctly found that the Complaint stated a claim that could go forward.

A.

Although the FTAIA has been parsed in a number of judicial opinions, including notably *Empagran*, we think it important to begin with the language of the statute, in order to place our discussion of these decisions in context. We note that the 1982 legislation that we are examining actually amended both the Sherman Act, see 15 U.S.C. § 6a, and the Federal Trade Commission Act, see 15 U.S.C. § 45(a)(3), using identical language. That fact is important insofar as it underscores the generality of the issue we face: The statute applies not only to private actions, such as this one, but also to actions brought by the two federal agencies entrusted with the enforcement of the antitrust laws. Since it is the Sherman Act that applies to our case, however, from this point forward we cite only its provision. It reads as follows [see page __, supra] ...

The opening phrase (sometimes referred to as a *chapeau* in international circles) reflects Congress’s effort to indicate that the Sherman Act does not apply to every arrangement that literally can be said to involve trade or commerce with foreign nations. As the Supreme Court stressed in *Empagran*, the public
recognition of this limitation was inspired largely by international comity. But, by inserting the parenthetical “other than import trade or import commerce” in the chapeau, Congress recognized that there was no need for this self-restraint with respect to imports, even though they represent part of the foreign commerce of the United States. Although some, including the Third Circuit in Animal Science, have referred to this as the “import exception,” that is not an accurate description. Import trade and commerce are excluded at the outset from the coverage of the FTAIA in the same way that domestic interstate commerce is excluded. This means only that conduct in both domestic and import trade is subject to the Sherman Act’s general requirements for effects on commerce, not to the special requirements spelled out in the FTAIA. Where the FTAIA does apply, it “remov[es] from the Sherman Act’s reach ... commercial activities taking place abroad, unless those activities adversely affect ... imports to the United States” Empagran, 542 U.S. at 161. The Court’s decision in Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993), suggests a pragmatic reason for this distinction: The applicability of U.S. law to transactions in which a good or service is being sent directly into the United States, with no intermediate stops, is both fully predictable to foreign entities and necessary for the protection of U.S. consumers. Foreigners who want to earn money from the sale of goods or services in American markets should expect to have to comply with U.S. law.

Next, we come to the statute’s treatment of non-import, non-domestic commerce. Empagran explained that the FTAIA handles that problem by “lay [ing] down a general rule placing all (nonimport) activity involving foreign commerce outside the Sherman Act’s reach ... [and then] bring[ing] such conduct back within” the Act provided that it meets the two criteria provided. Id. at 162, 124 Sc.D. 2359 (emphasis in original). The first criterion dictates the kinds of effects that truly foreign commerce must have in the U.S. market. Conduct “involving trade or commerce ... with foreign nations” must have “a direct, substantial, and reasonably foreseeable effect” on either [A] U.S. domestic commerce (phrased awkwardly as “trade or commerce which is not trade or commerce with foreign nations”) or U.S. import commerce, or [B] the export trade or commerce of a U.S. exporter. See § 6a(1). The export trade provision plays no part in our case, and so we do not address it further here. The second criterion, which was the focus of Empagran, is that the direct, substantial and foreseeable effect shown under subpart (1) must give rise to a substantive claim under the Sherman Act. The reason this was important in Empagran is that the plaintiffs there were foreign purchasers of allegedly price-fixed products that were sold in foreign markets. The Court held that their claims fell outside the scope of the Sherman Act. In our case, by contrast, the plaintiffs are all U.S. purchasers, and so the particular problem addressed in Empagran does not arise here.

Thus, before we can address the merits of the complaint, we must address two distinct questions of statutory interpretation. The first is how to define pure import commerce—that is, the kind of commerce that is not subject to the special rules created by the FTAIA. Second, we must explore the FTAIA’s standards further and explain what it takes to show that foreign conduct has a direct, substantial, and reasonably foreseeable effect on U.S. domestic or import commerce.

1.

There can be no question that the import commerce exclusion puts some of the conduct alleged in the Complaint outside the special rules created in the FTAIA for Sherman Act claims. The plaintiffs are U.S. entities that have purchased
potash directly from members of the alleged cartel. The defendant members of the cartel are all located outside the United States. Those transactions that are directly between the plaintiff purchasers and the defendant cartel members are the import commerce of the United States in this sector.

The FTAIA does not require any special showing in order to bring these transactions back into the Sherman Act, as Empagran put it, because they were never removed from the statute. That does not mean, however, that plaintiffs are home free. Rather, we must still apply the rules governing import commerce for purposes of the antitrust laws. For several decades, the leading authority on this subject was Judge Learned Hand’s opinion for the Second Circuit in United States v. Aluminum Co. of America, 148 F.2d 416, 444 (2d Cir. 1945) (Alcoa). There the court (sitting as a court of last resort because the Supreme Court lacked a quorum) held that the Sherman Act covers imports when actual and intended effects on U.S. commerce have been shown. In Hartford Fire, the Supreme Court confirmed this rule, stating that “the Sherman Act covers foreign conduct producing a substantial intended effect in the United States.” 509 U.S. at 797. The Third Circuit has suggested that this standard is met where “the defendants’ conduct target[s] import goods or services.” Animal Science, 654 F.3d at 470.

As noted, the Complaint before us alleges import transactions. Thus, the only outstanding question is whether this import trade has been substantially and intentionally affected by an anticompetitive arrangement (i.e., something that would violate the U.S. antitrust laws). There is nothing particularly “international” about that question. Effects on commerce are a part of every Sherman Act case. See, e.g., Hartford Fire, supra (import commerce); Summit Health, Ltd. v. Pinhas, 500 U.S. 322 (1991) (interstate commerce). We address the adequacy of the Complaint under the Sherman Act in more detail below.

2.

As we already have observed, trade involving only foreign sellers and domestic buyers (i.e., import trade) is not subject to the FTAIA’s extra layer of protection against Sherman Act claims implicating foreign activities. Some of the activities alleged in the Complaint, however, may be best understood as sufficiently outside the arena of simple import transactions as to require application of the FTAIA. For example, Canpotex is the unified marketing and sales agent for Agrium, Mosaic and PCS in all markets except Canada and the United States, yet its actions are an important part of the alleged scheme to set inflated benchmark prices. Presumably, in order to avoid Illinois Brick’s prohibition on “pass on” antitrust damages, 431 U.S. at 728, the plaintiffs are seeking to hold firms like Canpotex jointly and severally liable for any damages the direct sellers might be ordered to pay, perhaps under a conspiracy theory. If this were an action by the Department of Justice or the Federal Trade Commission, we would not need to worry about Illinois Brick, but regardless of whether the case is brought by the government or in private litigation, it is essential to meet the criteria spelled out by the FTAIA. We thus take a closer look at what kind of conduct “involve[s] trade or commerce ... with foreign nations” and what showing is necessary to demonstrate “direct, substantial and reasonably foreseeable” effects on domestic [i.e., “not trade or commerce with foreign nations”] or import commerce.

The first question—whether the conduct alleged in this case “involves” foreign commerce—is readily answered. The Complaint alleges an international cartel in a commodity, and it asserts that the cartel succeeded in raising prices for direct U.S. purchasers of the product, potash. This alleged arrangement plainly involves
foreign commerce, and so we move immediately to the second inquiry—the task of parsing the statute’s central requirements. As Empagran put it, after excluding foreign activities from the scope of the Sherman Act, the FTAIA brings back into the statute’s reach conduct that has a “direct, substantial, and reasonably foreseeable effect” on domestic or import commerce.

The potash cartel described in the Complaint is one for which the requirements of substantiality and foreseeability are easily met. There is little dispute that the Complaint has alleged substantial effects: The Complaint alleges that 5.3 million tons of potash were imported into the United States in 2008 alone, and the Complaint elsewhere asserts that the vast majority of these imports came from the defendants. From 2003 to 2008, the price of potash increased by over 600%. We do not need to belabor the point. These allegations easily satisfy the requirement to show substantial effects in the U.S. market. Wherever the floor may be, it is so far below these numbers that we do not worry about it here.

Foreseeability is equally straightforward. It is objectively foreseeable that an international cartel with a grip on 71% of the world’s supply of a homogeneous commodity will charge supracompetitive prices, and in the absence of any evidence showing that arbitrage is impossible (and there is none here), those prices (net of shipping costs) will be uniform throughout the world. Higher prices cannot be divorced from reductions in supply, and so the effects alleged here are a rationally expected outcome of the conduct stated in the Complaint.

The question that has caused more discussion among various courts and commentators is what it takes to show “direct” effects. One school of thought, launched by the Ninth Circuit’s split decision in United States v. LSL Biotechs., 379 F.3d 672 (9th Cir. 2004), has borrowed the definition of the word “direct” that the Supreme Court adopted for a different statute, the Foreign Sovereign Immunities Act (FSIA), 28 U.S.C. § 1605(a)(2); see Republic of Argentina v. Weltover, Inc., 504 U.S. 607 (1992). The word appears in the exception for foreign sovereign immunity that applies for commercial activity that takes place outside the territory of the United States when “that act causes a direct effect in the United States.” In that setting, the Court held that an effect is “direct” if it “follows as an immediate consequence of the defendant’s ... activity.” Id. at 618. The other school of thought has been articulated by the Department of Justice’s Antitrust Division, which takes the position that, for FTAIA purposes, the term “direct” means only “a reasonably proximate causal nexus.” Makan Delrahim, Drawing the Boundaries of the Sherman Act: Recent Developments in the Application of the Antitrust Laws to Foreign Conduct, 61 N.Y.U. ANN. SURV. AM. L. 415, 430 (2005) (remarks of the Deputy Assistant Attorney General); Brief for Appellant United States of America in United States v. LSL Biotechs., supra, available at http://www.justice.gov/atr/cases/f200200/200243.pdf (directness is a synonym for proximate cause).

In our view, the Ninth Circuit jumped too quickly to the assumption that the FSIA and the FTAIA use the word “direct” in the same way. Critically, the Supreme Court in Weltover reached its definition of “direct” for FSIA purposes only after refusing to import from the legislative history of that statute the notion that an effect is “direct” only if it is both “substantial” and “foreseeable.” 504 U.S. at 617. “[W]e reject,” it said, “the suggestion that § 1605(a)(2) contains any unexpressed requirement of ‘substantiability’ or ‘foreseeability.’” Id. at 618. Only then did the Court endorse the appellate court’s definition that an effect is “direct” if it follows “as an immediate consequence” of the defendant’s activity. Id.
No one needs to read the words “substantial” and “foreseeable” into the FTAIA. Congress put them there, and in so doing, it signaled that the word “direct” used along with them had to be interpreted as part of an integrated phrase. Superimposing the idea of “immediate consequence” on top of the full phrase results in a stricter test than the complete text of the statute can bear. To demand a foreseeable, substantial, and “immediate” consequence on import or domestic commerce comes close to ignoring the fact that straightforward import commerce has already been excluded from the FTAIA’s coverage.

We are persuaded that the Department of Justice’s approach is more consistent with the language of the statute. The word “direct” addresses the classic concern about remoteness—a concern, incidently, that has been at the forefront of international antitrust law at least since Judge Hand wrote in *Alcoa* that “[w]e should not impute to Congress an intent to punish all whom its courts can catch, for conduct which has no consequences within the United States.” 148 F.2d at 443; see also *LSL Biotechs.*, 379 F.3d at 683–91 (Aldisert, J., dissenting) (tracing the history of the FTAIA’s effects test through *Alcoa*). Just as tort law cuts off recovery for those whose injuries are too remote from the cause of an injury, so does the FTAIA exclude from the Sherman Act foreign activities that are too remote from the ultimate effects on U.S. domestic or import commerce.

This understanding of the FTAIA should allay any concern that a foreign company that does any import business at all in the United States would violate the Sherman Act whenever it entered into a joint-selling arrangement overseas regardless of its impact on the American market. A number of safeguards exist to protect against that risk. If the hypothetical foreign company is engaged in direct import sales, it must naturally comply with U.S. law just as all of its domestic competitors do. If its foreign sales do not meet the threshold for “effects” on import or domestic commerce established by cases such as *Hartford Fire* and *Summit Health*, then, for those transactions, it has nothing to worry about. If the hypothetical foreign company is engaged in the kind of conduct outside the United States that the FTAIA addresses, then its actions can be reached only if there are direct, substantial, and reasonably foreseeable effects. This is a standard with teeth, as the many cases that have been dismissed for failing to meet those criteria attest. E.g., *Turicentro, S.A. v. Am. Airlines, Inc.*, 303 F.3d 293 (3d Cir. 2002); *Carpet Grp. Intl v. Oriental Rug Imps. Ass’n*, 227 F.3d 62 (3d Cir. 2000); *McGlinchy v. Shell Chem. Co.*, 845 F.2d 802 (9th Cir. 1988); *Filetech S.A. v. France Telecom S.A.*, 212 F.Supp.2d 183 (S.D.N.Y. 2001).

*Empagran* is consistent with the interpretation we adopt here. While it holds that the U.S. antitrust laws are not to be used for injury to foreign customers, it goes on to reaffirm the well-established principle that the U.S. antitrust laws reach foreign conduct that harms U.S. commerce:

> [O]ur courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused.

*Empagran*, 542 U.S. at 165. Finally, we note that § 6a(2) will protect many a foreign defendant. No matter what the quality of the foreign conduct, the statute will not cover it unless the plaintiff manages to state a claim under the Sherman Act. In this connection, we point out that a great many joint-selling arrangements are legal, efficiency-enhancing structures. See, e.g., *Texaco Inc. v. Dagher*, 547 U.S.
CHAPTER 7 G LOBAL ECONOMY


B.

Having described the requirements for both simple import commerce and the FTAIA, our final task is to measure the Complaint against these standards. In particular, we must decide whether the plaintiffs have plausibly alleged that the defendants’ conduct took place either in import commerce and are thus subject to the more general rules of Hartford Fire for effects on commerce, or if they have in whole or in part described conduct subject to the FTAIA, and if so, whether the allegations describe direct, substantial, and foreseeable effects on domestic or import commerce.

1.

In our view, much of the Complaint alleges straightforward import transactions. Under Hartford Fire the plaintiffs thus must allege that the conduct of the foreign cartel members was (1) meant to produce and (2) did in fact produce some substantial effect in the United States. See also Animal Science, 654 F.3d at 470 (“[T]he import trade or commerce [exclusion] requires that the defendants’ conduct target import goods or services.”). The Complaint contains ample material supporting both of those points.

The plaintiffs describe a tight-knit global cartel, similar to OPEC in its heyday, that restrained global output of potash so that prices throughout this homogeneous world market would remain artificially high. Just like the raisin producers in California in the famous state-action antitrust case, Parker v. Brown, 317 U.S. 341 (1943), who controlled 90% of the world market in raisins, the alleged cartel members here control a comparable share of the world market in potash. The purpose of this cartel was to inflate the profits of its members. Its alleged effect was substantial. The United States, according to the Complaint, is one of the two largest consumers of potash in the world, and approximately 85% of U.S. potash comes from overseas. From 2003 to 2008, the price of potash increased six-fold. The inference from these allegations is not just plausible but compelling that the cartel meant to, and did in fact, keep prices artificially high in the United States.

2.

We turn next to an analysis of the conduct that falls outside the import exclusion to determine whether it may nevertheless be subject to the Sherman Act under the FTAIA. For example, the Complaint alleges that Canpotex, a Canadian entity that does not sell directly into the United States, restricted supply during a period of especially difficult price negotiations with China. This supply restriction compelled Chinese buyers to accept a price increase. We assume for present purposes that none of this literally involved import trade. Our discussion, however, is rooted in the facts of this Complaint. In that connection, it is important to recall that the FTAIA itself demands that the facts of each case must be evaluated for compliance with its demands. We thus address only the situation before us, in which several members of the cartel sold directly into the United States and others allegedly worked with them in connection with those efforts. The question before us is thus whether the allegations in the plaintiffs' Complaint describe conduct that had a direct, substantial, and reasonably foreseeable effect on domestic or import commerce by, for example, setting a benchmark price intended to govern later U.S. sales.
As we noted above, the effects of the supply restriction on U.S. potash prices were foreseeable. So too were the effects of forcing foreign purchasers to accept higher prices in a commoditized and cartelized market: Either someone in the cartel would cheat, or a new entrant would begin to arbitrage its purchases, or, as the plaintiffs allege, the cartel would succeed in pushing prices up across all of its markets, including the United States. And, as we have explained, there is every reason to infer that any such effects in the U.S. potash market were substantial.

We turn to the question whether these effects are “direct,” as we have defined the term. The plaintiffs allege that the defendants would first negotiate prices in Brazil, India, and China, and then they would use those prices for sales to U.S. customers. The alleged supply reductions led to price hikes in these foreign markets, and those increases showed up almost immediately in the prices of U.S. imports. The defendants do not suggest that the potash market is insulated from these effects by regulatory structures or other arrangements, and even if they did, that would be no reason to dismiss the Complaint outright. To the contrary, the plaintiffs have alleged that the cartel established benchmark prices in markets where it was relatively free to operate, and it then applied those prices to its U.S. sales. (Benchmark prices set in one market for general use are common: think, for instance of the London Interbank Offered Rate (LIBOR), in the credit market; the Brent Crude price, formally used for North Sea oil but in general use in oil markets; or even the Medicare Fee Schedule, which though technically only for Medicare reimbursements, has widespread effects on the healthcare market.) It is no stretch to say that the foreign supply restrictions, and the concomitant price increases forced upon the Chinese purchasers, were a direct—that is, proximate—cause of the subsequent price increases in the United States.

The allegations in the Complaint state a claim, as required by Federal Rule of Civil Procedure 8, and thus are enough to withstand a motion to dismiss under Rule 12(b)(6). … The Complaint is not defeated by the defendants’ contention that the alleged cartel was not efficacious. See In re High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651, 656 (7th Cir. 2002). We are also satisfied that the allegations suffice, at this stage, to support a plausible story of concerted action. See In re Text Messaging Antitrust Litig., 630 F.3d 622 (7th Cir. 2010). We stress, however, that our evaluation throughout has proceeded exclusively on the face of the Complaint. Nothing we have said should be understood as a prediction of the facts that may turn up in discovery, nor are we opining about the likely fate of any possible defenses. In particular, the defendants mentioned in their opposition to the petition for rehearing en banc that some of their actions were undertaken with the approval of foreign governments (e.g., Canada’s). We express no opinion on either the contours or the likely success of any such argument. Similarly, we do not have before us any question about the court’s personal jurisdiction over the various defendants. Cf. J. McIntyre Machinery, Ltd. v. Nicastro, 564 U.S. 873 (2011). We are not faced with the question of whether the actions of the non-selling defendants, such as Canpotex, fall outside the substantive scope of Sherman Act § 1 (as opposed to the law’s territorial reach), nor have the defendants argued that Congress as a matter of U.S. law has no constitutional power to enact laws with some extraterritorial effect. These or other theories may all be important to explore as the case goes forward, but they do not provide a reason to throw out the case on the grounds that the plaintiffs failed to show either that the challenged transactions occurred in import commerce or that they had a direct, substantial, and reasonably foreseeable effect on either the domestic or import commerce of the United States.
IV.

Foreign cartels, especially those over natural resources that are scarce in the United States and that are traded in a unified international market, have often been the target of either governmental or private litigation. The host country for the cartel will often have no incentive to prosecute it. Canada and Russia, here (just like California in Parker), would logically be pleased to reap economic rents from other countries; their losses from higher prices for the potash used in their own fertilizers are more than made up by the gains from the cartel price their exporters collect. Export cartels are often exempt from a country’s antitrust laws: the United States does just that, through its Webb–Pomerene Associations, see 15 U.S.C. §§ 61 et seq., and Export Trading Companies, see 15 U.S.C. §§ 4001 et seq. This case is actually the mirror image of the situation described in Empagran, where the foreign country whose consumers are hurt would have been the better enforcer. It is the U.S. authorities or private plaintiffs who have the incentive—and the right—to complain about overcharges paid as a result of the potash cartel, and whose interests will be sacrificed if the law is interpreted not to permit this kind of case.

The world market for potash is highly concentrated, and customers located in the United States account for a high percentage of sales. This is not a House—that–Jack–Built situation in which action in a foreign country filters through many layers and finally causes a few ripples in the United States. To the contrary: foreign sellers allegedly created a cartel, took steps outside the United States to drive the price up of a product that is wanted in the United States, and then (after succeeding in doing so) sold that product to U.S. customers. The payment of overcharges by those customers was objectively foreseeable, and the amount of commerce is plainly substantial. We AFFIRM the order of the district court denying the motion to dismiss for failure to state a claim.

NOTES AND QUESTIONS

1. Jurisdiction v. Merits. What exactly is at stake on the question whether the FTAIA is jurisdictional or instead about the applicable substantive scope of the Sherman Act? The language of the statute is the same either way and it isn’t as if we have different interpretative tools to apply to the statute depending on whether we are situated in federal jurisdiction or substantive antitrust? So why does it matter? (Hint: how will you go about deciding whether the necessary effects on the U.S. market are present? How many chances will you have?)

2. Joint and Several Liability in Antitrust. You are a Canadian potash firm. You are perfectly willing to join a cartel with other potash sellers and sell throughout the world, but you fear the U.S. treble damage regime and you decline to sell there. Your fellow cartelists aren’t such shrinking violets and sell into U.S. markets at inflated prices reflecting the success of the cartel. They get caught and face a Sherman Act case in the United States. Are you insulated from liability? After all, you didn’t sell directly into the U.S. markets. Or is the fact that you knowingly participated in the cartel and reaped its benefits enough to show that your role in the conspiracy had direct and foreseeable effects in U.S. markets? What turns on the answer to those questions?
1. **The Boundaries of Antitrust**

Any field needs to have a sense of its boundaries. What is inside and what is outside? Those boundaries need not be fixed permanently. At any given time, however, the field probably functions most straightforwardly if its essential limits are understood by the participants. Think about what that idea means for antitrust. In short, firms seeking to comply with antitrust law cannot do so if they don’t understand the essential contours of antitrust law.
Having known boundaries is even more important given antitrust’s punishment scheme. We will look at this in greater depth in the next chapter, but note for now that there is criminal antitrust enforcement and the core civil statute implements a treble damage regime. As mentioned in Chapter 1, people do go to jail for violating the antitrust laws (discussed in Chapter 1, supra [reference to Nash]). That fact raises standard issues about ignorance and knowledge of the law and the legitimacy of the state putting people in prison when the law is uncertain. That is not an issue distinctive to antitrust, but it arises here as well.

Then consider the treble damages regime. We will have to figure out how to measure damages in antitrust, but having done that, we will then have to multiply by three (as that might suggest, the second part is easier than the first part). Treble damages were baked into the Sherman Act from the very beginning—1890 as you will recall. Section 4 provides that the prevailing party in a civil action “shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney’s fee.” One function of treble damages is to correct against underenforcement of the statute. If we detected only half of antitrust violations, we would underdeter violations of the statute. To restore the deterrence we want to have (and making simplifying assumptions), we would need to double the penalties applied in those situations where we actually detect the violation. But the punitive nature of treble damages also raises issue about the clarity of antitrust boundaries.

Antitrust law is intended to promote economic welfare by prohibiting and deterring anticompetitive conduct. To serve its purpose, it also needs to be concerned about discouraging beneficial economic activity. Economic ingenuity generates enormous social value, and much of the rise in per capita incomes over the 20th Century can be attributed to it. If the fear of antitrust prosecution and treble damages -- and potentially incorrect judgments imposed by courts, juries, and regulators -- discouraged beneficial activity, that would be a substantial loss caused by the antitrust system.

That problem is made even worse by the fact that, as argued famously by Chicago School scholar Judge Frank Easterbrook, successful economic practices will often produce competitive losers who will be eager to seize upon whatever doctrines are available to seek redress in the courts. Because not every area of the law has a treble damages regime, disgruntled plaintiffs and their lawyers who believe that they have been injured by some practice might be eager to attempt to shoehorn that harm into antitrust’s treble damage regime.

Important limits on the reach of the antitrust laws were articulated in the Brunswick case discussed in Chapter 6 and in the Rambus case discussed in Chapter 8. The cases that follow set forth additional limits, starting with the Discon case we discussed in the last chapter in connection with Rambus.

A. SEPARATING ANTITRUST HARMs FROM OTHER HARMs

Antitrust law is not intended to enforce good behavior in general. The thing in question may be a bad thing, but that doesn’t necessarily make it an antitrust bad thing. We need to try to delimit what wrongs are within antitrust and which are outside it.

NYNEX Corp. v. Discon, Inc.
Supreme Court of the United States, 1998.
525 U.S. 128.

BREYER, J. In this case we ask whether the antitrust rule that group boycotts are illegal per se as set forth in Klor’s, Inc. v. Broadway–Hale Stores, Inc., 359 U.S. 207, 212 (1959), applies to a buyer’s decision to buy from one seller rather than another, when that decision cannot be justified in terms of ordinary competitive objectives. We hold that the per se group boycott rule does not apply.

violate Section 2 absent a duty to deal with the excluded rival. In a separate opinion, on behalf of himself and three other Justices, Justice Breyer said that he would not have reached the price squeeze question decided by the majority on the ground that that question could be addressed by the state regulatory body. Justice Breyer reasoned that, “[w]hen a regulatory structure exists to deter and remedy anticompetitive harm, the costs of antitrust enforcement are likely to be greater than the benefits.” He rejected the argument that the antitrust laws should not be displaced on the ground that the regulators could control only the wholesale prices, noting that plaintiffs could have asked the regulators to lower the wholesale prices “in light of the alleged price squeeze.” 129 S.Ct. at 1124.

8. Otter Tail’s status? Has Otter Tail in effect been overruled? In Otter Tail, the regulatory agency did not have a specific mandate to facilitate competition but did have the authority to oversee a tariff that the incumbent monopolist filed with the intent to harm or facilitate competition. The Otter Tail Court required the monopolist to file a tariff that “wheeled” power to a would-be rival and empowering the Federal Power Commission to oversee the terms of dealing that would be challenging for an antitrust court to oversee. For an argument that antitrust courts can and should take actions like those taken by the Court in Otter Tail, see Philip J. Weiser, Goldwasser, the Telecom Act, and Reflections on Antitrust Remedies, 55 ADMIN. L. REV. 1 (2003); and Philip J. Weiser, The Relationship of Antitrust and Regulation in a Deregulatory Era, 50 ANTITRUST BULL. 549, 557-61 (2005).

9. Comparing non-statutory exemptions. Is the “non-statutory” exemption for labor union activity (page XX, supra) based on the same principles as those articulated by the majority in Credit Suisse, or does it depend on considerations unique to labor markets and the labor laws?

C. STATE ACTION DOCTRINE

State law sometimes authorizes or requires private parties to take actions that significantly affect competition. To what extent should those actions be subject to federal antitrust laws? Viewed another way, why shouldn’t state law yield if there is a conflict with the federal antitrust laws; what happened to the Supremacy Clause? On the other hand, if state law always had to give way, what would be left of the state’s ability to regulate its own economy? Given the structure of federalism, should federal law be understood to allow space for states to operate even if their actions undermine the objectives of the antitrust laws? The next case is the key starting point for that doctrinal conversation.

Parker v. Brown
Supreme Court of the United States, 1943.
317 U.S. 341.

[Action brought by a producer and packer of raisins to enjoin various state officials charged with the administration of a marketing program under the California Agricultural Prorate Act. In order to “prevent economic waste in the marketing of agricultural products” and to “conserve the agricultural wealth of the State” the Act authorized the establishment of marketing programs which would “restrict competition among the growers and maintain prices” of certain agricultural products. The Act further authorized the establishment of a Commission which was to hold public hearings and make findings to the effect that the institution of a program would “prevent agricultural waste. . . without permitting unreasonable profits to producers.” The Commission could then select a program committee principally from nominees chosen by producers in the area, and the program committee was required to formulate a marketing program which the Commission, after public hearings, was authorized to approve.

The program would be instituted if consented to by 65 percent of the producers in the zone owning 51 percent of the acreage devoted to production of the particular crop. The zone in question in the case, Raisin Proration Zone No. 1, played an outsized role in U.S. and world raisin markets. Almost all of the raisins consumed in the U.S. were grown there
and was roughly 50% of the world crop. And 90-95% of the raisins grown in California were ultimately exported out of state to the rest of the country or the world.

The proration marketing program for raisins provided for classification of raisins as “standard,” “substandard,” and “inferior.” Inferior raisins were unfit for human consumption and were to be disposed of by the committee for by-product and other diversion purposes. Substandard raisins and at least 20 percent of total standard and substandard raisins were to be placed in a “surplus pool” to be disposed of for by-product and other diversion purposes with the producers receiving from $25 to $27.50 per ton. Of the remainder of the raisin crop, 50 percent was to be placed in a “stabilization pool” and disposed of by the committee “in such manner as to obtain stability in the market” with the producers receiving from $50 to $55 per ton; the other 30 percent was denominated “free tonnage” and could be sold through ordinary commercial channels if the producer paid a fee of $2.50 per ton.

Plaintiff-producer challenged the marketing program as invalid under both the “dormant” Commerce Clause of the Constitution and the Sherman Act.

STONE, C.J. . . . We may assume for present purposes that the California prorate program would violate the Sherman Act if it were organized and made effective solely by virtue of a contract, combination or conspiracy of private persons, individual or corporate. We may assume also, without deciding, that Congress could, in the exercise of its commerce power, prohibit a state from maintaining a stabilization program like the present because of its effect on interstate commerce . . . .

But it is plain that the prorate program here was never intended to operate by force of individual agreement or combination. It derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command. We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state’s control over its officers and agents is not lightly to be attributed to Congress.

The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state. The Act is applicable to “persons” including corporations, and it authorizes suits under it by persons and corporations. A state may maintain a suit for damages under it, . . . but the United States may not—conclusions derived not from the literal meaning of the words “person” and “corporation” but from the purpose, the subject matter, the context and the legislative history of the statute.

There is no suggestion of a purpose to restrain state action in the Act’s legislative history. The sponsor of the bill which was ultimately enacted as the Sherman Act declared that it prevented only “business combinations.” 21 Cong. Rec. 2562, 2457; see also at 2459, 2461. That its purpose was to suppress combinations to restrain competition and attempts to monopolize by individuals and corporations, abundantly appears from its legislative history. See Apex Hosiery Co. v. Leader, 310 U.S. 469, 492, 493 and n. 15; United States v. Addyston Pipe & Steel Co., 85 F. 271, affirmed 175 U.S. 211; Standard Oil Co. v. United States, 221 U.S. 1, 54–58.

True, a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful, Northern Securities Co. v. United States, 193 U.S. 197, 332, 344–347; and we have no question of the state or its municipality becoming a participant in a private agreement or combination by others for restraint of trade, cf. Union Pacific R. Co. v. United States, 313 U.S. 450. Here the state command to the Commission and to the program committee of the California Prorate Act is not rendered unlawful by the Sherman Act since, in view of the latter’s words and history, it must be taken to be a prohibition of individual and not state action. It is the state which has created the machinery for establishing the prorate program. Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of
producers, it is the state, acting through the Commission, which adopts the program and
which enforces it with penal sanctions, in the execution of a governmental policy. The
prerequisite approval of the program upon referendum by a prescribed number of
producers is not the imposition by them of their will upon the minority by force of
agreement or combination which the Sherman Act prohibits. The state itself exercises its
legislative authority in making the regulation and in prescribing the conditions of its
application. The required vote on the referendum is one of these conditions. . . .

The state in adopting and enforcing the prorate program made no contract or
agreement and entered into no conspiracy in restraint of trade or to establish monopoly
but, as sovereign, imposed the restraint as an act of government which the Sherman Act
did not undertake to prohibit. . . .

NOTES AND QUESTIONS

1. Federalism in Parker. In Parker, the benefit to the producers that participated in the
cartel was clear, and 90-95% of all raisins produced in California were exported outside the
state. California's residents would thus benefit from the cartel as producers much more than
they would be harmed as consumers. The apparent exploitation of out-of-state consumers in
dealing with local resources might have raised issues under the Commerce Clause of the U. S.
Constitution if Congress had not affirmatively exercised its commerce power in general
legislation supporting cartelization of agricultural products as national policy to combat the
depression in the 1930s. Would the antitrust laws have applied if the state statute had been
unconstitutional?

2. Role of Miller–Tydings. For many years, there was a statute known as the Miller–
Tydings Act, which immunized some forms of state “fair trade” laws from the Sherman Act.
That statute was passed before Parker was decided. Was it necessary, in retrospect, in light of
Parker? Reconsider this after reading California Retail Liquor Dealers Ass'n v. Midcal

two Phoenix attorneys challenged disciplinary rules prohibiting a lawyer from publicizing
himself or others in his firm through any form of advertising or “commercial publicity.” The
attorneys published a newspaper advertisement showing fees for the services of their “legal
clinic,” and for this, they were suspended from practice for a short period after a disciplinary
proceeding by the State Bar Association. The Supreme Court unanimously held the
disciplinary rules immune from Sherman Act challenge:

In Goldfarb we held that § 1 of the Sherman Act was violated by the publication of a
minimum-fee schedule by a county bar association and by its enforcement by the
State Bar. The schedule and its enforcement mechanism operated to create a rigid
price floor for services and thus constituted a classic example of price fixing. Both bar
associations argued that their activity was shielded by the state-action exemption.
This Court concluded that the action was not protected, emphasizing that “we need
to inquire further into the state-action question because it cannot fairly be said that
the State of Virginia through its Supreme Court Rules required the anticompetitive
activities of either respondent.” 421 U.S., at 790. In the instant case, by contrast, the
challenged restraint is the affirmative command of the Arizona Supreme Court under
its Rules 27(a) and 29(a) and its Disciplinary Rule 2–101(B). That court is the
ultimate body wielding the State’s power over the practice of law. . . and, thus, the
restraint is “compelled by direction of the State acting as a sovereign.” 421 U.S., at
791.

Appellants seek to draw solace from Cantor [in which the Court held that Parker does
not apply simply because the allegedly anticompetitive practice was embodied in a
tariff ‘routinely approved by the state public utility commission’]. . . . Since the
disciplinary rule at issue here is derived from the Code of Professional Responsibility
of the American Bar Association, appellants argue by analogy to Cantor that no
immunity should result from the bar’s success in having the Code adopted by the
State. They also assert that the interest embodied in the Sherman Act must prevail
over the state interest in regulating the bar. Particularly is this the case, they claim, because the advertising ban is not tailored so as to intrude upon the federal interest to the minimum extent necessary.

We believe, however, that the context in which Cantor arose is critical. . . . [T]he Court emphasized in Cantor that the State had no independent regulatory interest in the market for light bulbs. . . . There was no suggestion that the bulb program was justified by flaws in the competitive market or was a response to health or safety concerns. And an exemption for the program was not essential to the State’s regulation of electric utilities. In contrast, the regulation of the activities of the bar is at the core of the State’s power to protect the public. Indeed, this Court in Goldfarb acknowledged that “[t]he interest of the States in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been ‘officers of the courts.’” 421 U.S., at 792. . . . More specifically, controls over solicitation and advertising by attorneys have long been subject to the State’s oversight.

Federal interference with a State’s traditional regulation of a profession is entirely unlike the intrusion the Court sanctions in Cantor.

Finally, the light-bulb program in Cantor was instigated by the utility with only the acquiescence of the state regulatory commission. The State’s incorporation of the program into the tariff reflected its conclusion that the utility was authorized to employ the practice if it so desired. . . . The situation now before us is entirely different. The disciplinary rules reflect a clear articulation of the State’s policy with regard to professional behavior. Moreover, as the instant case shows, the rules are subject to pointed re-examination by the policymaker—the Arizona Supreme Court—in enforcement proceedings. Our concern that federal policy is being unnecessarily and inappropriately subordinated to state policy is reduced in such a situation; we deem it significant that the state policy is so clearly and affirmatively expressed and that the State’s supervision is so active.

Writing for a majority of five justices, Justice Blackmun then held that the First Amendment protects an attorney truthfully advertising the prices at which certain routine services may be performed. He reasoned that attorney advertising may be subject to some regulation but not blanket suppression, and, moreover, he suggested that the Court expected the bar would play a special role in assuring free but nondeceptive attorney advertising.

**California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.**

Supreme Court of the United States, 1980.

445 U.S. 97.

POWELL, J. . . . Under § 24866(b) of the California Business and Professions Code, all wine producers, wholesalers, and rectifiers must file fair trade contracts or price schedules with the State. If a wine producer has not set prices through a fair trade contract, wholesalers must post a resale price schedule for that producer’s brands. No state-licensed wine merchant may sell wine to a retailer at other than the price set “either in an effective price schedule or in an effective fair trade contract.”

The State is divided into three trading areas for administration of the wine pricing program. A single fair trade contract or schedule for each brand sets the terms for all

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1 The statute provides:

“Each wine grower, wholesaler licensed to sell wine, wine rectifier, and rectifier shall:

“(a) Post a schedule of selling prices of wine to retailers or consumers for which his resale price is not governed by a fair trade contract made by the person who owns or controls the brand.

“(b) Make and file a fair trade contract and file a schedule of resale prices, if he owns or controls a brand of wine resold to retailers or consumers.” Cal.Bus. & Prof.Code Ann. § 24866 (West 1964).
wholesale transactions in that brand within a given trading area. Similarly, state regulations provide that the wine prices posted by a single wholesaler within a trading area bind all wholesalers in that area. . . . A licensee selling below the established prices faces fines, license suspension, or outright license revocation. The State has no direct control over wine prices, and it does not review the reasonableness of the prices set by wine dealers.

Midcal Aluminum, Inc., is a wholesale distributor of wine in southern California. In July 1978, the Department of Alcoholic Beverage Control charged Midcal with selling 27 cases of wine for less than the prices set by the effective price schedule of the E. & J. Gallo Winery. The Department also alleged that Midcal sold wines for which no fair trade contract or schedule had been filed. Midcal stipulated that the allegations were true and that the State could fine it or suspend its license for those transgressions. Midcal then filed a writ of mandate in the California Court of Appeal for the Third Appellate District asking for an injunction against the State’s wine pricing system.

The Court of Appeal ruled that the wine pricing scheme restrains trade in violation of the Sherman Act. . . . An appeal was brought by the California Retail Liquor Dealers Association, an intervenor. The California Supreme Court declined to hear the case, and the Dealers Association sought certiorari from this Court. We granted the writ and now affirm the decision of the state court.

II

The threshold question is whether California’s plan for wine pricing violates the Sherman Act. This Court has ruled consistently that resale price maintenance illegally restrains trade. In Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 407 (1911), the Court observed that such arrangements are “designed to maintain prices . . ., and to prevent competition among those who trade in [competing goods].” For many years, however, the Miller–Tydings Act of 1937 permitted the States to authorize resale price maintenance. The goal of that statute was to allow the States to protect small retail establishments that Congress thought might otherwise be driven from the market place by large-volume discounters. But in 1975 that congressional permission was rescinded. The Consumer Goods Pricing Act of 1975, 89 Stat. 801, repealed the Miller–Tydings Act and related legislation. Consequently, the Sherman Act’s ban on resale price maintenance now applies to fair trade contracts unless an industry or program enjoys a special antitrust immunity.

California’s system for wine pricing plainly constitutes resale price maintenance in violation of the Sherman Act. The wine producer holds the power to prevent price competition by dictating the prices charged by wholesalers. As Mr. Justice Hughes pointed out in Dr. Miles, such vertical control destroys horizontal competition as effectively as if wholesalers “formed a combination and endeavored to establish the same restrictions. . . by agreement with each other.” 220 U.S., at 408. Moreover, there can be no claim that the California program is simply intrastate regulation beyond the reach of the Sherman Act. See Schwegmann Bros. v. Calvert Corp., supra; Burke v. Ford, 389 U.S. 320 (1967) (per curiam).

Thus, we must consider whether the State’s involvement in the price-setting program is sufficient to establish antitrust immunity under Parker v. Brown, 317 U.S. 341 (1943). That immunity for state regulatory programs is grounded in our federal structure. “In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state’s control over its officers and agents is not lightly to be attributed to Congress.” Id., at 351. In Parker v. Brown, this Court found in the Sherman Act no

2 Licensees that sell wine below the prices specified in fair trade contracts or schedules also may be subject to private damage suits for unfair competition.

5 The California Retail Liquor Dealers Association, a trade association of independent retail liquor dealers in California, claims over 3,000 members.
purpose to nullify state powers. Because the Act is directed against “individual and not state action,” the Court concluded that state regulatory programs could not violate it. *Id.*, at 352.

Under the program challenged in *Parker*, the State Agricultural Prorate Advisory Commission authorized the organization of local cooperatives to develop marketing policies for the raisin crop. The Court emphasized that the Advisory Commission, which was appointed by the Governor, had to approve cooperative policies following public hearings: “It is the state which has created the machinery for establishing the prorate program. . . . [I]t is the state, acting through the Commission, which adopts the program and enforces it. . . .” *Ibid.* In view of this extensive official oversight, the Court wrote, the Sherman Act did not apply. Without such oversight, the result could have been different. The Court expressly noted that “a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful. . . .” *Id.*, at 351.

Several recent decisions have applied *Parker*’s analysis. . . .* These decisions establish two standards for antitrust immunity under *Parker v. Brown*. First, the challenged restraint must be “one clearly articulated and affirmatively expressed as state policy”; second, the policy must be “actively supervised” by the State itself. *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 410 (1978) (opinion of Brennan, J.). The California system for wine pricing satisfies the first standard. The legislative policy is forthrightly stated and clear in its purpose to permit resale price maintenance. The program, however, does not meet the second requirement for *Parker* immunity. The State simply authorizes price-setting and enforces the prices established by private parties. The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any “pointed reexamination” of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement. As *Parker* teaches, “a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful. . . .” 317 U.S., at 351.

**NOTE: JUDICIAL ELABORATIONS ON MIDLACAL**

1. *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985). In this case, the United States brought an antitrust action against certain rate bureaus composed of private motor carriers operating in four southeastern states, each of which engaged in collective rate-setting for intrastate transactions (*i.e.*, price-fixing, in the Government’s opinion). The respective states authorized, but did not compel, that activity. The rate bureaus, on behalf of their members, submitted joint rate proposals to the Public Service Commissions in each State for approval or rejection. This collective ratemaking was authorized, but not compelled, by the States in which the rate bureaus operate. The lower courts ruled against the rate bureaus, and the Supreme Court “granted certiorari to decide whether petitioners’ collective ratemaking activities, though not compelled by the States in which they operate, are entitled to *Parker* immunity.”

The Court began by noting that, although *Parker* involved an action against a state official, the reasoning of that case extended to suits against private parties. The Court then turned to the substantive issue, noting that in *Midcal* the Court adopted the two-part test under which *Parker* immunity follows if (1) the restraint is one that is clearly articulated and affirmatively established as state policy and (2) the policy is actively supervised by the state itself.

The first part of that test was at issue in *Southern Motor Carriers*. The Court rejected the Government’s argument that only actual compulsion by the state would be sufficient to constitute “clear articulation” and “affirmative establishment” of the state policy. It explained

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* Ed. The Court then discussed the Goldfarb, Cantor, and New Motor Vehicle Board cases
that such analysis overlooked the importance of permissive state policies that allow a balance of collective ratemaking and individual submissions for lower rates by common carriers. The Court concluded that “[t]he federal antitrust laws do not forbid the States to adopt policies that permit, but do not compel, anticompetitive conduct by regulated private parties. As long as the State clearly articulates its intent to adopt a permissive policy, the first prong of the Midcal test is satisfied. . . .”

It explained its holding as follows:

The Parker doctrine represents an attempt to resolve conflicts that may arise between principles of federalism and the goal of the antitrust laws, unfettered competition in the marketplace. A compulsion requirement is inconsistent with both values. It reduces the range of regulatory alternatives available to the State. At the same time, insofar as it encourages States to require, rather than merely permit, anticompetitive conduct, a compulsion requirement may result in greater restraints on trade. We do not believe that Congress intended to resolve conflicts between two competing interests by impairing both more than necessary.

In summary, we hold Midcal’s two-pronged test applicable to private parties’ claims of state action immunity. Moreover, a state policy that expressly permits, but does not compel, anticompetitive conduct may be “clearly articulated” within the meaning of Midcal. Our holding today does not suggest, however, that compulsion is irrelevant. To the contrary, compulsion often is the best evidence that the State has a clearly articulated and affirmatively expressed policy to displace competition. See Town of Hallie v. City of Eau Claire. . . . Nevertheless, when other evidence conclusively shows that a State intends to adopt a permissive policy, the absence of compulsion should not prove fatal to a claim of Parker immunity. . . .

2. Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985). This case examined the other half of the Midcal test—what is enough to constitute active supervision—in the special context of municipal regulations. Specifically, it presented the question whether a municipality’s anticompetitive activities are protected by the state action exemption to the federal antitrust laws established by Parker v. Brown, 317 U.S. 341 (1943), when the activities are authorized, but not compelled, by the State, and the State does not actively supervise the anticompetitive conduct.

The plaintiffs were four unincorporated townships in Wisconsin that were suing the City of Eau Claire. Under the Federal Water Pollution Control Act, the City had obtained federal funds to help build a sewage treatment facility within the Eau Claire Service Area, which included the townships; the facility was the only one available to the townships. The City had refused to supply sewage treatment services to the townships, although it did supply the services to individual landowners located within the townships if the people living in that area voted in favor of annexation by the City and use of its sewage collection and transportation services.

Alleging that they were potential competitors of the City in the collection and transportation of sewage, the townships argued the City used its monopoly over sewage treatment to gain an unlawful monopoly over the provision of sewage collection and transportation services and that the City’s actions constituted an illegal tying arrangement and an unlawful refusal to deal. Both the district court and the Court of Appeals for the Seventh Circuit ruled in favor of the City.

The Supreme Court began its discussion of the Parker doctrine by noting that municipalities are not “the state” for purposes of the antitrust laws because they are not themselves sovereign, citing City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978). Rather, to obtain an exemption, municipalities (like the private parties in Southern Motor Carriers) must demonstrate that their anticompetitive activities were authorized by the State “pursuant to state policy to displace competition with regulation or monopoly public service.” The Court then summarized the rule pertaining to municipalities:

It is therefore clear from our cases that before a municipality will be entitled to the protection of the state action exemption from the antitrust laws, it must demonstrate that it is engaging in the challenged activity pursuant to a clearly expressed state
policy. We have never fully considered, however, how clearly a state policy must be articulated for a municipality to be able to establish that its anticompetitive activity constitutes state action. Moreover, we have expressly left open the question whether action by a municipality—like action by a private party—must satisfy the “active state supervision” requirement. City of Boulder, supra. We consider both of those issues below.

After a detailed examination of the provisions of Wisconsin law that allegedly authorized the City’s activities, the Court concluded that the statutes clearly contemplated that a city might engage in anticompetitive conduct. Such conduct is a foreseeable result of empowering the City to refuse to serve unannexed areas. It was not necessary for the state legislature to have stated explicitly that it expected the City to engage in conduct that would have anticompetitive effects. It was sufficient, instead, that the statutes authorized the City to provide sewage services and also to determine the areas to be served. The Court rejected the townships’ argument that the statutes at issue were neutral on state policy. “The Towns’ argument amounts to a contention that to pass the ‘clear articulation’ test, a legislature must expressly state in a statute or its legislative history that it intends for the delegated action to have anticompetitive effects. This contention embodies an unrealistic view of how legislatures work and of how statutes are written. No legislature can be expected to catalog all of the anticipated effects of a statute of this kind.”

In sum, the Court said, “we conclude that the Wisconsin statutes evidence a ‘clearly articulated and affirmatively expressed’ state policy to displace competition with regulation in the area of municipal provision of sewerage services. These statutory provisions plainly show that “the legislature contemplated the kind of action complained of.” City of Lafayette, supra. This is sufficient to satisfy the clear articulation requirement of the state action test.”

Finally, the Court held that the “active state supervision” requirement of the Midcal test should not be imposed in cases in which the actor is a municipality. That element served only an evidentiary function: it furnished one way of ensuring that the actor is engaging in the challenged conduct pursuant to state policy. The danger perceived in Midcal of a state’s circumventing the Sherman Act’s proscriptions “by casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement,” 445 U.S. at 10, might be a real one where a private party is engaging in the anticompetitive activity. “Where the actor is a municipality, there is little or no danger that it is involved in a private price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals. This danger is minimal, however, because of the requirement that the municipality act pursuant to a clearly articulated state policy. Once it is clear that state authorization exists, there is no need to require the State to supervise actively the municipality’s execution of what is a properly delegated function.”

Questions:

a. Was the Court correct in asserting that there is “little or no danger” that a municipality is “involved in a private price-fixing arrangement”?

b. In City of Lafayette, which is discussed in Town of Hallie, two Louisiana cities allegedly required that customers located outside city limits purchase electricity from their utilities as a condition of continued water and gas service to the detriment of competing private utilities. The Supreme Court rejected the cities’ “state action” defense, noting in a plurality opinion: (1) that municipalities must be distinguished from the states from which they derive their existence; (2) that they did not “exercise the sovereign power of the state” for “state action” purposes, since their interests are necessarily more parochial than, and might even conflict with, the broader interest of the states recognized in the Parker case; (3) that redress through political action did not protect those injured by municipalities’ conduct outside their borders; and (4) that, if the “62,437 different units of local government in this country . . . were free to make economic choices without regard to anticompetitive effects,” the national policy embodied in the antitrust laws would be seriously subverted. Would the case have been decided differently if it had come after Town of Hallie? What more do you need to know to answer that question?
3. *FTC v. Ticor Title Insurance Co.*, 504 U.S. 621 (1992). This was a case brought by the Federal Trade Commission against six of the nation’s largest title insurance companies, alleging horizontal price fixing in their fees for title searches and title examinations effectuated through rating bureaus in various states. The companies defended on the basis of both McCarran-Ferguson Act and state-action immunity.

The Commission (and ALJ) found that the rating bureaus were not pooling risk information or otherwise setting insurance rates according to actuarial loss experience. Instead, they were looking simply at profitability studies. Each of the four States in question used what has come to be called a “negative option” system to approve rate filings by the bureaus. This meant in practice that the rating bureau filed rates for title searches and title examinations with the state insurance office, and the rates became effective unless the state rejected them within a specified period, such as 30 days. Although the negative option system provided a theoretical mechanism for substantive review, the ALJ determined that the rate filings were subject to minimal scrutiny by state regulators.

This was not enough, in the Commission’s opinion, to rise to the level of “active supervision” for *Parker* and *Midcal* purposes. The court of appeals held that it was enough if a state regulatory program was staffed, funded, and empowered by law to supervise the private actions. The Supreme Court disagreed with that standard, with the following explanation:

The principle of freedom of action for the States, adopted to foster and preserve the federal system, explains the later evolution and application of the *Parker* doctrine in our decisions in *Midcal*, *supra*, and *Patrick v. Burget*, 486 U.S. 94 (1988). . . . *Midcal* confirms that while a State may not confer antitrust immunity on private persons by fiat, it may displace competition with active state supervision if the displacement is both intended by the State and implemented in its specific details. Actual state involvement, not deference to private price-fixing arrangements under the general auspices of state law, is the precondition for immunity from federal law. Immunity is conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint. In *Midcal* we found that the intent to restrain prices was expressed with sufficient precision so that the first part of the test was met, but that the absence of state participation in the mechanics of the price posting was so apparent that the requirement of active supervision had not been met....

Our decisions make clear that the purpose of the active supervision inquiry is not to determine whether the State has met some normative standard, such as efficiency, in its regulatory practices. Its purpose is to determine whether the State has exercised sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties. Much as in causation inquiries, the analysis asks whether the State has played a substantial role in determining the specifics of the economic policy. The question is not how well state regulation works but whether the anticompetitive scheme is the State’s own.

...The fact of the matter is that the States regulate their economies in many ways not inconsistent with the antitrust laws. For example, Oregon may provide for peer review by its physicians without approving anticompetitive conduct by them. . . . Or Michigan may regulate its public utilities without authorizing monopolization in the market for electric light bulbs. See *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 596 (1976). So we have held that state-action immunity is disfavored, much as are repeals by implication. *Lafayette v. Louisana Power & Light Co.*, 435 U.S. 389, 398–399 (1978). By adhering in most cases to fundamental and accepted assumptions about the benefits of competition within the framework of the antitrust laws, we increase the States’ regulatory flexibility. . . .

The respondents contend that these concerns are better addressed by the requirement that the States articulate a clear policy to displace the antitrust laws with their own forms of economic regulation. This contention misapprehends the close relation between *Midcal’s* two elements. Both are directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended
state policy. In the usual case, *Midcal*’s requirement that the State articulate a clear policy shows little more than that the State has not acted through inadvertence; it cannot alone ensure, as required by our precedents, that particular anticompetitive conduct has been approved by the State. It seems plain, moreover, in light of the *amici curiae* brief to which we have referred, that sole reliance on the requirement of clear articulation will not allow the regulatory flexibility that these States deem necessary. For States whose object it is to benefit their citizens through regulation, a broad doctrine of state-action immunity may serve as nothing more than an attractive nuisance in the economic sphere. To oppose these pressures, sole reliance on the requirement of clear articulation could become a rather meaningless formal constraint.

The Court held that, “to establish the requisite level of active supervision,” the party claiming the immunity must show that state officials have undertaken the necessary steps to determine the specifics of the price-fixing or rate-setting scheme. The Court distinguished between the mere potential for state supervision and an actual decision by the State.

The Court remanded for further findings on the actual extent of state supervision. Justice Scalia concurred, commenting that, while the Court’s standard was faithful to what prior cases had said about active supervision, it was troubling in its vagueness. He also noted that he was “skeptical about the *Parker v. Brown* exemption for state-programmed private collusion in the first place.” Chief Justice Rehnquist (with Justices O’Connor and Thomas joining him) dissented, finding that the Court’s standard was neither warranted by earlier cases nor sound as a matter of policy. He expressed concern about the way in which the courts were to decide whether a state had played a substantial enough role in determining the specifics of a policy to justify the immunity. Because, in the States at issue in the *Ticor* case itself, the particular conduct was approved by a state agency when it raised no objection, he would have found enough to satisfy the “active supervision” requirement.

4. *FTC v. Phoebe Putney Health Sys. Inc.*, 133 S. Ct. 1003 (2013). At issue was a Georgia statute, the Hospital Authorities Law, which authorized counties and municipalities to create “hospital authorities” — public bodies delegated all necessary and convenient powers to “carry out...the duty which the State owed to its indigent sick.” *Id.* at 1007 (quoting DeJarnette v. Hospital Auth. of Albany, 195 Ga. 189, 200 (1942)). The law expressly authorized the hospital authorities “[t]o acquire by purchase, lease, or otherwise and to operate” hospitals and health care facilities; “[t]o construct, reconstruct, improve, alter, and repair” these facilities, “[t]o establish rates and charges for the services and use of the facilities,” and to exercise eminent domain power. The law also provided that hospital authorities may not operate their facilities for profit, and that rates must be no higher than necessary to cover operating expenses and create reasonable reserves.

Pursuant to this law, a Georgia county created a hospital authority, which in turn formed a non-profit corporation, Phoebe Putney Health Systems (Phoebe Putney), to operate Phoebe Putney Memorial Hospital (Memorial Hospital). Phoebe Putney planned to purchase and operate the primary competing hospital in the region, Palmyra, which was owned by a private, for-profit entity. Together Palmyra and Memorial Hospital served 86% of customers in the six-county area. The Federal Trade Commission challenged Phoebe Putney’s purchase of Palmyra, claiming that it would result in a virtual monopoly in the market for healthcare services within the area. The district and appellate courts both concluded that Phoebe Putney was immune from antitrust liability under the state-action doctrine.

The Supreme Court reversed on the ground that the Hospital Authorities Law did not “expressly authorize” hospital authorities to engage in monopolistic or anticompetitive behavior. The Court reaffirmed that, in order for private parties executing a state program to be immune from antitrust liability, their anticompetitive action must be “clearly articulated and affirmatively expressed as state policy.” *Id.* (quoting *Midcal Aluminum*). The Hospital Authorities Law could not be said to “expressly authorize” anticompetitive conduct because authorization for the hospital authorities to participate in the market does not amount to authorization to engage in conduct that restricts competition. The anticompetitive conduct must be an “inherent, logical or ordinary result of the exercise of authority delegated by the state legislature.” In *Hallie*, by contrast. the statute authorizing municipalities to require a
town to incorporate into the city before they would provide the town with sewage services was an express authorization to engage in tying conduct because its purpose was to ensure that the city could force towns benefiting from city sewage service to become part of the city. Unlike the actors in Hallie, the hospital authority could carry out the activities described by the statute without engaging in anticompetitive behavior; and the statute thus cannot be said to expressly authorize anticompetitive behavior. It was not enough that the legislature would likely have foreseen the anticompetitive consequences of allowing the authority to purchase hospitals given the fact that there are few hospitals in many rural areas: “A reasonable legislature’s ability to anticipate that (potentially undesirable) possibility falls well short of clearly articulating an affirmatively state policy to displace competition with a regulatory alternative.”

Questions:

- In concluding that state-action immunity applied, the Eleventh Circuit observed that the statute granted remarkably broad authority to hospital authorities — it gave them power to do what is “necessary” and “convenient” to provide hospital services; it also gave the authorities the power of eminent domain. Does this broad grant of power to hospital authorities bear on whether the statute “expressly authorizes” anticompetitive behavior? Should it?
- The state of Georgia joined the FTC in filing suit in district court to enjoin Phoebe Memorial from acquiring Palmyra Hospital (though it dropped out of the litigation at the appellate stage). Does the fact that the state of Georgia joined in the suit to hold the hospital authority liable under federal antitrust law constitute an admission from the state that the hospital authority has not been “expressly authorized” to engage in anticompetitive practices? If the state opposes the anticompetitive practice, how can the state actor engaging in the practice be entitled to state-action immunity? Is there any problem with the state’s choosing a brief in court as the vehicle for the expression of a general state policy?

NOTES AND QUESTIONS

1. **Clear articulation requirement.** May any institution, agency, or part of state government, other than the legislature or the state’s highest court, provide state authorization for regulation rather than competition? See, e.g., Hoover v. Ronwin, 466 U.S. 558 (1984); Hardy v. City Optical Inc., 39 F.3d 765 (7th Cir. 1994); Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice 678–81 (1994).

2. **State supervision.** Was there adequate state supervision in the Parker case? After Ticor, how far may (or must) federal courts now go in reviewing the effectiveness of state supervision? What if a state commission is tilted towards—or corrupted by—a regulated group? Against what policy objectives should active supervision by the state be measured? Why do municipalities get a free pass, if they really are nothing more than corporate creations of the state? What about an actual state-owned corporation? What about an Indian tribe?

3. **Tacit supervision.** In 324 Liquor Corp. v. Duffy, 479 U.S. 335 (1987), the State of New York required retailers to charge at least 112 percent of the “posted” wholesale price for liquor, but permitted wholesalers to sell to retailers at less than the “posted” price. Justice Powell, writing for seven members of the Supreme Court, declared the legislation invalid and reasoned as follows:

   Section 101–bb directly restricts retail prices, and retailers are subject to penalties for failure to adhere to the resale price schedules. The New York statute, moreover, applies to all wholesalers and retailers of liquor. We have noted that industry wide resale price maintenance also may facilitate cartelization. . . . Mandatory industry wide resale price fixing is virtually certain to reduce interbrand competition as well as intrabrand competition, because it prevents manufacturers and wholesalers from allowing or requiring retail price competition. The New York statute specifically forbids retailers from reducing the minimum prices set by wholesalers. . . .

   Our decisions have established a two-part test for determining immunity under Parker v. Brown. . . . New York’s liquor pricing system meets the first requirement.
The state legislature clearly has adopted a policy of resale price maintenance. Just as clearly, however, New York’s liquor pricing system is not actively supervised by the State. As in Midcal, the State “simply authorizes price setting and enforces the prices established by private parties.” New York “neither establishes prices nor reviews the reasonableness of the price schedules.” New York “does not monitor market conditions or engage in any ‘pointed reexamination’ of the program.”

4. Local Government Antitrust Act. After the City of Lafayette and City of Boulder decisions, but before Town of Hallie, Congress responded to lower court treble damage awards against municipalities and municipal officials and a widespread fear of a deluge of such suits with the passage of the Local Government Antitrust Act of 1984. The Act prohibits plaintiffs from recovering monetary damages “from any local government, or official or employee thereof acting in an official capacity.” The Act also provides that no damages may be recovered from any person “based on any official action directed by a local government, or official or employee thereof acting in an official capacity.” The Act leaves intact the possibility of obtaining injunctive relief against local governments or other persons. In light of Town of Hallie and Omni Outdoor (p. 451 infra), should the Act now be repealed? (Note that the Eleventh Amendment makes unconstitutional a direct action for damages against the state, though it still usually permits an official-action case for injunctive relief against the responsible state official.)

5. Supervision standard with different state actors. What if, altering the facts of Goldfarb, the Supreme Court of Virginia, without specific legislative authority, had mandated minimum fee schedules and authorized each county bar to establish local levels of fees? Would complying associations, or their members, be subject to Sherman Act scrutiny? Would it make a difference if the Virginia Supreme Court reviewed each such schedule for reasonableness prior to its adoption? What if the Virginia Supreme Court (or the legislature) actually set mandatory minimum fee schedules itself?

6. Leegin. The underlying antitrust claim in Midcal was based on the 1911 Dr. Miles decision declaring minimum resale price maintenance a per se violation of Section 1 of the Sherman Act. Dr. Miles was subsequently overturned in Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007). Is there any reason to think that the Court would have approached the questions in Midcal differently if Leegin had been the law then?

North Carolina State Board of Dental Examiners v. FTC
Supreme Court of the United States, 2015.
135 S.Ct. 1101.

KENNEDY, J. This case arises from an antitrust challenge to the actions of a state regulatory board. A majority of the board’s members are engaged in the active practice of the profession it regulates. The question is whether the board’s actions are protected from

6 A simple “minimum markup” statute requiring retailers to charge 112 percent of their actual wholesale cost may satisfy the “active supervision” requirement, and so be exempt from the antitrust laws under Parker v. Brown, 317 U.S. 341 (1943). See Morgan v. Division of Liquor Control, 664 F.2d 353 (2d Cir. 1981) (upholding a simple markup statute). Section 101–bb, however, is not a simple minimum markup statute because it imposes a markup on the “posted bottle price,” a price that may greatly exceed what the retailer actually paid for the liquor. As we have explained, Bulletin 471 permits wholesalers to reduce the case price—the price actually paid by most retailers—without reducing the bottle price. The New York Court of Appeals expressly held that Bulletin 471 “is consistent with Alcoholic Beverage Control Law § 101–b(3) which does not mandate any price ratio between scheduled case and bottle prices.” . . . We thus have no occasion to consider whether a simple minimum markup statute would be entitled to antitrust immunity under Parker v. Brown.


13 See, e.g., Cohn v. Wilkes General Hospital, 767 F.Supp. 111 (W.D.N.C.), aff’d sub. nom., Cohn v. Bond, 953 F.2d 154 (4th Cir. 1991), cert. denied, 505 U.S. 1230 (1992) (rejecting claim that the Act does not protect private physician defendants, at a municipal hospital, if they use their official capacity “as a cloak for advancing their private economic interests” because the Act does not require consideration of the actors’ intentions but rather grants immunity for acts undertaken in an official capacity).
Sherman Act regulation under the doctrine of state-action antitrust immunity, as defined and applied in this Court’s decisions beginning with Parker v. Brown, 317 U.S. 341 (1943).

I

A

In its Dental Practice Act (Act), North Carolina has declared the practice of dentistry to be a matter of public concern requiring regulation. N.C. Gen. Stat. Ann. § 90–22(a) (2013). Under the Act, the North Carolina State Board of Dental Examiners (Board) is “the agency of the State for the regulation of the practice of dentistry.” § 90–22(b).

The Board’s principal duty is to create, administer, and enforce a licensing system for dentists. See §§ 90–29 to 90–41. To perform that function it has broad authority over licensees. See § 90–41. The Board’s authority with respect to unlicensed persons, however, is more restricted: like “any resident citizen,” the Board may file suit to “perpetually enjoin any person from ... unlawfully practicing dentistry.” § 90–40.1.

The Act provides that six of the Board’s eight members must be licensed dentists engaged in the active practice of dentistry. § 90–22. They are elected by other licensed dentists in North Carolina, who cast their ballots in elections conducted by the Board. Ibid. The seventh member must be a licensed and practicing dental hygienist, and he or she is elected by other licensed hygienists. Ibid. The final member is referred to by the Act as a “consumer” and is appointed by the Governor. Ibid. All members serve 3–year terms, and no person may serve more than two consecutive terms. Ibid. The Act does not create any mechanism for the removal of an elected member of the Board by a public official. See Ibid.

Board members swear an oath of office, § 138A–22(a), and the Board must comply with the State’s Administrative Procedure Act, § 150B–1 et seq., Public Records Act, § 132–1 et seq., and open-meetings law, § 143–318.9 et seq. The Board may promulgate rules and regulations governing the practice of dentistry within the State, provided those mandates are not inconsistent with the Act and are approved by the North Carolina Rules Review Commission, whose members are appointed by the state legislature. See §§ 90–48, 143B–30.1, 150B–21.9(a).

B

In the 1990’s, dentists in North Carolina started whitening teeth. Many of those who did so, including 8 of the Board’s 10 members during the period at issue in this case, earned substantial fees for that service. By 2003, nondentists arrived on the scene. They charged lower prices for their services than the dentists did. Dentists soon began to complain to the Board about their new competitors. Few complaints warned of possible harm to consumers. Most expressed a principal concern with the low prices charged by nondentists.

Responding to these filings, the Board opened an investigation into nondentist teeth whitening. A dentist member was placed in charge of the inquiry. Neither the Board’s hygienist member nor its consumer member participated in this undertaking. The Board’s chief operations officer remarked that the Board was “going forth to do battle” with nondentists. The Board’s concern did not result in a formal rule or regulation reviewable by the independent Rules Review Commission, even though the Act does not, by its terms, specify that teeth whitening is “the practice of dentistry.”

Starting in 2006, the Board issued at least 47 cease-and-desist letters on its official letterhead to nondentist teeth whitening service providers and product manufacturers. Many of those letters directed the recipient to cease “all activity constituting the practice of dentistry”; warned that the unlicensed practice of dentistry is a crime; and strongly implied (or expressly stated) that teeth whitening constitutes “the practice of dentistry.” In early 2007, the Board persuaded the North Carolina Board of Cosmetic Art Examiners to warn cosmetologists against providing teeth whitening services. Later that year, the Board sent letters to mall operators, stating that kiosk teeth whiteners were violating the
Dental Practice Act and advising that the malls consider expelling violators from their premises.

These actions had the intended result. Nondentists ceased offering teeth whitening services in North Carolina.

C

In 2010, the Federal Trade Commission (FTC) filed an administrative complaint charging the Board with violating § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The FTC alleged that the Board’s concerted action to exclude nondentists from the market for teeth whitening services in North Carolina constituted an anticompetitive and unfair method of competition. The Board moved to dismiss, alleging state-action immunity. An Administrative Law Judge (ALJ) denied the motion. On appeal, the FTC sustained the ALJ’s ruling. It reasoned that, even assuming the Board had acted pursuant to a clearly articulated state policy to displace competition, the Board is a “public/private hybrid” that must be actively supervised by the State to claim immunity. The FTC further concluded the Board could not make that showing.

Following other proceedings not relevant here, the ALJ conducted a hearing on the merits and determined the Board had unreasonably restrained trade in violation of antitrust law. On appeal, the FTC again sustained the ALJ. The FTC rejected the Board’s public safety justification, noting, inter alia, “a wealth of evidence ... suggesting that non-dentist provided teeth whitening is a safe cosmetic procedure”....

On petition for review, the Court of Appeals for the Fourth Circuit affirmed the FTC in all respects. This Court granted certiorari.

II

Federal antitrust law is a central safeguard for the Nation's free market structures. In this regard it is “as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.” United States v. Topco Associates, Inc., 405 U.S. 596 (1972). The antitrust laws declare a considered and decisive prohibition by the Federal Government of cartels, price fixing, and other combinations or practices that undermine the free market.

The Sherman Act, 15 U.S.C. § 1 et seq., serves to promote robust competition, which in turn empowers the States and provides their citizens with opportunities to pursue their own and the public’s welfare. See FTC v. Ticor Title Ins. Co., 504 U.S. 621, 632 (1992). The States, however, when acting in their respective realm, need not adhere in all contexts to a model of unfettered competition. While “the States regulate their economies in many ways not inconsistent with the antitrust laws,” id., at 635–636, in some spheres they impose restrictions on occupations, confer exclusive or shared rights to dominate a market, or otherwise limit competition to achieve public objectives. If every duly enacted state law or policy were required to conform to the mandates of the Sherman Act, thus promoting competition at the expense of other values a State may deem fundamental, federal antitrust law would impose an impermissible burden on the States’ power to regulate. See Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 133 (1978); see also Easterbrook, Antitrust and the Economics of Federalism, 26 J. Law & Econ. 23, 24 (1983).

III

In this case the Board argues its members were invested by North Carolina with the power of the State and that, as a result, the Board’s actions are cloaked with *Parker* immunity. This argument fails, however. A nonsovereign actor controlled by active market participants—such as the Board—enjoys *Parker* immunity only if it satisfies two requirements: “first that ‘the challenged restraint ... be one clearly articulated and affirmatively expressed as state policy,’ and second that ‘the policy ... be actively supervised by the State.’” FTC v. Phoebe Putney Health System, Inc., 568 U.S. ––––, –––– (2013) (quoting California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980)). The parties have assumed that the clear articulation requirement is satisfied, and we do the same. While North Carolina prohibits the unauthorized practice of dentistry, however, its Act is silent on whether that broad prohibition covers teeth whitening. Here, the Board did not receive active supervision by the State when it interpreted the Act as addressing teeth whitening and when it enforced that policy by issuing cease-and-desist letters to nondentist teeth whiteners.

A

Although state-action immunity exists to avoid conflicts between state sovereignty and the Nation’s commitment to a policy of robust competition, *Parker* immunity is not unbounded. “[G]iven the fundamental national values of free enterprise and economic competition that are embodied in the federal antitrust laws, 'state action immunity is disfavored, much as are repeals by implication.'” *Phoebe Putney*, supra, at ––––, 133 S.Ct., at 1010 (quoting *Ticor*, supra, at 636).

....State legislation and “decision[s] of a state supreme court, acting legislatively rather than judicially,” will satisfy this standard, and “ipso facto are exempt from the operation of the antitrust laws” because they are an undoubted exercise of state sovereign authority. *Hoover*, supra, at 567–568.

But while the Sherman Act confers immunity on the States’ own anticompetitive policies out of respect for federalism, it does not always confer immunity where, as here, a State delegates control over a market to a non-sovereign actor. See *Parker*, supra, at 351 (“[A] state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful”). For purposes of *Parker*, a nonsovereign actor is one whose conduct does not automatically qualify as that of the sovereign State itself. See *Hoover*, supra, at 567–568. State agencies are not simply by their governmental character sovereign actors for purposes of state-action immunity. See Goldfarb v. Virginia State Bar, 421 U.S. 773, 791 (1975) (“The fact that the State Bar is a state agency for some limited purposes does not create an antitrust shield that allows it to foster anticompetitive practices for the benefit of its members”). Immunity for state agencies, therefore, requires more than a mere facade of state involvement, for it is necessary in light of *Parker*’s rationale to ensure the States accept political accountability for anticompetitive conduct they permit and control. See *Ticor*, 504 U.S., at 636.

Limits on state-action immunity are most essential when the State seeks to delegate its regulatory power to active market participants, for established ethical standards may blend with private anticompetitive motives in a way difficult even for market participants to discern. Dual allegiances are not always apparent to an actor. In consequence, active market participants cannot be allowed to regulate their own markets free from antitrust accountability. See *Midcal*, supra, at 106 (“The national policy in favor of competition cannot be thwarted by casting [a] gauzy cloak of state involvement over what is essentially a private price-fixing arrangement”). **

*Parker* immunity requires that the anticompetitive conduct of nonsovereign actors, especially those authorized by the State to regulate their own profession, result from procedures that suffice to make it the State’s own. The question is not whether the challenged conduct is efficient, well-functioning, or wise. Rather, it is “whether anticompetitive conduct engaged in by [nonsovereign actors] should be deemed state action and thus shielded from the antitrust laws.” Patrick v. Burget, 486 U.S. 94, 100 (1988).
CHAPTER 9

To answer this question, the Court applies the two-part test set forth in California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, a case arising from California’s delegation of price-fixing authority to wine merchants. Under Midcal, “[a] state law or regulatory scheme cannot be the basis for antitrust immunity unless, first, the State has articulated a clear policy to allow the anticompetitive conduct, and second, the State provides active supervision of [the] anticompetitive conduct.” Ticor, supra, at 631, (citing Midcal, supra, at 105).

Midcal’s clear articulation requirement is satisfied “where the displacement of competition [is] the inherent, logical, or ordinary result of the exercise of authority delegated by the state legislature. In that scenario, the State must have foreseen and implicitly endorsed the anticompetitive effects as consistent with its policy goals.” Phoebe Putney, 568 U.S., at ——. The active supervision requirement demands, inter alia, “that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy.” Patrick, supra, 486 U.S., at 101.

* * *

Midcal’s supervision rule “stems from the recognition that ‘[w]here a private party is engaging in anticompetitive activity, there is a real danger that he is acting to further his own interests, rather than the governmental interests of the State.’” Patrick, supra, at 100. Concern about the private incentives of active market participants animates Midcal’s supervision mandate, which demands “realistic assurance that a private party’s anticompetitive conduct promotes state policy, rather than merely the party’s individual interests.” Patrick, supra, at 101.

B

In determining whether anticompetitive policies and conduct are indeed the action of a State in its sovereign capacity, there are instances in which an actor can be excused from Midcal’s active supervision requirement. In Hallie v. Eau Claire, 471 U.S. 34, 45 (1985), the Court held municipalities are subject exclusively to Midcal’s “clear articulation” requirement. That rule, the Court observed, is consistent with the objective of ensuring that the policy at issue be one enacted by the State itself. Hallie explained that “[w]here the actor is a municipality, there is little or no danger that it is involved in a private price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals.” 471 U.S., at 47. Hallie further observed that municipalities are electorally accountable and lack the kind of private incentives characteristic of active participants in the market. See id., at 45, n. 9. Critically, the municipality in Hallie exercised a wide range of governmental powers across different economic spheres, substantially reducing the risk that it would pursue private interests while regulating any single field. See ibid. That Hallie excused municipalities from Midcal’s supervision rule for these reasons all but confirms the rule’s applicability to actors controlled by active market participants, who ordinarily have none of the features justifying the narrow exception Hallie identified. See 471 U.S., at 45.

Following Goldfarb, Midcal, and Hallie, which clarified the conditions under which Parker immunity attaches to the conduct of a nonsovereign actor, the Court in Columbia v. Omni Outdoor Advertising, Inc., 499 U.S. 365, addressed whether an otherwise immune entity could lose immunity for conspiring with private parties. In Omni, an aspiring billboard merchant argued that the city of Columbia, South Carolina, had violated the Sherman Act—and forfeited its Parker immunity—by anticompetitively conspiring with an established local company in passing an ordinance restricting new billboard construction. 499 U.S., at 367–368. The Court disagreed, holding there is no “conspiracy exception” to Parker. Omni, supra, at 374.

 Omni, like the cases before it, recognized the importance of drawing a line “relevant to the purposes of the Sherman Act and of Parker: prohibiting the restriction of competition for private gain but permitting the restriction of competition in the public interest.” 499 U.S., at 378. In the context of a municipal actor which, as in Hallie, exercised substantial governmental powers, Omni rejected a conspiracy exception for “corruption”
as vague and unworkable, since “virtually all regulation benefits some segments of the society and harms others” and may in that sense be seen as “corrupt.” 499 U.S., at 377. Omni also rejected subjective tests for corruption that would force a “deconstruction of the governmental process and probing of the official ‘intent’ that we have consistently sought to avoid.” Ibid. Thus, whereas the cases preceding it addressed the preconditions of Parker immunity and engaged in an objective, ex ante inquiry into nonsovereign actors’ structure and incentives, Omni made clear that recipients of immunity will not lose it on the basis of ad hoc and ex post questioning of their motives for making particular decisions.

Omni’s holding makes it all the more necessary to ensure the conditions for granting immunity are met in the first place. The Court’s two state-action immunity cases decided after Omni reinforce this point. In Ticor the Court affirmed that Midcal’s limits on delegation must ensure that “[a]ctual state involvement, not deference to private price-fixing arrangements under the general auspices of state law, is the precondition for immunity from federal law.” 504 U.S., at 633. And in Phoebe Putney the Court observed that Midcal’s active supervision requirement, in particular, is an essential condition of state-action immunity when a nonsovereign actor has “an incentive to pursue [its] own self-interest under the guise of implementing state policies.” 568 U.S., at (quoting Hallie, supra, at 46–47). The lesson is clear: Midcal’s active supervision test is an essential prerequisite of Parker immunity for any nonsovereign entity—public or private—controlled by active market participants.

C

The Board argues entities designated by the States as agencies are exempt from Midcal’s second requirement. That premise, however, cannot be reconciled with the Court’s repeated conclusion that the need for supervision turns not on the formal designation given by States to regulators but on the risk that active market participants will pursue private interests in restraining trade.

State agencies controlled by active market participants, who possess singularly strong private interests, pose the very risk of self-dealing Midcal’s supervision requirement was created to address. This conclusion does not question the good faith of state officers but rather is an assessment of the structural risk of market participants’ confusing their own interests with the State’s policy goals. See Patrick, 486 U.S., at 100–101.

The Court applied this reasoning to a state agency in Goldfarb. There the Court denied immunity to a state agency (the Virginia State Bar) controlled by market participants (lawyers) because the agency had “joined in what is essentially a private anticompetitive activity” for “the benefit of its members.” 421 U.S., at 791. This emphasis on the Bar’s private interests explains why Goldfarb, though it predates Midcal, considered the lack of supervision by the Virginia Supreme Court to be a principal reason for denying immunity. See 421 U.S., at 791; see also Hoover, 466 U.S., at 569 (emphasizing lack of active supervision in Goldfarb); Bates v. State Bar of Ariz., 433 U.S. 350, 361–362 (1977) (granting the Arizona Bar state-action immunity partly because its “rules are subject to pointed re-examination by the policymaker”).

While Hallie stated “it is likely that active state supervision would also not be required” for agencies, 471 U.S., at 46, n. 10, the entity there, as was later the case in Omni, was an electorally accountable municipality with general regulatory powers and no private price-fixing agenda. In that and other respects the municipality was more like prototypical state agencies, not specialized boards dominated by active market participants. In important regards, agencies controlled by market participants are more similar to private trade associations vested by States with regulatory authority than to the agencies Hallie considered. And as the Court observed three years after Hallie, “[t]here is no doubt that the members of such associations often have economic incentives to restrain competition and that the product standards set by such associations have a serious potential for anticompetitive harm.” Allied Tube, 486 U.S., at 500. For that reason, those associations must satisfy Midcal’s active supervision standard. See Midcal, 445 U.S., at 105–106.
The similarities between agencies controlled by active market participants and private trade associations are not eliminated simply because the former are given a formal designation by the State, vested with a measure of government power, and required to follow some procedural rules. See Hallie, supra, at 39 (rejecting “purely formalistic” analysis). Parker immunity does not derive from nomenclature alone. When a State empowers a group of active market participants to decide who can participate in its market, and on what terms, the need for supervision is manifest. The Court holds today that a state board on which a controlling number of decisionmakers are active market participants in the occupation the board regulates must satisfy Midcal’s active supervision requirement in order to invoke state-action antitrust immunity.

D

The State argues that allowing this FTC order to stand will discourage dedicated citizens from serving on state agencies that regulate their own occupation. If this were so—and, for reasons to be noted, it need not be so—there would be some cause for concern. The States have a sovereign interest in structuring their governments, see Gregory v. Ashcroft, 501 U.S. 452, 460 (1991), and may conclude there are substantial benefits to staffing their agencies with experts in complex and technical subjects, see Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48, 64 (1985). There is, moreover, a long tradition of citizens esteemed by their professional colleagues devoting time, energy, and talent to enhancing the dignity of their calling.

Adherence to the idea that those who pursue a calling must embrace ethical standards that derive from a duty separate from the dictates of the State reaches back at least to the Hippocratic Oath. In the United States, there is a strong tradition of professional self-regulation, particularly with respect to the development of ethical rules. Dentists are no exception. The American Dental Association, for example, in an exercise of “the privilege and obligation of self-government,” has “call[ed] upon dentists to follow high ethical standards,” including “honesty, compassion, kindness, integrity, fairness and charity.” American Dental Association, Principles of Ethics and Code of Professional Conduct 3–4 (2012). State laws and institutions are sustained by this tradition when they draw upon the expertise and commitment of professionals.

Today’s holding is not inconsistent with that idea. The Board argues, however, that the potential for money damages will discourage members of regulated occupations from participating in state government. But this case, which does not present a claim for money damages, does not offer occasion to address the question whether agency officials, including board members, may, under some circumstances, enjoy immunity from damages liability. See Goldfarb, 421 U.S., at 792, n. 22. And, of course, the States may provide for the defense and indemnification of agency members in the event of litigation. States, furthermore, can ensure Parker immunity is available to agencies by adopting clear policies to displace competition; and, if agencies controlled by active market participants interpret or enforce those policies, the States may provide active supervision.

***

E

The Board does not contend in this Court that its anticompetitive conduct was actively supervised by the State or that it should receive Parker immunity on that basis....

IV

...Active supervision need not entail day-to-day involvement in an agency’s operations or micromanagement of its every decision. Rather, the question is whether the State’s review mechanisms provide “realistic assurance” that a nonsovereign actor’s anticompetitive conduct “promotes state policy, rather than merely the party’s individual interests.” Patrick, supra, at 100–101; see also Ticor, 504 U.S., at 639–640.

The Court has identified only a few constant requirements of active supervision: The supervisor must review the substance of the anticompetitive decision, not merely the
procedures followed to produce it, see *Patrick*, 486 U.S., at 102–103; the supervisor must have the power to veto or modify particular decisions to ensure they accord with state policy, see *ibid.*; and the “mere potential for state supervision is not an adequate substitute for a decision by the State,” *Ticor*, *supra*, at 638. Further, the state supervisor may not itself be an active market participant. In general, however, the adequacy of supervision otherwise will depend on all the circumstances of a case.

* * *

The judgment of the Court of Appeals for the Fourth Circuit is affirmed.

■ ALITO, J., with SCALIA and THOMAS, JJ., join, dissenting. The Court’s decision in this case is based on a serious misunderstanding of the doctrine of state-action antitrust immunity that this Court recognized more than 60 years ago in *Parker* v. *Brown*, 317 U.S. 341 (1943). In *Parker*, the Court held that the Sherman Act does not prevent the States from continuing their age-old practice of enacting measures, such as licensing requirements, that are designed to protect the public health and welfare. Id., at 352, 63 S.Ct. 307. The case now before us involves precisely this type of state regulation—North Carolina’s laws governing the practice of dentistry, which are administered by the North Carolina Board of Dental Examiners (Board).

Today, however, the Court takes the unprecedented step of holding that *Parker* does not apply to the North Carolina Board because the Board is not structured in a way that merits a good-government seal of approval; that is, it is made up of practicing dentists who have a financial incentive to use the licensing laws to further the financial interests of the State’s dentists. There is nothing new about the structure of the North Carolina Board. When the States first created medical and dental boards, well before the Sherman Act was enacted, they began to staff them in this way. Nor is there anything new about the suspicion that the North Carolina Board—in attempting to prevent persons other than dentists from performing teeth-whitening procedures—was serving the interests of dentists and not the public. Professional and occupational licensing requirements have often been used in such a way. But that is not what *Parker* immunity is about. Indeed, the very state program involved in that case was unquestionably designed to benefit the regulated entities, California raisin growers.

The question before us is not whether such programs serve the public interest. The question, instead, is whether this case is controlled by *Parker*, and the answer to that question is clear. Under *Parker*, the Sherman Act (and the Federal Trade Commission Act, see FTC v. *Ticor* Title Ins. Co., 504 U.S. 621, 635 (1992)) do not apply to state agencies; the North Carolina Board of Dental Examiners is a state agency; and that is the end of the matter. By straying from this simple path, the Court has not only distorted *Parker*; it has headed into a morass. Determining whether a state agency is structured in a way that mitigates against regulatory capture is no easy task, and there is reason to fear that today’s decision will spawn confusion. The Court has veered off course, and therefore I cannot go along.

I

In order to understand the nature of *Parker* state-action immunity, it is helpful to recall the constitutional landscape in 1890 when the Sherman Act was enacted. At that time, this Court and Congress had an understanding of the scope of federal and state power that is very different from our understanding today. The States were understood to possess the exclusive authority to regulate “their purely internal affairs.” *Leisy* v. *Hardin*, 135 U.S. 100, 122 (1890). In exercising their police power in this area, the States had long enacted measures, such as price controls and licensing requirements, that had the effect of restraining trade.

The Sherman Act was enacted pursuant to Congress’ power to regulate interstate commerce, and in passing the Act, Congress wanted to exercise that power “to the utmost extent.” United States v. South–Eastern Underwriters Assn., 322 U.S. 533, 558 (1944). But in 1890, the understanding of the commerce power was far more limited than it is today. See, e.g., *Kidd* v. *Pearson*, 128 U.S. 1, 17–18 (1888). As a result, the Act did not pose a threat to traditional state regulatory activity.
By 1943, when *Parker* was decided, however, the situation had changed dramatically. This Court had held that the commerce power permitted Congress to regulate even local activity if it “exerts a substantial economic effect on interstate commerce.” *Wickard v. Filburn*, 317 U.S. 111, 125 (1942). This meant that Congress could regulate many of the matters that had once been thought to fall exclusively within the jurisdiction of the States. The new interpretation of the commerce power brought about an expansion of the reach of the Sherman Act. And the expanded reach of the Sherman Act raised an important question. The Sherman Act does not expressly exempt States from its scope. Does that mean that the Act applies to the States and that it potentially outlaws many traditional state regulatory measures? The Court confronted that question in *Parker*....

The Court’s holding in *Parker* was not based on either the language of the Sherman Act or anything in the legislative history affirmatively showing that the Act was not meant to apply to the States. Instead, the Court reasoned that “[i]n a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state’s control over its officers and agents is not lightly to be attributed to Congress.” 317 U.S., at 351. For the Congress that enacted the Sherman Act in 1890, it would have been a truly radical and almost certainly futile step to attempt to prevent the States from exercising their traditional regulatory authority, and the *Parker* Court refused to assume that the Act was meant to have such an effect.

When the basis for the *Parker* state-action doctrine is understood, the Court’s error in this case is plain. In 1890, the regulation of the practice of medicine and dentistry was regarded as falling squarely within the States’ sovereign police power. By that time, many States had established medical and dental boards, often staffed by doctors or dentists, and had given those boards the authority to confer and revoke licenses. This was quintessential police power legislation, and although state laws were often challenged during that era under the doctrine of substantive due process, the licensing of medical professionals easily survived such assaults....

**II**

As noted above, the only question in this case is whether the North Carolina Board of Dental Examiners is really a state agency, and the answer to that question is clearly yes.

- The North Carolina Legislature determined that the practice of dentistry “affect[s] the public health, safety and welfare” of North Carolina’s citizens and that therefore the profession should be “subject to regulation and control in the public interest” in order to ensure “that only qualified persons be permitted to practice dentistry in the State.” N.C. Gen. Stat. Ann. § 90–22(a) (2013).

- To further that end, the legislature created the North Carolina State Board of Dental Examiners “as the agency of the State for the regulation of the practice of dentistry in the State.” § 90–22(b).

- The legislature specified the membership of the Board. § 90–22(c). It defined the “practice of dentistry,” § 90–29(b), and it set out standards for licensing practitioners, § 90–30. The legislature also set out standards under which the Board can initiate disciplinary proceedings against licensees who engage in certain improper acts. § 90–41(a).

- The legislature empowered the Board to “maintain an action in the name of the State of North Carolina to perpetually enjoin any person from ... unlawfully practicing dentistry.” § 90–40.1(a). It authorized the Board to conduct investigations and to hire legal counsel, and the legislature made any “notice or statement of charges against any licensee” a public record under state law. §§ 90–41(d)–(g).

- The legislature empowered the Board “to enact rules and regulations governing the practice of dentistry within the State,” consistent with relevant statutes. § 90–48. It has required that any such rules be included in the
As this regulatory regime demonstrates, North Carolina's Board of Dental Examiners is unmistakably a state agency created by the state legislature to serve a prescribed regulatory purpose and to do so using the State's power in cooperation with other arms of state government.

The Board is not a private or “nonsovereign” entity that the State of North Carolina has attempted to immunize from federal antitrust scrutiny. _Parker_ made it clear that a State may not “‘give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful.’” (quoting _Parker_, 317 U.S., at 351). When the _Parker_ Court disapproved of any such attempt, it cited Northern Securities Co. v. United States, 193 U.S. 197 (1904), to show what it had in mind. In that case, the Court held that a State's act of chartering a corporation did not shield the corporation's monopolizing activities from federal antitrust law. _Id_., at 344–345. Nothing similar is involved here. North Carolina did not authorize a private entity to enter into an anticompetitive arrangement; rather, North Carolina created a state agency and gave that agency the power to regulate a particular subject affecting public health and safety.

Nothing in _Parker_ supports the type of inquiry that the Court now prescribes. The Court crafts a test under which state agencies that are “controlled by active market participants,” must demonstrate active state supervision in order to be immune from federal antitrust law. The Court thus treats these state agencies like private entities. But in _Parker_, the Court did not examine the structure of the California program to determine if it had been captured by private interests. If the Court had done so, the case would certainly have come out differently, because California conditioned its regulatory measures on the participation and approval of market actors in the relevant industry.

Establishing a prorate marketing plan under California's law first required the petition of at least 10 producers of the particular commodity. _Parker_, 317 U.S., at 346. If the Commission then agreed that a marketing plan was warranted, the Commission would “select a program committee from among nominees chosen by the qualified producers.” _Ibid_. (emphasis added). That committee would then formulate the proration marketing program, which the Commission could modify or approve. But even after Commission approval, the program became law (and then, automatically) only if it gained the approval of 65 percent of the relevant producers, representing at least 51 percent of the acreage of the regulated crop. _Id_., at 347. This scheme gave _decisive_ power to market participants. But despite these aspects of the California program, Parker held that California was acting as a “sovereign” when it “adopt[ed] and enfor[ced] the prorate program.” _Id_., at 352. This reasoning is irreconcilable with the Court's today.

III

The Court goes astray because it forgets the origin of the _Parker_ doctrine and is misdirected by subsequent cases that extended that doctrine (in certain circumstances) to private entities. The Court requires the North Carolina Board to satisfy the two-part test set out in California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, (1980), but the party claiming _Parker_ immunity in that case was not a state agency but a private trade association. Such an entity is entitled to _Parker_ immunity, _Midcal_ held, only if the anticompetitive conduct at issue was both “clearly articulated” and “actively supervised by the State itself.” 445 U.S., at 105. Those requirements are needed where a State authorizes private parties to engage in anticompetitive conduct. They serve to identify those situations in which conduct by private parties can be regarded as the conduct of a State. But when the conduct in question is the conduct of a state agency, no such inquiry is required.

This case falls into the latter category, and therefore _Midcal_ is inapposite. The North Carolina Board is not a private trade association. It is a state agency, created and
empowered by the State to regulate an industry affecting public health. It would not exist if the State had not created it. And for purposes of *Parker*, its membership is irrelevant; what matters is that it is part of the government of the sovereign State of North Carolina.

**IV**

Not only is the Court’s decision inconsistent with the underlying theory of *Parker*; it will create practical problems and is likely to have far-reaching effects on the States’ regulation of professions. As previously noted, state medical and dental boards have been staffed by practitioners since they were first created, and there are obvious advantages to this approach. It is reasonable for States to decide that the individuals best able to regulate technical professions are practitioners with expertise in those very professions. Staffing the State Board of Dental Examiners with certified public accountants would certainly lessen the risk of actions that place the well-being of dentists over those of the public, but this would also compromise the State’s interest in sensibly regulating a technical profession in which lay people have little expertise.

As a result of today’s decision, States may find it necessary to change the composition of medical, dental, and other boards, but it is not clear what sort of changes are needed to satisfy the test that the Court now adopts. The Court faults the structure of the North Carolina Board because “active market participants” constitute “a controlling number of [the] decisionmakers,” but this test raises many questions.

What is a “controlling number”? Is it a majority? And if so, why does the Court eschew that term? Or does the Court mean to leave open the possibility that something less than a majority might suffice in particular circumstances? Suppose that active market participants constitute a voting bloc that is generally able to get its way? How about an obstructionist minority or an agency chair empowered to set the agenda or veto regulations?

Who is an “active market participant”? If Board members withdraw from practice during a short term of service but typically return to practice when their terms end, does that mean that they are not active market participants during their period of service?

What is the scope of the market in which a member may not participate while serving on the board? Must the market be relevant to the particular regulation being challenged or merely to the jurisdiction of the entire agency? Would the result in the present case be different if a majority of the Board members, though practicing dentists, did not provide teeth whitening services? What if they were orthodontists, periodontists, and the like? And how much participation makes a person “active” in the market? The answers to these questions are not obvious, but the States must predict the answers in order to make informed choices about how to constitute their agencies.

I suppose that all this will be worked out by the lower courts and the Federal Trade Commission (FTC), but the Court’s approach raises a more fundamental question, and that is why the Court’s inquiry should stop with an examination of the structure of a state licensing board. When the Court asks whether market participants control the North Carolina Board, the Court in essence is asking whether this regulatory body has been captured by the entities that it is supposed to regulate. Regulatory capture can occur in many ways. So why ask only whether the members of a board are active market participants? The answer may be that determining when regulatory capture has occurred is no simple task. That answer provides a reason for relieving courts from the obligation to make such determinations at all. It does not explain why it is appropriate for the Court to adopt the rather crude test for capture that constitutes the holding of today’s decision.

**NOTES AND QUESTIONS:**

1. *Comparing* *Parker*. Is the dissent correct in saying that the decision in North Carolina State Board is “irreconcilable” with the decision in *Parker*? How well do the two situations match up regarding the incentives of the states? Recall that, in *Parker*, 90-95% of the raisins in issue were exported out of California. What is the likely incidence of the restrictions at issue
in *North Carolina Dental*? Intrastate? Interstate? Should that matter for how the Court should define state-action immunity? Should the answer depend on whether the political process will ensure that a decision to permit monopoly was undertaken willingly by those who will pay the higher prices?

2. **Active supervision.** The Court said that the state statute was silent as to whether it applied to teeth whitening and that the Board was not actively supervised by the state “when it interpreted the Act as addressing teeth whitening and when it enforced that policy by issuing cease-and-desist letters.” Would the Court have reached the same result if the statute had explicitly stated that it applied to teeth whitening?

3. **Regulatory capture.** The dissent argues that *Parker* immunity does not turn on “whether a state agency is structured in a way that militates against regulatory capture.” Is that argument responsive to the analysis of the majority? In addressing that question, consider the majority’s approving discussion of the Court’s earlier decision in *Omni* rejecting a “conspiracy exception” to *Parker*. Is having a state board controlled by “active market participants” different for purposes of state action immunity from other failures to structure a board in a way that does not “militate[] against regulatory capture”?

4. **Defining state entities.** According to the dissent, the determination that the Board is a State entity should end the matter. The dissent based its conclusion that the Board is a State entity on the language of the statute and the fact that the state created the entity and did not just delegate regulatory authority to an existing entity. Would the dissent have reached the same result if the legislation had used similar language and included similar provisions in a statute that deemed an existing trade association of dentists to be “an agency of the state for the regulation of the practice of dentistry”? What if the legislation had created a new agency and provided that its members should consist of the governing board of the trade association?

**PREEMPTION BY ANTITRUST LAW**

1. In *Rice v. Norman Williams Co.*, the Supreme Court held that a “state statute is not pre-empted by the federal antitrust laws simply because the state scheme may have an anticompetitive effect,” 458 U.S. 654, 659 (1982). See *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 133 (1978). A state statute must be invalidated on preemption grounds “only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute.” 458 U.S., at 661. The same rule, the Court observed, applied to municipal ordinances. Furthermore, legislation that would otherwise be preempted under *Rice* may nonetheless survive if it is found to be state action immune from antitrust scrutiny under *Parker v. Brown*, 317 U.S. 341 (1943). The ultimate source of that immunity can be only the State, not its subdivisions.

2. In *Fisher v. City of Berkeley*, 475 U.S. 260 (1986), the Court rejected, on the basis of “traditional antitrust analysis,” a challenge on preemption grounds to a rent control ordinance enacted by the City of Berkeley, California, pursuant to popular initiative. The Ordinance placed strict rent controls on all real property that “is being rented or is available for rent for residential use in whole or in part”; it made exceptions for government-owned units, transient units, cooperatives, hospitals, certain small owner-occupied buildings, and all newly constructed buildings.

The Court agreed that, if the owners of residential rental property in Berkeley had voluntarily banded together to stabilize rents in the city, their activities would not be saved from antitrust attack by claims that they had set reasonable prices out of solicitude for the welfare of their tenants. *See National Society of Professional Engineers v. United States*, 435 U.S., at 695; *United States v. Trans–Missouri Freight Assn.*, 166 U.S. 290 (1897). What distinguished the operation of Berkeley’s Ordinance from the activities of a benevolent landlords’ cartel was not that the Ordinance will necessarily have a different economic effect, but that the rent ceilings imposed by the Ordinance and maintained by the Stabilization Board were unilaterally imposed by government upon landlords to the exclusion of private control.

The Court reasoned that “the ordinary relationship between the government and those who must obey its regulatory commands whether they wish to or not is not enough to establish
a conspiracy. Similarly, the mere fact that all competing property owners must comply with the same provisions of the Ordinance is not enough to establish a conspiracy among landlords.”

The Court distinguished so-called hybrid restraints, in which private actors have some degree of private regulatory power. It acknowledged that “[t]here may be cases in which what appears to be a state-or municipality-administered price stabilization scheme is really a private price-fixing conspiracy, concealed under a “gauzy cloak of state involvement,” citing Midcal, supra at 106. The Berkeley ordinance did not present such case, however. The Court concluded:

Because under settled principles of antitrust law, the rent controls established by Berkeley’s Ordinance lack the element of concerted action needed before they can be characterized as a per se violation of § 1 of the Sherman Act, we cannot say that the Ordinance is facially inconsistent with the federal antitrust laws. See Rice v. Norman Williams Co., supra, 458 U.S., at 661. We therefore need not address whether, even if the controls were to mandate § 1 violations, they would be exempt under the state-action doctrine from antitrust scrutiny. See Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985).

Is Fisher consistent with Midcal? With North Carolina Dentists? Was there an “agreement” in Midcal between the producers and the retailers with respect to resale prices? After Fisher, how do you distinguish unilateral acts of government from concerted activities or “hybrid restraints”? Would Fisher have been decided differently if, for example, tenant representatives had sat on Berkeley’s Rent Stabilization Board? What if landlord representatives dominated the Rent Stabilization Board? What if landlords had lobbied hard for what purported to be a rent stabilization program?

3. In Hertz Corp. v. City of New York, 1 F.3d 121 (2d Cir. 1993), the City of New York passed a local law to prevent Hertz from charging higher rates to residents of different parts of the city. Hertz brought suit claiming that the law controlled an aspect of Hertz’s pricing process and thus violated the Sherman Act. On the issue of whether the city ordinance was a “contract, combination, or conspiracy,” the Second Circuit distinguished Fisher as follows:

First, the law is not a “pure regulatory scheme,” [citing Fisher] because it is not a “scheme” at all; the law is simply a directive for all rental-car companies doing business in New York City to remove one factor from their competitive-pricing structures. Second, the law lacks the independent, quasi-judicial board that in Berkeley could adjust rates and provide relief in individual circumstances. Finally, the City of Berkeley was operating in an area vital to its municipal authority—housing; less vital is the rental-car industry in New York City.

Nor does the Hertz law easily fit the fact pattern of the cases held to involve “hybrid” restraints—those that restrain trade through some combination of governmental and private conduct. The three Supreme Court cases in this category involved the pricing of liquor [citing 324 Liquor, Midcal, and Schweigmann]. Each involved classic price-setting that was delegated by statute or regulation to private industry but was left unsupervised by the state legislature. The Hertz law, in contrast, does not purport to authorize price-setting by private industry; it simply eliminates an element of price competition among industry members.

We reject the city’s suggestion to apply Fisher expansively so as to view Local Law No. 21 as a unilateral action that lacks the degree of private-governmental agreement required to be a contract, combination, or conspiracy in restraint of trade. To do so would remove from the reach of the antitrust laws all local governmental actions not fitting the precise fact pattern of the liquor cases. 1 F.3d at 127.

The Second Circuit concluded that the New York City law was best characterized as a “hybrid” situation, where the law called for “anticompetitive private conduct in setting rental rates and making rental decisions.” It was therefore a contract, combination, or conspiracy that would have to be evaluated—because no state action was found—under the Sherman Act. 1 F.3d at 127.
# CHAPTER 10

## INSTITUTIONAL FRAMEWORK

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THE THREE-LEVEL ANTITRUST ENFORCEMENT PATTERN

The antitrust laws are administered and enforced by the Antitrust Division of the Department of Justice and by the Federal Trade Commission. Both agencies enforce the Clayton Act. While the Justice Department alone is charged with government enforcement of the Sherman Act, the FTC is in effect able to enforce the Sherman Act by exercise of its authority under Section 5 of the Federal Trade Commission Act, which authorizes it to proscribe “unfair methods of competition,” a term that has been interpreted to encompass conduct that violates the Sherman Act and other antitrust laws. The agencies generally seek equitable relief for violations of the antitrust laws, and the Justice Department can also seek fines and imprisonment in criminal cases.

In addition to federal agency enforcement, the antitrust laws are also enforced by state attorneys general and private parties. State attorneys general, usually acting as representatives of those injured as a result of antitrust violations, and private parties can seek not only equitable relief but also treble damages, the cost of suit, and a reasonable attorney’s fee.

1. GOVERNMENT ENFORCERS AND THEIR REMEDIES

A. SPECIAL ISSUES RELATED TO ENFORCEMENT BY THE FEDERAL AGENCIES

1. INVESTIGATIVE AUTHORITY AND REQUIRED PRE-MERGER REPORTING

Most antitrust investigations proceed through informal interviews and questionnaires, with voluntary compliance by the person or firm being investigated. In 1962, the Antitrust Division obtained from Congress broad civil investigatory powers under the Antitrust Civil Process Act. The Act enables the Antitrust Division to issue civil investigative demands (“CIDs”) to obtain documentary evidence from non-natural persons (e.g., corporations) suspected of committing a violation.

In 1976, in the Hart–Scott–Rodino Act, enhanced the ability of the Antitrust Division to conduct investigation by authorizing it to issue CIDs (i) for oral testimony or written interrogatories (in addition to documentary evidence), (ii) to all persons (both non-natural and natural), (iii) including “non-target” third parties (such as competitors, suppliers, customers, and employees) with relevant information. In addition to the authority to investigate past or present violations, the Act also gives investigators authority to inquire into “activities in preparation for a merger, acquisition, joint venture, or similar transaction, which, if consummated, may result in an antitrust violation.” In 1980, Congress further strengthened the Antitrust Division’s CID power. The FTC has similar investigative powers.

As discussed in Chapter 6, the Hart–Scott–Rodino Act also requires that parties, including foreign interests, that intend to enter into certain kinds of acquisitions must file a pre-merger notification form with the FTC and Antitrust Division before consummating a merger. The statute and FTC implementing regulations now require (as of 2016) that filing for contemplated mergers meet a “size-of-transaction” threshold of over $78 million

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1 See discussion, pp. ___–___ infra.
(up from the original $15 million). Unless the size of the transaction is in excess of $312 million, a "size of person test" applies, requiring filing for matters where one firm has annual net sales or total assets of $156.3 million or more and the other has at least an annual net sales or total assets of $15.6 million or more. Filing parties must pay a graduated filing fee based on the size of the transaction. An automatic waiting period prior to the consummation of the merger, ranging from 15 to at least 50 days depending on circumstances and the type of merger, in required in order to permit pre-closing review of the merger by the antitrust agencies.

2. CASE SELECTION AND PROSECUTORIAL DISCRETION

As a practical matter, government enforcers have great discretion on what cases to bring. In the merger context, as discussed in Chapter 6, matters are brought to the agencies’ attention under the Hart-Scott-Rodino Act. As for non-merger matters, competitors, consumers, industry observers, members of Congress, and state and local government officials, among others, will refer to possible violations for violations to the DOJ and FTC. Typically, government lawyers will conduct preliminary investigations and, where an issue is serious enough to warrant a full investigation, the relevant section at the DOJ or FTC will write a memorandum recommending that the agency open an investigation. The next stage in the process is to consider whether to bring a case or close the investigation.

In the past, thoughtful critics of governmental antitrust enforcement have focused on deficiencies in policy planning and case selection at both the Antitrust Division and FTC. Many have urged more systematic policy planning. Effective planning would, for example, involve consideration of available enforcement techniques (e.g., case-by-case litigation, rulemaking, guides, stimulation of industry self-regulation), and selection of cases and litigating theories that would achieve maximum deterrence of anticompetitive activities.

For an exemplary effort to do the type of policy planning many have advocated, consider the FTC’s effort in 1995–96 to investigate the impact of technological change and globalization on the agency’s mission. After two months of hearings during the fall of 1995, the FTC released a report, dated May 1996, that “analyzes and makes recommendations on how to continue the FTC’s mission in light of increased global and innovation-based competition.” The report, among other topics, deals with: “competition at the close of the century”; efficiencies; “innovation, intellectual property, and competition”; joint ventures; and “themes for the future.” In so doing, it laid the groundwork for, among other things, the important antitrust matters discussed in Chapter 8.

3. LITIGATION OR SETTLEMENT

If either the DOJ or the FTC believes that the antitrust laws were violated and the parties do not agree on a settlement, the agency commences litigation by filing a complaint. In the case of the DOJ, complaints are filed in federal court. As for the FTC, actions are brought before an Administrative Law Judge. Once the litigation commences, the usual civil discovery procedures are available, and extensive use of interrogatories and depositions is customary. The discovery phase is followed by a bench trial with customary procedures.

Like civil litigation generally, the vast majority (i.e., 80% or more) of government antitrust cases never go to trial but rather are settled through some sort of voluntary agreement. The Antitrust Division and the FTC both accept “consent” decrees or orders, respectively, which, in effect, are negotiated settlements between the staff of the agency and counsel for the litigants, approved by a federal district court in Antitrust Division proceedings or by the commissioners in FTC matters. In addition, the FTC occasionally will accept assurances of voluntary compliance and informal corrective actions, which are written commitments by respondents to discontinue objectionable practices. These have

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no legal effect, except that the FTC is more likely to take vigorous enforcement action against a company that continues a violation after voluntary compliance has been assured.

Settlements of government enforcement actions provide several benefits. They save legal costs, bring clarity to the parties’ responsibilities, and obtain relief desired by the government much sooner than would be possible if the cases were litigated to a final judgment. But some have criticized heavy reliance on settlements on the grounds that settlements in effect enable the government to prohibit conduct that if litigated might be found not to violate the antitrust laws and that, because they resolve cases without judicial decision, settlements do not contribute to the development of antitrust doctrine.

Settlements are especially common in merger cases because parties often cannot keep deals alive during the time it takes to litigate the case. Some critics have expressed concerns that agency decisions to challenge mergers are often therefore not sufficiently disciplined by the agency’s understanding that it will have to prove its case to an independent tribunal.

During the 1960’s and early 1970’s observers of the antitrust scene increasingly came to realize that major questions of antitrust policy were being resolved in the context of consent negotiations. In a famous scandal, the Nixon Administration used the pendency and settlement of an antitrust case as a political tool, settling an action against ITT after that company pledged money for the 1972 Republican National Convention. In 1974, as part of the post-Watergate reforms, Congress enacted the Antitrust Procedures and Penalties Act, known as the Tunney Act, which subjects antitrust settlements made by the Antitrust Division to greater court and public scrutiny. The Act requires the Department of Justice to file with the court a detailed “competitive impact statement” with respect to any proposed consent decree and creates a 60–day waiting period (to allow for public comment) between the filing of a proposed consent judgment and the effective date of the decree. The “competitive impact statement” must include descriptions of the nature and purposes of the proceeding and an explanation of the proposed consent decree. The sponsors of the Act suggested these statements would: (i) increase public understanding of, and participation in, consent decree proceedings; (ii) focus government attorneys on the public impact of their case; and (iii) encourage district judges more carefully to review consent decrees in appropriate instances.

Under the Act, a district judge is not to enter a proposed consent judgment unless he or she determines that it is “in the public interest.” Congress contemplated that district judges would be more deeply involved in evaluating consent judgments than had previously been the practice, and evidence suggests that district judges are respecting this Congressional mandate.

District judges can, however, carry their mandate too far. In a celebrated case, United States v. Microsoft Corp., 56 F.3d 1448 (D.C. Cir. 1995), the district court had refused to enter a proposed consent decree between the Antitrust Division and Microsoft. The Circuit Court concluded that the district court exceeded its authority and reasoned:

At the heart of this case, then, is the proper scope of the district court’s inquiry into the “public interest.” Is the district judge entitled to seize hold of the matter—the investigation into the putative defendant’s business practices—and decide for himself the appropriate combined response of the executive and judicial branches to those practices? With respect to the specific allegations in the government’s complaint, may the court interpose its own views of the appropriate remedy over those the government seeks as a part of its overall settlement? To be sure, Congress, in passing the Tunney Act, intended to prevent “judicial rubber stamping” of the Justice Department’s proposed consent decree . . .

[Nevertheless, although] the language of section 16(e) is not precise, we think the government is correct in contending that section 16(e)(1)’s reference to the alleged violations suggests that Congress did not mean for a district judge to construct his own hypothetical case and then evaluate the decree against that.

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case. Moreover, in section 16(e)(2), the court is authorized to consider “the public
benefit . . . of the determination of the issues at trial.” Putting aside the
perplexing question of how the district judge could insure a trial if the
government did not wish one, “the issues” referred to must be those formulated
in the complaint. Congress surely did not contemplate that the district judge
would, by reformulating the issues, effectively redraft the complaint himself.\textsuperscript{7}

In 2004, in response to the D.C. Circuit’s \textit{Microsoft} decision, Congress amended the
Tunney Act to make clear that district courts are to undertake a thorough and
independent determination of whether a proposed consent decree is adequate to remedy
the violations alleged in light of litigation risk and in the public interest.

The FTC is not subject to a statutory requirement to adhere to particular procedures
when accepting a settlement, but it has developed FTC Rules of Practice to govern
settlements. \textit{See} 16 C.F.R. §§0.0 et seq. The first step is the negotiation of an Agreement
Containing Consent Order. Typically, the parties will waive the right to judicial review
and acknowledge that they have read the Complaint to be filed by the FTC in settling the
case. Assuming that the Commission concludes that there is a “reason to believe” that the
FTC Act was violated, and that the settlement reasonably addresses the violation, the
FTC votes to issue the complaint and proposed consent order for public comment. In
principle, the FTC can change the complaint or consent order after receiving comments.
In practice, however, it rarely does so.

Either the government or a defendant may petition for court modification of a
previously entered consent decree, but consent decrees have seldom been modified absent
the agreement of the original parties. Both the Antitrust Division and the FTC now have
active programs for reviewing past consent decrees to determine whether or not they
continue to effectuate antitrust objectives. Moreover, the enforcement agencies now
generally sunset consent decrees so that they expire at a date certain (say, ten years after
they are entered).

B. THE DEPARTMENT OF JUSTICE

1. STRUCTURE, RELATIONSHIP TO AG AND WHITE HOUSE

\textit{Statutory Responsibilities.} Within the Department of Justice is the Antitrust
Division, headed by an Assistant Attorney General. The Antitrust Division is responsible
for enforcing the Sherman and Clayton Acts, and is required or permitted to intervene in
some proceedings before federal administrative agencies involving considerations of public
policy with respect to competition and monopoly.\textsuperscript{8}

\textit{Reporting Relationship.} As a formal matter, the Assistant Attorney General reports
to the Attorney General and, in turn, to the President. As a practical matter, however, it
is extremely rare for the White House to become involved in an enforcement matter.
During the antitrust case against AT&T, the Reagan White House considered ordering
the Justice Department to drop the case, but eventually declined to do so. \textit{See} Steven Coll,
Deal of the Century (1986). Similarly, it is rare for the Attorney General to overrule the
Assistant Attorney General on antitrust decisions. Antitrust cases are often technical and
complex and usually do not involve politically sensitive issues.

\textit{Budget and Personnel.} After a period of growth in the mid 1970’s, the resources
available to the Antitrust Division stabilized through 1980, and then dramatically
decreased throughout the rest of the decade. During the 1990’s and early years of the new
century, the resources increased but did not reach the level of the late 1970’s. In fiscal
1972, the Antitrust Division had about 325 attorneys and a budget of approximately $12
million. In fiscal 1977, the Antitrust Division had about 421 attorneys and a budget of

\textsuperscript{7} 56 F.3d 1448, 1458–59 (D.C. Cir. 1995).

\textsuperscript{8} For example, the Antitrust Division has responsibility to intervene before administrative agencies, functioning
wholly or in part under regulatory statutes that require an accommodation between their purposes and those of the
antitrust laws, such as the Commodities Futures Trading Commission, Federal Reserve Board, FCC, International
Trade Commission, and the SEC. In the past few decades, the Antitrust Division has become much more active in this
sort of intervention, generally advocating a policy of free competition before these regulatory agencies.
almost $27 million. In fiscal 1989, the Antitrust Division’s budget was only about $45 million, and because inflation had taken a toll, the number of attorneys was down to 229. For fiscal 2002, the Antitrust Division was authorized to employ about 400 attorneys and had a budget of about $141 million. Since then, increases have mostly kept up with inflation. In fiscal year 2015, for example, the Antitrust Division received a total appropriation of $162 million, and had about 380 attorneys.

Given the continued growth of the national economy, the increased need for vigilance created by newly deregulated corporations and foreign companies (with different traditions) doing business in the United States in the shrinking global market, the breadth of responsibilities imposed on the Antitrust Division, the technical complexity of the products and services produced by the so-called “new economy,” and the economic strength of many antitrust defendants, thoughtful observers worry about whether the resources available to the Antitrust Division in the early years of the 21st century are adequate. A consensus developed within the antitrust bar that the resources available were inadequate. Along those lines, an ABA Task Force on the Federal Antitrust Agencies concluded in 2001:

The Task Force believes that more resources should be devoted to the full range of tasks that are inherent in the broad mission responsibilities of the federal antitrust agencies. . . . [T]he performance of the U.S. competition policy system today suffers from the failure of budgets to keep pace with legitimate enforcement and policymaking functions assigned to the two federal enforcement agencies.

2. CIVIL ENFORCEMENT

Violations of Sections 1 and 2 of the Sherman Act can be enforced in both civil and criminal proceedings. Section 4 of the Sherman Act and Section 15 of the Clayton Act confer jurisdiction on the federal courts to “prevent and restrain” violations of the antitrust laws in cases brought by the Justice Department. That provision has been construed to permit also equitable remedies intended to restore competition to a market in which competition was reduced because of the unlawful conduct. Remedies for antitrust cases may thus enjoin conduct different from that which prompted the suit. The classic statement is found in *International Salt Co. v. United States*, 332 U.S. 392, 400 (1947):

The District Court is not obliged to assume, contrary to common experience, that a violator of the antitrust laws will relinquish the fruits of his violation more completely than the court requires him to do. . . . When the purpose to restrain trade appears from a clear violation of law, it is not necessary that all the untraveled roads to that end be left open and that only the worn one be closed.

3. CRIMINAL ENFORCEMENT

When the Sherman Act was enacted in 1890, the criminal sanctions were imprisonment “not to exceed one year” for a misdemeanor and a $5,000 fine. From 1890 until relatively recently, criminal prosecution followed by imprisonment of individuals was rare; and fines were seldom large enough to constitute much of a deterrent. This fact frequently was cited by critics of the antitrust system as an instance of weak law enforcement against “white collar” crime.

*Criminal fines.* Beginning in the mid 1970’s, the Antitrust Division put new emphasis on criminal prosecutions. In “Guidelines for Sentencing Recommendations in Felony

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9 These figures are taken from data prepared in 1989 by the Department of Justice for the Subcommittee on Antitrust, Monopolies and Business Restraints of the Senate Judiciary Committee.
Cases Under the Sherman Act,” issued in 1977, the Antitrust Division explained that an antitrust offender “has a clear option to engage or not to engage in criminal activity.” Prison sentences for hard-core offenses (e.g., horizontal price fixing or market allocations), therefore,

are uniquely effective in deterring antitrust violators (who are generally white collar businessmen) who may view a fine as a “license fee” for fixing prices but who view the threat of a substantial prison term more seriously.14

This theme has been consistently repeated by Antitrust Division officials. The significant issues raised by this emphasis on criminal prosecutions are discussed at pages 75–78 infra.

In 2004, Congress passed the Antitrust Criminal Penalty Enforcement and Reform Act. The statute substantially increased civil and criminal penalties for antitrust violations. Congress’ purpose was to make criminal penalties for antitrust offenses more consistent with the harsh penalties for white collar crime established in recent legislation, including by making a Sherman Act offense a felony. Criminal proceedings under the antitrust laws can result in imprisonment of individuals for a maximum of ten years (up from three years previously). Criminal fines for corporations were increased from $10 million to $100 million, and criminal fines for individuals were increased from $350,000 to $1 million.15

In addition, under the Criminal Fine Improvements Act of 1987, fines as high as $500 million have been imposed for violations of the antitrust laws. The Improvements Act, which is applicable to all felonies, reads as follows:

(d) Alternative fine based on gain or loss.

If any person derives pecuniary gain from the offense, or if the offense results in pecuniary loss to a person other than the defendant, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless imposition of a fine under this subsection would unduly complicate or prolong the sentencing process.16

As applied to a Sherman Act offense, this fine is an alternative to what would otherwise be the maximum statutory fine. Thus, for example, in a price-fixing case, the alternative fine would be twice the excess profit derived (i.e., the difference, between the fixed price and the price under normal conditions, times the number of units sold at the unlawful price) by each defendant from a conspiracy, which could total hundreds of millions or even billions of dollars.17 Most fines in price-fixing cases are now set based on this provision.

Until fiscal 1992, the largest corporate fine ever imposed in an antitrust prosecution was $2 million, and during the late 1980’s and early 1990’s, annual fines collected by the Antitrust Division averaged about $27 million. By contrast, since the Improvements Act was applied to antitrust (by way of a $100 million fine in a price-fixing case against Archer Daniels Midland in 1996), 17 defendants have been fined $100 million or more (including a $500 million fine and a $400 million fine, with fines rising to over $700 million in fiscal

16 18 U.S.C. § 3571(d). An important use of this provision was first made in 1996, in a price-fixing case against Archer Daniels Midland, where a “$100 million criminal fine—the largest criminal antitrust fine ever”—was collected. Department of Justice, Press Release (Oct. 15, 1996). Since 1996, 17 other antitrust defendants have been fined $100 million or more, including a $500 million fine imposed in 1999 on F. Hoffmann–La Roche for its leadership role in an international price-fixing cartel involving vitamins. The second largest fine imposed was $400 million on LG Display Co. in 2009.
17 As we will discuss below, the relevant fine and prison sentence is guided by the sentencing guidelines. Under the U.S. Sentencing Guidelines, Part R, sec. 2R1.1 addresses Antitrust Offenses and, in particular bid-rigging, price-fixing, or market-allocation agreements among competitors. The Guidelines establish a base offense level of 12 for an antitrust offender, and then add on levels depending on the volume of commerce affected. So, for instance, if more than $100 million is affected, another 8 levels get added on. For a first-time offender (Criminal History Cat. I), that gives a sentencing range of 33 to 41 months – in other words, real prison time.
year 2008. Since then, as captured by the chart below, fines have tended to rise, with a record $3.6 billion collected in fiscal year 2015.

Imprisonment. Since the mid 1970’s, there has also been increasing recognition of the significance of imprisonment as a uniquely important antitrust sanction. Until 1977, the most notable instance of the imposition of prison sentences involved 30–day sentences for General Electric and Westinghouse executives after they pleaded guilty to price fixing on electrical equipment in the early 1960’s. But no one convicted of an antitrust violation—no matter how egregious or hard-core—received a prison sentence from fiscal 1962 through 1968. From 1969 to 1977, fewer than a dozen individuals received prison sentences of more than 30 days. Even in the GE–Westinghouse price-fixing cases, most observers concluded that although the 30–day sentences may have made a few executives contrite, the real bite came from the approximately 1,800 private lawsuits which cost GE and other companies upwards of $350 million to litigate and settle.

In 1974, however, in the Antitrust Procedures and Penalties Act, Congress in effect mandated heavier prison sentences for antitrust violators by increasing the maximum prison term to three years and by making violations felonies. A cynical wag suggested that: “Congress decided on three years by adding up all of the time spent in prison by antitrust violators since 1890.” There is, of course, truth in the statement, but it misses the point. Congress was really saying that criminal fines, treble damages, and injunctive provisions were not enough; to make antitrust enforcement work, what was needed was the general deterrence created by the threat of imprisonment for meaningful periods of time.

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18 See Sherman Act Violations Chart, Antitrust Division Spring 2009 Update; Hammond, A Review of Recent Cases and Developments in the Antitrust Division’s Criminal Enforcement Program (Conference Board program March 7, 2002).
21 See p. ___ n.10 supra.
In 1977, the Department of Justice issued sentencing guidelines for felony cases under the Sherman Act. The guidelines indicate that the Antitrust Division had taken Congress’ hint. The Antitrust Division said that it would recommend to district judges that antitrust violators—at least where hard-core offenses were involved—should go to jail. The guidelines also indicated that fines were “poor alternatives” to imprisonment and would be recommended only where prison sentences were inappropriate.

Although *Nash v. United States*, 229 U.S. 373 (1913), largely put to rest the question whether the criminal provisions of the Sherman Act would be declared void for vagueness, critics of criminal enforcement still raise the “vagueness” policy issue: “Is it fair,” they ask, “to prosecute a defendant who was understandably confused about the state of the law?” The Antitrust Division’s answer is that criminal prosecutions will take place only where hard-core offenses—for example, horizontal price fixing, bid-rigging schemes, and market allocations—are involved. Even in these areas, it is unlikely that criminal cases will be brought if a potential defendant was understandably confused about the state of the law or otherwise acted reasonably and in good faith.

A significant development with respect to sentencing for antitrust offenses came in the Sentencing Guidelines, which took effect on November 1, 1987. The background notes to the antitrust Guideline predicted that prison terms for antitrust offenders would become more common, and usually longer, than was the case under pre-Guidelines practice. This prediction has come to pass. From 1984 to 1988, the average sentence for an antitrust felony was 5 months. In the five-year period ending in February 1993, the average sentence was 10 months for offenses under the Sentencing Guidelines (where judges had more limited discretion) and 7.5 months for non-Guideline offenses. During fiscal 2001, the average prison term had increased to nearly 15 months. Although the Supreme Court made the Sentencing Guidelines advisory and no longer mandatory in 2005, average prison sentences for pricing fixing have continued to increase. From fiscal years 2010-2015, the average prison sentence was 24 months.

**Leniency.** In order to induce individuals or corporations involved in price fixing, or other hard-core cartel activity, to come forward and cooperate, the Antitrust Division put in place leniency programs. The leniency program conserves government resources by encouraging parties to turn in their co-conspirators. In this context, leniency means that a qualifying corporation or individual will not be charged criminally for the activity being reported. The Antitrust Division first implemented its Corporate Leniency Program in 1978, but revised it in 1993 to create more opportunities for individuals and companies to come forward and to increase their incentives to do so. In recent years, the Antitrust Division has received roughly 25 applications a year and the result has been scores of convictions, billions of dollars of criminal fines, and the dismantling of dozens of large international cartels.

**4. BUSINESS REVIEW LETTERS**

Another instrument for influencing business behavior and providing businesses with valuable guidance is the issuance of business review letters. As described below, the

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22 The Sentencing Reform Act of 1984 (Title II of the Comprehensive Crime Control Act of 1984) established the United States Sentencing Commission in the Judicial Branch. It charged the Commission with developing a set of guidelines that would, while reducing the variance in sentences imposed for similar offenses, also meet the goals of criminal sentencing: respect for the law, deterrence, incapacitation, and rehabilitation. It is important to bear in mind that antitrust offenses are only the smallest part of the overall Sentencing Guidelines, which cover virtually all federal crimes.


24 See Hammond, A Review of Recent Cases and Developments in the Antitrust Division’s Criminal Enforcement Program (Conference Board program March 7, 2002).


Justice Department (and the FTC in a parallel procedure, called Competition Advisory Opinions) provides guidance on its enforcement intentions when asked to do so by businesses.

**Introduction to Antitrust Division Business Reviews**

*Purpose*

The Antitrust Division’s business review procedure provides a way for businesses to determine how the Division may respond to proposed joint ventures or other business conduct. 28 C.F.R. § 50.6. The business review procedure benefits both the Division and the business community because the Division can analyze and comment on the possible competitive impact of proposed business conduct, possibly avoiding lawsuits or other actions.

*Requesting a Review*

The business review process starts with a written request to the Assistant Attorney General. The Division may refuse to consider the request. Refusals usually occur when the request relates to ongoing instead of proposed business conduct. If the business conduct must be approved by a regulatory agency, the Division may decline to consider a request until after agency approval is obtained. In any event, the procedure relates only to the Division’s enforcement intentions under the antitrust laws, not under any other Federal or state statute or regulation. 28 C.F.R. § 50.6(7)(a).

*Processing the Request*

If the Division agrees to consider a request, the Division’s Office of Operations refers the request to the section or field office having jurisdiction over the product or service involved. The business must provide the Division with all information and documents identified in the regulation. 28 C.F.R. § 50.6(5). The Division may request additional information. Staff attorneys also may conduct whatever independent investigation they think is necessary. The amount of time it takes for the Division to respond depends on the complexity of the proposed conduct and the time required for the requesting party to compile all information sought by the Division. However, for business reviews concerning export trade, a response will be issued within 30 business days from the date that the Division receives all relevant data.

*The Division’s Response: Business Review Letters*

A business requesting a business review generally receives one of three responses in a business review letter from the Division:

1) The Department of Justice does not presently intend to bring an enforcement action against the proposed conduct.
2) The Department of Justice declines to state its enforcement intentions. The Division may or may not file suit if the proposed conduct happens.
3) The Department of Justice will sue if the proposed conduct happens.

Generally, a business review letter from the Division includes the following:

1) The procedural history of the request.

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29 The regulations were issued on February 1, 1968, 33 Fed. Reg. 2,422, and have been amended twice, 38 Fed. Reg. 34,804 (December 19, 1973) and 42 Fed. Reg. 11,831 (March 1, 1977).

30 The initiation of a business review request does not in any way alter the responsibility of a requesting business to comply with the premerger notification provisions of the Hart-Scott-Rodino Antitrust Improvements Act of 1976. 28 C.F.R. § 50.6(7)(b).
2) A description of the representations made by the business.
3) A statement of the Division’s enforcement intentions.
4) A description of how the Division makes public the information in the business review file.

A business review letter is signed by the Assistant Attorney General or the Acting Assistant Attorney General. At the same time that the Division issues a business review letter to the requesting business, the Division issues a press release describing the action and attaching a copy of the Division’s business review letter. The request letter and the Division’s business review letter are placed in a file available to the public. Within 30 days after notification, the information supplied in support of the business review request is placed in the publicly available file in the Division’s Antitrust Documents Group.

Information submitted by a requesting business may be withheld from public disclosure if that disclosure would have a detrimental effect on the business’s operations or relations with customers, employees, suppliers, stockholders, or competitors. 28 C.F.R. § 50.6(10)(c). The type of information usually withheld from public disclosure is confidential commercial or financial information exempt from compulsory disclosure under the Freedom of Information Act. 5 U.S.C. § 552(b)(4).

It is important to note that a business review letter states only the Division’s enforcement intentions as of the date of the letter, and the Division remains free to bring whatever action it subsequently comes to believe is required by the public interest. However, when the Division has stated an intention not to bring suit, the Division has never subsequently brought a criminal action (see 28 C.F.R § 506 n.9) if there was full disclosure at the time the business review request was presented to the Division.

C. THE FEDERAL TRADE COMMISSION

1. INDEPENDENT AGENCY, FIVE COMMISSIONERS, RELATIONSHIP TO CONGRESS

Origins of the FTC and Statutory Responsibilities. The FTC is an independent regulatory agency established in 1914 under the Federal Trade Commission Act. That statute and the Clayton Act were the culmination of several years of congressional debate and embodied compromises among the provisions in a series of proposed bills. In a general sense, these statutes constituted a response to the Standard Oil decision of 1911, in which the Supreme Court first enunciated a “rule of reason” approach to antitrust violations. Advocates of a vigorous antitrust policy felt that this flexible approach gave undesirable and unreviewable power over the nation’s economic development to the judiciary, and businesses worried about how to stay within the confines of this vague standard.

One result was a series of statutory provisions in the Clayton Act that outlawed specific business practices such as creation of certain holding companies, price discrimination, and tie-in sales. Of course, specificity in describing illegal practices generated the danger that businesses might skirt the edges of practices declared illegal. To deal with this problem, Congress enacted Section 5 of the FTC Act, which declared unlawful “unfair methods of competition”—an exceptionally broad and vague grant of authority to supervise the functioning of the economy. Congress also created a new agency to enforce these laws. The FTC was given concurrent jurisdiction with the Department of Justice to enforce the Clayton Act and exclusive jurisdiction to enforce the FTC Act. Section 5 of the FTC Act has since been construed to cover both trade practices that violate the antitrust laws and those “which conflict with the basic policies of the Sherman and

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32 Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).
on unfair methods of competition encompasses not only those acts and practices that violate the Sherman or Clayton Act but also those that contravene the spirit of the antitrust laws and those that, if allowed to mature or complete, could violate the Sherman or Clayton Act.

Congress chose not to define the specific acts and practices that constitute unfair methods of competition in violation of Section 5, recognizing that application of the statute would need to evolve with changing markets and business practices. Instead, it left the development of Section 5 to the Federal Trade Commission as an expert administrative body, which would apply the statute on a flexible case-by-case basis, subject to judicial review. This statement is intended to provide a framework for the Commission’s exercise of its “standalone” Section 5 authority to address acts or practices that are anticompetitive but may not fall within the scope of the Sherman or Clayton Act.

In deciding whether to challenge an act or practice as an unfair method of competition in violation of Section 5 on a standalone basis, the Commission adheres to the following principles:

- the Commission will be guided by the public policy underlying the antitrust laws, namely, the promotion of consumer welfare;
- the act or practice will be evaluated under a framework similar to the rule of reason, that is, an act or practice challenged by the Commission must cause, or be likely to cause, harm to competition or the competitive process, taking into account any associated cognizable efficiencies and business justifications; and
- the Commission is less likely to challenge an act or practice as an unfair method of competition on a standalone basis if enforcement of the Sherman or Clayton Act is sufficient to address the competitive harm arising from the act or practice.

NOTES AND QUESTIONS:

1. Reaction to the Statement. The Statement was welcomed by some members of the antitrust bar for helping to clarify the scope of Section 5. Others criticized the statement for, among other things, leaving important unresolved ambiguities.

2. Significance of the Statement. For the administrative law mavens, stop and consider exactly what this statement is supposed to be. It wasn’t adopted through formal notice-and-comment procedures pursuant to the Administrative Procedures Act. Instead, the Commission characterized it as “guidance.” What is that exactly? Is it binding on the Commission? On the next iteration of the Commission?

2. PRIVATE ENFORCERS AND THEIR REMEDIES

A. PRIVATE PLAINTIFFS

Statutory Authority and Profile of Private Actions. The key legislative provisions authorizing and controlling private treble damage actions are Sections 4 and 5(a) of the Clayton Act, which read as follows:

Sec. 4. Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides, or is found, or has an agent, without respect to the amount in controversy, and shall recover treble the damages by him sustained, and the cost of suit, including a reasonable attorney’s fee. . . .

Sec. 5. (a) A final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima

facie evidence against such defendant in any action or proceeding brought by any other party against such defendant under said laws as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto: Provided, That this section shall not apply to consent judgments or decrees entered before any testimony has been taken.

Until the 1960’s, very few private plaintiffs were successful. During the period 1890 to 1940, 175 private damage suits proceeded to final adjudication, and plaintiffs prevailed in only 13. In between 1952 and 1958, plaintiffs recovered in only 20 of 144 reported cases. In addition, plaintiffs were able to achieve an advantageous settlement in only about 25% of all private suits filed.

The lack of successful private litigation during the first 70 years of antitrust enforcement was particularly remarkable in light of the fact that so many litigants relied on prior government judgments. It has been estimated that approximately 75% of private treble damage suits prior to 1960 were initiated after government suit, and in reliance on prior judgments against defendants. Since 1960, however, the situation has changed, largely as a result of a number of Supreme Court decisions that eased procedural hurdles and damage standards and changed substantive norms.

Since 1941, private suits have been the predominant form of antitrust litigation—at least in terms of number of cases filed. Professors Salop and White explained:

Until 1965, with the exception of a “spike” in 1962 due to the electrical conspiracy follow-on cases, the ratio of private to government cases tended to be 6 to 1 or less. From the mid 1960’s until the late 1970’s the absolute and relative number of private antitrust cases grew, reaching a peak of 1,611 cases in 1977, while the ratio of private to public cases exceeded 20 to 1. In the 1980’s, however, both the absolute and relative numbers of antitrust cases have declined, and the private to public ratio has fallen to the 10 to 1 range.

This pattern of private and government enforcement appears to have continued into the 21st century.

B. ANTITRUST INJURY AND STANDING

Section 4 of the Clayton Act requires that a private treble damage plaintiff be a “person” (defined in the Act to include corporations and associations) that was “injured in his business or property.” The Supreme Court noted in *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337 (1979), that Section 4 “contains little in the way of restrictive language.” Nevertheless, numerous lower court decisions have restricted the class of plaintiffs that may claim damages under Section 4. For example, a shareholder may not sue in his own right (as opposed to derivatively for his corporation) for a reduction in the value of his stock as a result of harm to the corporation. Neither a trade association nor a nonprofit institution may maintain private actions to recover damages allegedly inflicted on members, nor according to most cases may a landlord sue for harm suffered by it as a result of damage to a tenant’s business, even if the rental payments for the property

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46 Bicks, The Department of Justice and Private Treble Damage Actions, 4 Antitrust Bull. 5, 11 (1959).
47 Under 15 U.S.C. § 16(a), private parties can invoke judgments in cases where the federal government prevailed against an antitrust defendant and such rulings constitute “prima facie evidence.” Moreover, Congress more recently provided that such rulings can be given collateral estoppel, enabling, for example, a ruling on liability established by the government to enable a private plaintiff to proceed to the remedies phase without proving liability.
51 See Lovett v. General Motors Corp., 975 F.2d 518, 521 (8th Cir. 1992); Peter v. Western Newspaper Union, 200 F.2d 867 (5th Cir. 1953).
include a percentage of the tenant’s profits.\(^5^3\) A state or municipality can sue for treble damages for injuries to its property and \textit{parens patrie} for injury to its residents, but a state may not sue in \textit{aparens patriae} capacity for general damages to the state’s economy.\(^5^4\)

\textbf{Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.}

United States Supreme Court, 1977.

429 U.S. 477.

\textbf{MR. JUSTICE MARSHALL} delivered the opinion of the Court: This case raises important questions concerning the interrelationship of the antimerger and private damages action provisions of the Clayton Antitrust Act.

\textit{I}

Petitioner is one of the two largest manufacturers of bowling equipment in the United States. Respondents are three of the 10 bowling centers owned by Treadway Companies, Inc. Since 1965, petitioner has acquired and operated a large number of bowling centers, including six in the markets in which respondents operate. Respondents instituted this action contending that these acquisitions violated various provisions of the antitrust laws.

In the late 1950’s, the bowling industry expanded rapidly, and petitioner’s sales of lanes, automatic pinsetters, and ancillary equipment rose accordingly.\(^1\) Since this equipment requires a major capital expenditure $12,600 for each lane and pinsetter, most of petitioner’s sales were for secured credit.

In the early 1960’s, the bowling industry went into a sharp decline. Petitioner’s sales quickly dropped to preboom levels. Moreover, petitioner experienced great difficulty in collecting money owed it; by the end of 1964 over $100,000,000, or more than 25%, of petitioner’s accounts were more than 90 days delinquent. Repossessions rose dramatically, but attempts to sell or lease the repossessed equipment met with only limited success.\(^2\) Because petitioner had borrowed close to $250,000,000 to finance its credit sales, it was, as the Court of Appeals concluded, “in serious financial difficulty.” NBO Industries Treadway Cos., Inc. v. Brunswick Corp., 523 F.2d 262, 267 (CA3 1975).

To meet this difficulty, petitioner began acquiring and operating defaulting bowling centers when their equipment could not be resold and a positive cash flow could be expected from operating the centers. During the seven years preceding the trial in this case, petitioner acquired 222 centers, 54 of which it either disposed of or closed. These acquisitions made petitioner by far the largest operator of bowling centers, with over five times as many centers as its next largest competitor. Petitioner’s net worth in 1965 was more than eight times greater, and its gross revenue more than seven times greater, than the total for the 11 next largest bowling chains. Nevertheless, petitioner controlled only 2% of the bowling centers in the United States.

At issue here are acquisitions by petitioner in the three markets in which respondents are located: Pueblo, Colo., Poughkeepsie, N.Y., and Paramus, N.J. In 1965, petitioner acquired one defaulting center in Pueblo, one in Poughkeepsie, and two in the Paramus area. In 1969, petitioner acquired a third defaulting center in the Paramus market, and in 1970 petitioner acquired a fourth. Petitioner closed its Poughkeepsie center in 1969 after three years of unsuccessful operation; the Paramus center acquired in 1970 also proved unsuccessful, and in March 1973 petitioner gave notice that it would cease


\(^1\) Sales of automatic pinsetters, for example, went from 1,890 in 1956, to 16,288 in 1961.

\(^2\) Repossessions of pinsetters increased from 300 in 1961 to 5,996 in 1965. In 1963, petitioner resold over two-thirds of the pinsetters repossessed; more typically, only one-third were resold, and in 1965, less than one-quarter were resold.
operating the center when its lease expired. The other four centers were operational at the time of trial.

Respondents initiated this action in June 1966, alleging, inter alia, that these acquisitions might substantially lessen competition or tend to create a monopoly in violation of § 7 of the Clayton Act, 15 U.S.C. § 18. Respondents sought damages, pursuant to § 4 of the Act, 15 U.S.C. § 15, for three times “the reasonably expectable profits to be made (by respondents) from the operation of their bowling centers.” Respondents also sought a divestiture order, an injunction against future acquisitions, and such “other further and different relief” as might be appropriate under § 16 of the Act, 15 U.S.C. § 26.

Trial was held in the spring of 1973, following an initial mistrial due to a hung jury. To establish a § 7 violation, respondents sought to prove that because of its size, petitioner had the capacity to lessen competition in the markets it had entered by driving smaller competitors out of business. To establish damages, respondents attempted to show that had petitioner allowed the defaulting centers to close, respondents’ profits would have increased. At respondents’ request, the jury was instructed in accord with respondents’ theory as to the nature of the violation and the basis for damages. The jury returned a verdict in favor of respondents in the amount of $2,358,030, which represented the minimum estimate by respondents of the additional income they would have realized had the acquired centers been closed. As required by law, the District Court trebled the damages. It also awarded respondents costs and attorneys’ fees totaling $446,977.32, and, sitting as a court of equity, it ordered petitioner to divest itself of the centers involved here, Treadway Cos. v. Brunswick Corp., 389 F.Supp. 996 (N.J. 1974). Petitioner appealed.

II

The issue for decision is a narrow one. Petitioner does not presently contest the Court of Appeals’ conclusion that a properly instructed jury could have found the acquisitions unlawful. Nor does petitioner challenge the Court of Appeals’ determination that the evidence would support a finding that had petitioner not acquired these centers, they would have gone out of business and respondents’ income would have increased. Petitioner questions only whether antitrust damages are available where the sole injury alleged is that competitors were continued in business, thereby denying respondents an anticipated increase in market shares.

To answer that question it is necessary to examine the antimerger and treble-damages provisions of the Clayton Act. Section 7 of the Act proscribes mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly.” It is, as we have observed many times, a prophylactic measure, intended “primarily to arrest apprehended consequences of intercorporate relationships before those relationships could work their evil” United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 597 (1957).

Section 4, in contrast, is in essence a remedial provision. It provides treble damages to “(a)ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws” Of course, treble damages also play an important role in penalizing wrongdoers and deterring wrongdoing, as we also have frequently observed. Perma Life Mufflers v. International Parts Corp., 392 U.S. 134, 139 (1968). It nevertheless is true that the treble-damages provision, which makes awards available only to injured parties, and measures the awards by a multiple of the injury actually proved, is designed primarily as a remedy.

Intermeshing a statutory prohibition against acts that have a potential to cause certain harms with a damages action intended to remedy those harms is not without difficulty. Plainly, to recover damages respondents must prove more than that petitioner violated § 7, since such proof establishes only that injury may result. Respondents contend that the only additional element they need demonstrate is that they are in a worse position than they would have been had petitioner not committed those acts. The Court of Appeals agreed, holding compensable any loss “causally linked” to “the mere presence of the
violator in the market.” 523 F.2d, at 272-273. Because this holding divorces antitrust recovery from the purposes of the antitrust laws without a clear statutory command to do so, we cannot agree with it.

Every merger of two existing entities into one, whether lawful or unlawful, has the potential for producing economic readjustments that adversely affect some persons. But Congress has not condemned mergers on that account; it has condemned them only when they may produce anticompetitive effects. Yet under the Court of Appeals’ holding, once a merger is found to violate § 7, all dislocations caused by the merger are actionable, regardless of whether those dislocations have anything to do with the reason the merger was condemned. This holding would make § 4 recovery entirely fortuitous, and would authorize damages for losses which are of no concern to the antitrust laws.

Both of these consequences are well illustrated by the facts of this case. If the acquisitions here were unlawful, it is because they brought a “deep pocket” parent into a market of “pygmies.” Yet respondents’ injury the loss of income that would have accrued had the acquired centers gone bankrupt bears no relationship to the size of either the acquiring company or its competitors. Respondents would have suffered the identical “loss” but no compensable injury had the acquired centers instead obtained refinancing or been purchased by “shallow pocket” parents as the Court of Appeals itself acknowledged. Thus, respondents’ injury was not of “the type that the statute was intended to forestall,” Wyandotte Co. v. United States, 389 U.S. 191, 202 (1967).

But the antitrust laws are not merely indifferent to the injury claimed here. At base, respondents complain that by acquiring the failing centers petitioner preserved competition, thereby depriving respondents of the benefits of increased concentration. The damages respondents obtained are designed to provide them with the profits they would have realized had competition been reduced. The antitrust laws, however, were enacted for “the protection of competition not competitors,” Brown Shoe Co. v. United States, 370 U.S., at 320. It is inimical to the purposes of these laws to award damages for the type of injury claimed here. ***

We therefore hold that the plaintiffs to recover treble damages on account of § 7 violations, they must prove more than injury causally linked to an illegal presence in the market. Plaintiffs must prove antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants’ acts unlawful. The injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation. It should, in short, be “the type of loss that the claimed violations . . . would be likely to cause.” Zenith Radio Corp. v. Hazeltine Research, 395 U.S., at 125.

This does not necessarily mean, as the Court of Appeals feared, 523 F.2d at 272, that § 4 plaintiffs must prove an actual lessening of competition in order to recover. The short-term effect of certain anticompetitive behavior predatory below-cost pricing, for example may be to stimulate price competition. But competitors may be able to prove antitrust injury before they actually are driven from the market and competition is thereby lessened. Of course, the case for relief will be strongest where competition has been diminished.

III

We come, then, to the question of appropriate disposition of this case. At the very least, petitioner is entitled to a new trial, not only because of the instructional errors noted by the Court of Appeals that are not at issue here, but also because the District Court’s instruction as to the basis for damages was inconsistent with our holding as outlined above. Our review of the record, however, persuades us that a new trial on the damages claim is unwarranted. Respondents based their case solely on their novel damages theory which we have rejected. While they produced some conclusory testimony suggesting that in operating the acquired centers petitioner had abused its deep pocket by engaging in anticompetitive conduct, they made no attempt to prove that they had lost any income as a result of such predation. Rather, their entire proof of damages was based on their claim to profits that would have been earned had the acquired centers closed. Since respondents
did not prove any cognizable damages and have not offered any justification for allowing respondents, after two trials and over 10 years of litigation, yet a third opportunity to do so, it follows that, petitioner is entitled, in accord with its motion made pursuant to Rule 50(b), to judgment on the damages claim notwithstanding the verdict.

Respondents’ complaint also prayed for equitable relief, and the Court of Appeals held that if respondents established a § 7 violation, they might be entitled to an injunction against “those practices by which a deep pocket market entrant harms competition.” 523 F.2d, at 279. Because petitioner has not contested this holding, respondents remain free, on remand, to seek such a decree.

The judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

NOTES AND QUESTIONS

1. Geography and bowling competition. This Chapter is not about merger doctrine, but we can’t ignore the facts of the case. What was Brunswick’s market share? The answer is 2% nationwide. Is that the right way to think about market definition here? Put the question differently: How far are you willing to travel to bowl? If there is robust competition among bowling centers in Peoria, IL and only one bowling center in Naperville, IL—separated by 143.4 miles—does the fierce competition in Peoria do anything for someone living in Naperville? We need to define relevant geographic markets for bowling, so the 2% figure doesn’t necessarily match up to anything meaningful for the market analysis that needs to be done. Instead, we need to ask, as the case does, about competition in particular local markets, here Pueblo, Colo., Poughkeepsie, N.Y., and Paramus, N.J.

2. Technology change, sunk costs and competition. Build a picture in your mind of what bowling looked like in the United States in the late 1950s and 1960s. Think cigarettes and stale air and rented bowling shoes (and more stale air). That was all atmospherics. More relevantly, there was a boom and then a bust in bowling in this time, and we see all of that in footnotes 1 and 2 in the case.

Automatic pin setter sales jumped dramatically between 1956 and 1961. Bowling was going through a technology change: human beings—pinboys in the presumably accurate but gendered term of the era—had reset pins that bowlers managed to knock down, but now that was being done by new machines, the automatic pinsetter. (Run an Internet search and look at the diagrams in Brunswick’s U.S. patent no. 2,973,204, filed for on Nov. 25, 1955 and granted on Feb. 28, 1961.)

Everything suggests that the market was overbuilt. Brunswick was selling the automatic pinsetters on credit, and it took a security interest in the equipment in an effort to boost its chances to collect in case the bowling business failed. As footnote 2 makes clear, many bowling centers with Brunswick equipment failed.

Note two key points here. In the introduction on competition and monopoly (Chapter 2), we started with a given demand curve and worked through the analysis with that in hand. We noted that that was artificial in a fundamental way, and a case like Brunswick makes that clear. It is actually quite difficult to know the demand for a product, especially a new product. Setting up a new small business is an exercise in demand uncertainty, and many new businesses fail because they do not accurately assess demand.

That gets us to the second point on reversibility of investment and what Brunswick should have done when faced with a customer who couldn’t pay it for the pinsetters. Some investments are easily reversible, meaning that the assets originally deployed in a business can be broken up and moved to different uses. Many commercial real estate spaces are fairly generic, and you may see a string of businesses occupy a particular space until one finally succeeds.

Other equipment is highly specific and has only a narrow set of uses (or even just one). Once Brunswick had built a pinsetter and sold it, there wasn’t a good alternative use for that equipment. It presumably needed to stay in bowling, and even moving the equipment from one local geographic market had to be expensive. Couple that point with the business uncertainty idea—is there really no market for bowling here or was this operator just particularly bad?—
and you can see quickly why Brunswick might have thought that it was sensible to start operating failed bowling centers.

3. But-for causation? That gets us the conflict in the case. What exactly were the plaintiffs complaining about here? The answer is reasonably straightforward and is framed in a well-known legal framework, but-for causation. According to the plaintiffs, had Brunswick not taken over the failed bowling centers, the plaintiffs would have faced less competition and would have made more money. The plaintiffs believed that they should have a remedy under the antitrust laws if that loss could be traced to a violation of the antitrust laws. And, probably remarkably, they were able to prove that the acquisition of the bowling centers violated Section 7 of the Clayton Act, which addresses mergers and asset acquisitions. That finding by the district court survived on appeal and was not challenged in the Supreme Court. To make sense of this and to understand the importance of the case, you should assume that the merger was illegal because it injured competition in one way and that it increased competition in a different way.

4. Antitrust injury. The plaintiffs had losses directly traceable to an antitrust violation and therefore believed that they were entitled to treble damages. Note that this is not a case where antitrust law should be confident that the alleged harms would be redressed by other applicable law. Instead, the question presented to the Supreme Court was whether the harms from “too much” competition, excess competition caused by an antitrust violation, should be compensated. By creating a distinct conception of antitrust injury, the Supreme Court said no.

In rejecting a simple notion of but-for causation, did the Court depart from ordinary principles of tort law? Consider this hypothetical: Driver A and passenger B are in a car on a mountain road. The car is speeding negligently. A boulder falls on top of the car from a location not visible from the road and injures B. B sues A claiming that A’s speeding was a but-for cause of his injuries because, if A had not been speeding, the car would not have been at that point on the road when the boulder fell. A argues that the risks whose creation cause speeding to be deemed to be negligent have to do with driver reaction time and control of the vehicle, not being on one part of the road rather than another, and thus that B was not harmed by A’s negligence. Who wins?

5. Usefulness of the test. Go back and look at the test for antitrust injury formulated in Brunswick. You should always ask whether the test as formulated will be easily implemented by lower courts and whether it offers a straightforward guide for conduct for firms seeking to comply with antitrust law.

NOTE ON STANDING THEORY

The theory underlying standing cases in antitrust law has often been stated elliptically and without analytical precision. Many of the cases cannot be reconciled. The language of standing cases—e.g., was the injury “direct” or “indirect,” was plaintiff within the “target area” of the offense—often obscures underlying policy issues. In general, what courts should be doing in this area is analyzing the purposes of the antitrust laws and the probable costs and benefits to the antitrust system of allowing a particular plaintiff to vindicate its claim to protection against antitrust injuries. At issue will be a series of discrete policy questions such as: Are the injuries to this particular plaintiff too speculative or remote to make it an appropriate antitrust enforcer? Is the injury of a type with which the antitrust laws should be concerned? Is there an excessive risk of duplicative recovery? Would affording standing create unmanageable complexity, and on balance, discourage vigorous private enforcement? A precise analysis of the answers to these questions is what is desirable. In recent years, the Supreme Court has moved in this direction.

Blue Shield of Virginia v. McCready, 457 U.S. 465 (1982), in which the justices split 5–4, illustrates the Supreme Court’s approach and the difficult policy issues that lie at the heart of standing cases. Careful note should be taken of the Court’s sympathetic attitude towards private enforcement and of its analytical framework for resolving standing issues. McCready’s antitrust complaint alleged that Blue Shield’s practice of refusing to reimburse subscribers for psychotherapy performed by psychologists, while providing reimbursement for comparable treatment by psychiatrists, was in furtherance of an
unlawful conspiracy to restrain competition in the psychotherapy market. The question presented was “whether a subscriber who employed the services of a psychologist has standing to maintain an action under § 4 of the Clayton Act based upon the plan’s failure to provide reimbursement for the costs of that treatment.” The Supreme Court held that McCready had standing. Justice Brennan, writing for the majority, emphasized the “broad remedial and deterrent objectives” of Section 4 of the Clayton Act. Nevertheless, he “acknowledged two types of limitation on the availability of the § 4 remedy.”

For the first type of limitation Justice Brennan cited Hawaii v. Standard Oil Co., 405 U.S. 251 (1972), and Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977) (discussed infra), and explained these cases as “focused on the risk of duplicative recovery” not present in the McCready case. Id. at 474. The Court noted that a subordinate theme in the Hawaii and Illinois Brick cases involved a concern about “burdening § 4 actions with damages issues giving rise to the need for ‘massive evidence and complicated theories,’ where the consequence would be to discourage vigorous enforcement.” The Court concluded, however, that “our cautious approach to speculative, abstract, or impractical damages theories has no application to McCready’s suit.” Id. at 475 n.11.

The second type of limitation related to the “conceptually more difficult question ‘of which persons have sustained injuries too remote . . . to give them standing to sue.’” As to this issue, the Court reasoned:

An antitrust violation may be expected to cause ripples of harm to flow through the Nation’s economy; but “despite the broad wording of § 4 there is a point beyond which the wrongdoer should not be held liable.” . . . It is reasonable to assume that Congress did not intend to allow every person tangentially affected by an antitrust violation to maintain an action to recover threefold damages for the injury to his business or property. Of course, neither the statutory language nor the legislative history of § 4 offers any focused guidance on the question of which injuries are too remote from the violation and the purposes of the antitrust laws to form the predicate for a suit under § 4; indeed, the unrestrictive language of the section, and the avowed breadth of the congressional purpose, cautions us not to cabin § 4 in ways that will defeat its broad remedial objective. But the potency of the remedy implies the need for some care in its application. In the absence of direct guidance from Congress, and faced with the claim that a particular injury is too remote from the alleged violation to warrant § 4 standing, the courts are thus forced to resort to an analysis no less elusive than that employed traditionally by courts at common law with respect to the matter of “proximate cause.” . . . In applying that elusive concept to this statutory action, we look (1) to the physical and economic nexus between the alleged violation and the harm to the plaintiff, and, (2) more particularly, to the relationship of the injury alleged with those forms of injury about which Congress was likely to have been concerned in making defendant’s conduct unlawful and in providing a private remedy under § 4. Id. at 476–78.

In answer to item (1), the “physical and economic nexus,” the Court concluded:

We do not think that because the goal of the conspirators was to halt encroachment by psychologists into a market that physicians and psychiatrists sought to preserve for themselves, McCready’s injury is rendered “remote.” The availability of the § 4 remedy to some person who claims its benefit is not a question of the specific intent of the conspirators. Here the remedy cannot reasonably be restricted to those competitors whom the conspirators hoped to eliminate from the market. McCready claims that she has been the victim of a concerted refusal to pay on the part of Blue Shield, motivated by a desire to deprive psychologists of the patronage of Blue Shield subscribers. Denying reimbursement to subscribers for the cost of treatment was the very means by which it is alleged that Blue Shield sought to achieve its illegal ends. The harm to McCready and her class was clearly foreseeable; indeed, it was a necessary step in effecting the ends of the illegal conspiracy. Id. at 478–79.
In answer to item (2), the “relationship of the injury” to Congress’ antitrust concern, the Court concluded:

Relying on . . . [language in Brunswick Corp. v. Pueblo Bowl–O–Mat, Inc., 429 U.S. 477, 489 (1977), as to the need to “prove antitrust injury”], petitioners reason that McCready can maintain no action under § 4 because her injury “did not reflect the anticompetitive effect” of the alleged violation.

Brunswick is not so limiting. Indeed, as we made clear in a footnote to the relied-upon passage, a § 4 plaintiff need not “prove an actual lessening of competition in order to recover. . . .[C]ompetitors may be able to prove antitrust injury before they actually are driven from the market and competition is thereby lessened.” . . . Thus while an increase in price resulting from a dampening of competitive market forces is assuredly one type of injury for which § 4 potentially offers redress, see Reiter v. Sonotone, supra, that is not the only form of injury remediable under § 4. We think it plain that McCready’s injury was of a type that Congress sought to redress in providing a private remedy for violations of the antitrust laws.

. . . [W]e think that McCready’s injury “flows from that which makes defendants’ acts unlawful” within the meaning of Brunswick, and falls within the area of congressional concern. Id. at 482–84.

Two dissenting opinions found no “antitrust injury” within the meaning of Brunswick (Justices Burger, Rehnquist, and O'Connor) and no injury to plaintiff’s “property by reason of the alleged antitrust violation” (Justice Stevens).

The “causality” and “antitrust injury” cases referred to in the McCready opinions also use “direct-indirect” and “target area” terminology. These cases appear to have the same conceptual and policy underpinnings as do the standing cases.

In Associated General Contractors v. California State Council of Carpenters, 459 U.S. 519, 537–46 (1983), the Supreme Court decided that the plaintiff union was not a proper party to bring a private antitrust action. The Court focused principally on whether the harm to plaintiff was: (i) the sort that the Sherman Act was designed to protect; (ii) direct or indirect; (iii) intended; (iv) speculative; (v) likely to lead to duplicative recoveries, difficulties of apportionment, or burdensome complex trials; and (vi) likely to be vindicated by more direct victims of the alleged wrongful acts or whether harm was likely to go undetected or unremedied. Cf. Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. (1986).

Circuit court opinions, reaching opposite or varying conclusions, illustrate both the interplay among the “standing,” “causation,” and “antitrust injury” concepts and the difficult policy judgments that must be made. In Ostrofe v. H.S. Crocker Co., Inc., 670 F.2d 1378, 1382 (9th Cir. 1982) (Ostrofe I), the Ninth Circuit ruled that an employee who was forced to resign because he refused to participate in an alleged price-fixing and market-allocation scheme by his employer and others had standing to bring a treble damage action against his employer.

The Supreme Court vacated the Ninth Circuit’s judgment in Ostrofe and directed that on remand the lower court review its decision in light of the Supreme Court’s Associated General Contractors case, supra. In Ostrofe II, the Ninth Circuit reaffirmed plaintiff’s standing and focused on the fact that he was an “essential participant” in the price-fixing scheme, which “could not succeed without his active cooperation”; moreover, no one had as strong an interest as the discharged employee in vindicating the public interest in effective antitrust enforcement. 740 F.2d 739, 745–47 (9th Cir. 1984). More recently, the Ninth Circuit dismissed a terminated employee’s claim because the “loss of a job is not the type of injury that the antitrust laws were designed to prevent.” Ostrofe II

55 For a discussion of “antitrust injury” in the merger context, see p. infra. See Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328 (1990) (“Although a vertical maximum price-fixing agreement . . . [was] then (but not now, see Chapter 7 infra per se] unlawful under § 1 of the Sherman Act, it does not cause a competitor injury unless it results in predatory pricing”).

was distinguished as involving a limited exception for an “essential participant” whose dismissal was a “necessary means” to accomplish the anticompetitive scheme.\textsuperscript{57}

Other circuit courts have rejected Ostrofe I and II. The Seventh Circuit, for example, in Bichan v. Chemetron Corp., 681 F.2d 514, 519 (7th Cir. 1982), concluded that plaintiff had not established “antitrust injury” because he was “not the target of the alleged anticompetitive practices.”

[A] determination of antitrust standing should focus not only on whether there has been an “antitrust injury,” but also on whether the particular plaintiff is the appropriate antitrust enforcer. Thus, the conflicting interests of deterrence through private antitrust enforcement and redress for injury must be balanced against the avoidance of excessive treble damages litigation. An appropriate balance is achieved by granting standing only to those who, as consumers or competitors, suffer immediate injuries with respect to their business or property, while excluding persons whose injuries were more indirectly caused by the antitrust conduct.\textsuperscript{58}

In thinking about these employee cases, consider the following: Was not the deterrence of anticompetitive acts a fundamental congressional concern? Who is in a better position than an employee to prevent—or alleviate early—the consequences of—unlawful acts? How much danger is there here of duplicative recovery or of any of the other concerns articulated in the Supreme Court’s McCready and Associated General Contractors opinions? There is, of course, real danger of increased litigation (true or untrue allegations of this type may be made by disgruntled present or former employees), and treble damage exposure could lead to unwarranted settlements. How would you draw the policy balance? Is the Ninth Circuit on the right track in concluding that all employees or agents need not be treated alike?

C. SPECIAL ISSUES RELATED TO PRIVATE ENFORCEMENT

Private treble damage actions can be big business. Although the Department of Justice stipulated to the dismissal of its monopolization case against IBM in 1982, in 1973 Control Data settled its private monopolization action against IBM involving many of the same allegations for upwards of $100 million (including $15 million to reimburse legal fees and expenses); senior officers of Control Data boasted that the lawsuit had been the best investment the company had ever made. In the early 1980’s, private antitrust actions shook the paper industry to its economic foundations; as the result of this series of private actions (through settlements and judgments), over $1 billion changed hands. Similarly, in the 1990’s and early 2000’s, large litigations and settlements involved actions against pharmaceutical manufacturers, Microsoft, Sotheby’s and Christie’s auction houses, and an international vitamin cartel.

In general, as Section A supra demonstrates, private antitrust enforcement now dwarfs government enforcement in the number of cases brought and in many areas, because of treble damage provisions, in economic impact. In older cases, the courts often were reluctant to authorize massive recoveries, partly because of the vague line between legal and illegal conduct in many areas of antitrust. More recently, however, a recognition of the importance of the contribution of these “private attorneys general” to an effective national antitrust policy has led the courts to clear many obstacles—procedural, substantive, and related to damages—from the path of private actions. But, particularly during roughly the past thirty years, courts fearful of overdeterrence and self-interested plaintiff’s lawyers have put new obstacles in the path of private litigation. Discussed below are procedural and process issues related to private enforcement that have special antitrust significance.

\textsuperscript{57} Vinci v. Waste Management Inc., 80 F.3d 1372 (9th Cir. 1996); see NicSand, Inc. v. 3M Co., 507 F.3d 442 (6th Cir. 2007).

1. DAMAGES AND LIMITS ON EQUITABLE RELIEF

**Damages**

Enormous time and effort in private antitrust litigation is devoted to proof of the fact and amount of damages. *Bigelow v. RKO Radio Pictures, Inc.* is a landmark case and generally adopted a liberal posture toward plaintiffs’ claims. Plaintiffs, owners of a motion picture theater, had alleged that the defendants had discriminated against them in distribution of motion pictures pursuant to a conspiracy, and as a result profits were reduced. To support the damage claim, plaintiffs introduced evidence comparing their profits with those of a competing theater, and also comparing profits during the period of the alleged conspiracy with corresponding receipts for the years immediately preceding. Noting that defendant “by his own wrong has prevented a more precise computation,” the Supreme Court affirmed a jury verdict based on those two categories of evidence. “Any other rule would enable the wrongdoer to profit by his wrongdoing at the expense of his victim. It would be an inducement to make wrongdoing so effective and complete in every case as to preclude any recovery, by rendering the measure of damages uncertain.”

Today, questions related to damages generally arise after threshold issues are resolved concerning standing, causation, and antitrust injury. Once these hurdles have been cleared, *Bigelow* remains good law, and proof of the actual amount of damage is treated liberally and realistically.

Particularly difficult damage questions arise where the plaintiff is a party that claims it was prevented from starting a business by the anticompetitive activities of the defendant because the plaintiff has had no actual experience in the market to use as a basis for assessing what profits might have been earned absent the challenged conduct. The Supreme Court has said the following on the topic of future profits:

>[E]ach separate action that so accrues entitles a plaintiff to recover not only those damages which he has suffered at the date of accrual, but also those which he will suffer in the future from particular invasion.... On the other hand, it is hornbook law, in antitrust actions as in others, that even if injury and a cause of action have accrued as of a certain date, future damages that might arise from the conduct sued on are unrecoverable if the fact of their accrual is speculative or their amount and nature unprovable.

A numerical example. We should try a simple numerical example to give some sense of the issues at stake in calculating damages. And this example will set up the analysis for the next section on the indirect purchaser doctrine. We have our standard consumer demand curve for the product in question given by \( P = 10 - Q \). We have two business levels involved in putting goods into consumer hands, manufacturers and retailers. The marginal cost curve for manufacturers is flat and equal to 2. The same is true for retailers.

Start by assuming that both levels of productions are competitive. What happens then? In this example, competition is defined by setting price = marginal cost. That means that the wholesale price charged by manufacturers to retailers would be equal to 2. And that in turn means that the price charged to consumers would be 4 (a retailer’s own marginal costs of 2 plus the wholesale price of 2 paid to manufacturers). Given the demand curve, that would mean 6 units of the good would be sold to consumers, and that would produce total consumer surplus (and overall social welfare) equal to 18. (Recall that consumer surplus here is just given by the area of the triangle formula and there are zero economic profits.) Note for completeness that the manufacturers have total revenues and costs of 12 and for the retailers the corresponding numbers are 24 and 24.

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59 327 U.S. 251 (1946).
60 327 U.S. at 264.
All is good so far, but now assume that the manufacturers form a cartel and act as a monopolist would act. The retail sector remains competitive. How does the outcome change? Competition in retailing means that $P = MC$ or here $P = 2 + P_w$, where $P_w$ is the wholesale price charged by the manufacturing cartel. Substitute the equation for the demand curve and we have $10 - Q = 2 + P_w$, or, rewriting, $P_w = 8 - Q$. This is another derived demand curve—think back to the discussion of double marginalization in Chapter 4—and that means we have determined the demand curve facing the manufacturing cartel. Remember that a monopolist maximizes profit by setting $MR = MC$, so we need the marginal revenue curve. The easiest way to find that is through a little calculus, but just work with the idea that $MR = 8 - 2Q$. Marginal cost for the manufacturing cartel is 2, so $2 = 8 - 2Q$ or $Q = 3$. That means the wholesale price is 6 and the final price to consumers is 7.

Calculate a few other results. With $Q = 3$, consumer surplus is 4.5. Retailers have total revenues of 21 against total costs of 21 for profits of 0, just as they had when manufacturing was competitive. The manufacturing cartel earns profits of 9: 3 in profit for each unit sold and 3 units sold. And the deadweight loss triangle—the social value destroyed by the manufacturing cartel—is given by 4.5 as well. That represents the total social loss compared to the competitive case, assuming that we treat the transfer of 9 away from consumers to the manufacturers as a wash (a loss to consumers balanced by an equal gain to manufacturers).

Turn to the question of damages and remedies. Assume that the manufacturing cartel is discovered and a violation of Section 1 of the Sherman Act is proven. Who should have a claim against the manufacturers and what should the amount of that claim be? Should we focus on the deadweight loss and the consumers who would have purchased had the manufacturers competed? Should we force the manufacturers to disgorge their monopoly profits, and should those profits be returned to the consumers who would have obtained that value as consumer surplus under full competition. Are the retailers irrelevant here? After all, they had profits of zero under full competition and profits of zero after the manufacturing cartel formed so they don’t appear to have been injured at all.

As set out above, Section 4 of the Clayton Act calls for threefold damages—treble damages—but it also doesn’t set out a particular measure of damages. Trebling itself raises a variety of issues. Is this a type of punitive damage and rough justice? Instead, does this reflect the idea that violations are imperfectly detected and that damages have to be multiplied when detected to achieve the right level of deterrence? (Be clear on that: if you could violate Section 1 and grab $100 two times and if you got caught only one time, you would be $100 to the good. We would need to double the penalty when you were caught to hope to deter you from violating the statute.)

But whatever your theory of an appropriate damage multiplier, we still need to determine how to calculate damages and who can assert that claim. The most common measure of damages in antitrust in these circumstances is the overcharge: the increase in price compared to the competitive price, here 3, paid by those purchasers who bought at the inflated price. That would cause the profits to be disgorged, but it would not compensate those consumers whose harm is included in the deadweight loss.

**Injunctive relief**

Since 1914, Section 16 of the Clayton Act has permitted private plaintiffs to obtain injunctive relief. As in damage actions, plaintiffs asking for injunctive relief must allege “threatened loss or damage ‘of the type the antitrust laws were designed to prevent and that flows from that which makes defendant’s acts unlawful.’” The Supreme Court has observed: “Section 16 should be construed and applied . . . with the knowledge that the remedy it affords, like other equitable remedies, is flexible and capable of nice adjustments and reconciliation between the public interest and private needs. . . .” In general, the courts have exercised their injunctive powers flexibly and appear to grant

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injunctive relief much more readily to the government than to private plaintiffs. The issue of the availability of divestiture as a remedy in private actions and actions by state attorneys general under Section 7 of the Clayton Act (i.e., where a merger or an acquisition is involved), which the Supreme Court has recently resolved in favor of such relief, is discussed in Chapter 6 supra.

2. THE INDIRECT PURCHASER DOCTRINE

The doctrine arises out of two Supreme Court case, Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968), and Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977). The Supreme Court returned to the issues raised in those cases in a new context in 1990.

**Kansas v. UtiliCorp United, Inc.**

United States Supreme Court, 1990.

497 U.S. 199.

Justice Kennedy delivered the opinion of the Court: Section 4 of the Clayton Act, 15 U.S.C. § 15, authorizes any person injured by a violation of the antitrust laws to sue for treble damages, costs, and an attorney’s fee. We must decide who may sue under § 4 when, in violation of the antitrust laws, suppliers overcharge a public utility for natural gas and the utility passes on the overcharge to its customers. Consistent with Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968), and Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977), we hold that only the utility has the cause of action because it alone has suffered injury within the meaning of § 4.

I

The respondent, UtiliCorp United, Inc., an investor-owned public utility operating in Kansas and western Missouri, purchased natural gas from a pipeline company for its own use and for resale to its commercial and residential customers. Together with a second utility and several other gas purchasers, the respondent sued the pipeline company and five gas production companies in the United States District Court for the District of Kansas. The utilities alleged that the defendants had conspired to inflate the price of their gas in violation of the antitrust laws. They sought treble damages, pursuant to § 4 of the Clayton Act, for both the amount overcharged by the pipeline company and the decrease in sales to their customers caused by the overcharge.

The petitioners, the States of Kansas and Missouri, initiated separate § 4 actions in the District Court against the same defendants for the alleged antitrust violation. Acting as parens patriae, the petitioners asserted the claims of all natural persons residing within Kansas and Missouri who had purchased gas from any utility at inflated prices. They also asserted claims as representatives of state agencies, municipalities, and other political subdivisions that had purchased gas from the defendants. The District Court consolidated all of the actions.

The defendants, in their answer, asserted that the utilities lacked standing under § 4. They alleged that, pursuant to state and municipal regulations and tariffs filed with state regulatory agencies, the utilities had passed through the entire wholesale cost of the natural gas to their customers. As a result, the defendants contended, the utility customers had paid 100 percent of the alleged overcharge, and the utilities had suffered no antitrust injury as required by § 4.

The utilities moved for partial summary judgment with respect to this defense, and the District Court granted their motion. The court ruled that our decisions in Hanover Shoe and Illinois Brick controlled its interpretation of § 4. It read these cases to hold that a direct purchaser from an antitrust violator suffers injury to the full extent of an illegal overcharge even if it passes on some or all of the overcharge to its customers. The District Court concluded that utilities, as direct purchasers, had suffered antitrust injury, but that their customers, as indirect purchasers, had not.
In light of its ruling, the District Court chose to treat the partial summary judgment motion as a motion to dismiss the petitioners’ parens patriae claims. It then granted this motion but allowed the petitioners to take an interlocutory appeal under 28 U.S.C. § 1292(b). It certified the following question to the Court of Appeals:

“In a private antitrust action under 15 U.S.C. § 15 involving claims of price fixing against the producers of natural gas, is a State a proper plaintiff as parens patriae for its citizens who paid inflated prices for natural gas, when the lawsuit already includes as plaintiffs those public utilities who paid the inflated prices upon direct purchase from the producers and who subsequently passed on most or all of the price increase to the citizens of the State?” In re Wyoming Tight Sands Antitrust Cases, 695 F.Supp. 1109, 1120 (Kan. 1988).

The Court of Appeals answered the question in the negative. ***

II

Section 4 of the Clayton Act provides in full:

“[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney’s fee.” 15 U.S.C. § 15(a).

As noted by the District Court and the Court of Appeals, we have applied this section in two cases involving allegations that a direct purchaser had passed on an overcharge to its customers.

In Hanover Shoe, Inc. v. United Shoe Machinery Corp., supra, Hanover alleged that United had monopolized the shoe manufacturing machinery industry in violation of § 2 of the Sherman Act. It sought treble damages under § 4 of the Clayton Act for overcharges paid in leasing certain machinery from United. United defended, in part, on the ground that Hanover had passed on the overcharge to its customers and, as a result, had suffered no injury. We rejected the defense for two reasons. First, noting that a wide range of considerations may influence a company’s pricing decisions, we concluded that establishing the amount of an overcharge shifted to indirect purchasers “would normally prove insurmountable.” 392 U.S., at 493. Second, we reasoned that a pass-on defense would reduce the effectiveness of § 4 actions by diminishing the recovery available to any potential plaintiff.

In Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977), we applied these considerations to reach a similar result. The State of Illinois sued Illinois Brick and other concrete block manufacturers for conspiring to raise the cost of concrete blocks in violation of § 1 of the Sherman Act. We ruled that the State had suffered no injury within the meaning of § 4 because Illinois Brick had not sold any concrete blocks to it. The company, instead, had sold the blocks to masonry subcontractors, who in turn had sold them to the State’s general contractors. We decided that, because Illinois Brick could not use a pass-on defense in an action by direct purchasers, it would risk multiple liability to allow suits by indirect purchasers. We declined to overrule Hanover Shoe or to create exceptions for any particular industries.

Like the State of Illinois in Illinois Brick, the consumers in this case have the status of indirect purchasers. In the distribution chain, they are not the immediate buyers from the alleged antitrust violators. They bought their gas from the utilities, not from the suppliers said to have conspired to fix the price of the gas. Unless we create an exception to the direct purchaser rule established in Hanover Shoe and Illinois Brick, any antitrust claim against the defendants is not for them, but for the utilities to assert.

The petitioners ask us to allow them to press the consumers’ claims for three reasons. First, they assert that none of the rationales underlying Hanover Shoe or Illinois Brick exist in cases involving regulated public utilities. Second, they argue that we should apply an exception, suggested in Illinois Brick, for actions based upon cost-plus contracts. Third,
they maintain that § 4C of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 15c, authorizes them to assert claims on behalf of utility customers even if the customers could not assert any claims themselves. Affirming the Court of Appeals, we reject each of these contentions in turn.

III

The petitioners assert that we should allow indirect purchaser suits in cases involving regulated public utilities that pass on 100 percent of their costs to their customers. They maintain that our concerns in *Hanover Shoe* and *Illinois Brick* about the difficulties of apportionment, the risk of multiple recovery, and the diminution of incentives for private antitrust enforcement would not exist in such cases. We disagree. Although the rationales of *Hanover Shoe* and *Illinois Brick* may not apply with equal force in all instances, we find it inconsistent with precedent and imprudent in any event to create an exception for regulated public utilities.

A

The direct purchaser rule serves, in part, to eliminate the complications of apportioning overcharges between direct and indirect purchasers. The petitioners find the rule unnecessary, in this respect, when a utility passes on its costs to its customers pursuant to state regulations or tariffs filed with a utility commission. In such cases, they assert, the customers pay the entire overcharge, obviating litigation over its apportionment. They maintain that they can prove the exact injury to the residential customers whom they represent because the respondent made periodic public filings showing the volume and price of gas that it sold to these consumers. They ask us to allow them to sue for the entire amount of the overcharge and to limit the respondent’s recovery to damages for its lost business.

The petitioners have oversimplified the apportionment problem in two respects. First, an overcharge may injure a utility, apart from the question of lost business, even if the utility raises its rates to offset its increased costs. As we explained in *Hanover Shoe*:

“[T]he mere fact that a price rise followed an unlawful cost increase does not show that the sufferer of the cost increase was undamaged. His customers may have been ripe for his price rise earlier; if a cost rise is merely the occasion for a price increase a businessman could have imposed absent the rise in his costs, the fact that he was earlier not enjoying the benefits of the higher price should not permit the supplier who charges an unlawful price to take those benefits from him without being liable for damages. This statement merely recognizes the usual principle that the possessor of a right can recover for its unlawful deprivation whether or not he was previously exercising it.” 392 U.S., at 493, n. 9.

In other words, to show that a direct purchaser has borne no portion of an overcharge, the indirect purchaser would have to prove, among other things, that the direct purchaser could not have raised its rates prior to the overcharge.

In *Hanover Shoe*, however, we decided not to allow proof of what the direct purchaser might have done because of the “nearly insuperable difficulty” of the issue. *Id.*, at 493. The petitioners assume that the presence of state regulation would make the proof less difficult here. We disagree. The state regulation does not simplify the problem but instead imports an additional level of complexity. To decide whether a utility has borne an overcharge, a court would have to consider not only the extent to which market conditions would have allowed the utility to raise its rates prior to the overcharge, as in the case of an unregulated business, but also what the state regulators would have allowed. In particular, to decide that an overcharge did not injure a utility, a court would have to determine that the State’s regulatory schemes would have barred any rate increase except for the amount reflected by cost increases. Proof of this complex preliminary issue, one irrelevant to the liability of the defendant, would proceed on a case-by-case basis and would turn upon the intricacies of state law.
From the certified question in this case, we do not know whether the respondent could have raised its prices prior to the overcharge. Its customers may have been willing to pay a greater price, and the Kansas and Missouri regulators may have allowed a rate increase based on factors other than strict costs. To the extent that the respondent could have sought and gained permission to raise its rates in the absence of an overcharge, at least some portion of the overcharge is being borne by it; whether by overcharge or by increased rates, consumers would have been paying more for natural gas than they had been paying in the past. Because of this potential injury, the respondent must remain in the suit. If we were to add indirect purchasers to the action, we would have to devise an apportionment formula. This is the very complexity that Hanover Shoe and Illinois Brick sought to avoid.

Second, difficult questions of timing might necessitate apportioning overcharges if we allowed indirect suits by utility customers. Even if, at some point, a utility can pass on 100 percent of its costs to its customers, various factors may delay the passing-on process. Some utilities must seek approval from the governing regulators prior to raising their rates. Other utilities, pursuant to purchase gas adjustment clauses (PGA's) filed with state regulators, may adjust their rates to reflect changes in their wholesale costs according to prearranged formulas without seeking regulatory approval in each instance. Yet, even utilities that use PGA’s often encounter some delay. During any period in which a utility’s costs rise before it may adjust its rates, the utility will bear the costs in the form of lower earnings. Even after the utility raises its rates, moreover, the pass-through process may take time to complete. During this time, the utility and its customers each would pay for some of the increased costs.

In this case, we could not deprive the respondent of its § 4 action without first determining that the passing-on process in fact had allowed it to shift the entire overcharge to its customers. The certified question, however, leaves unclear whether the respondent had passed on “most or all” of its costs at the time of the suit. In addition, even the means by which the pass-through occurred remain unsettled. The petitioners allege that, pursuant to formulas in PGA’s filed with the Kansas Corporation Commission and the Missouri Public Service Commission, the respondent “automatically” adjusted some of its rates to reflect increases in the wholesale cost of gas. The respondent, however, maintains that PGA’s did not govern all of its sales. The difficulties posed by issues of this sort led us to adopt the direct purchaser rule, and we must decline to create an exception that would require their litigation. As we have stated before: “[T]he task of disentangling overlapping damages claims is not lightly to be imposed upon potential antitrust litigants, or upon the judicial system.” McCready, 457 U.S., at 475, n. 11.

In addition to these complications, the regulation of utilities itself may make an exception to Illinois Brick unnecessary. Our decisions in Hanover Shoe and Illinois Brick often deny relief to consumers who have paid inflated prices because of their status as indirect purchasers. Although one might criticize Illinois Brick for this consequence in other circumstances, the criticism may have less validity in the context of public utilities. Both the Court of Appeals in this case and the Seventh Circuit in Illinois ex rel. Hartigan v. Panhandle Eastern Pipe Line Co., 852 F.2d 891 (1988), have suggested that state regulators would require the utilities to pass on at least some of the recovery obtained in a § 4 suit. State regulators have followed this approach elsewhere. See, e.g., Louisiana Power & Light Co., Ex Parte, Nos. U-17906, U-12636, U-17649, 1989 La. PUC LEXIS 3, 31-32 (Mar. 1, 1989) (requiring Louisiana Power & Light Co., which won a $190 million judgment against United Gas Pipe Line Co., to flow the proceeds back to ratepayers through reduced rates over a 5-year period). If Kansas and Missouri impose similar requirements, then even if the customers cannot sue the alleged antitrust violators, they may receive some of the compensation obtained by the respondent. Creating an exception to allow apportionment in violation of Illinois Brick would make little sense when, in light of all its difficulty, its practical significance is so diminished.

B

The Illinois Brick rule also serves to eliminate multiple recoveries. The petitioners assert that no risk of multiple recovery would exist here, if we allowed them to sue, because the direct and indirect purchasers would be seeking different, not duplicative,
damages; the petitioners would recover the amount of the overcharge and the utilities would recover damages for their lost sales. Leaving aside the apportionment issue, we reject the argument in this case, just as we did in *Illinois Brick*. Bringing all classes of direct and indirect purchasers together in a single lawsuit may reduce the risk of multiple recovery, but the reduction comes at too great a cost.

This case already has become quite complicated. It involves numerous utilities and other companies operating in several States under federal, state, and municipal regulation and, in some instances, under no rate regulation at all. Even apart from gas sold to customers, the utilities seek damages for lost sales and for gas purchased for their own use. The petitioners, in addition to their *parens patriae* claims, are asserting direct claims on behalf of numerous state agencies. Other direct purchasers also seek several measures of damages. Allowing the petitioners to proceed on behalf of consumers would complicate the proceedings further. Even if they could represent consumers residing in Kansas and Missouri, they could not represent industrial and commercial purchasers or consumers from other States. See 15 U.S.C. § 15c(a)(1) (extending parens patriae representation only to resident natural persons). These unrepresented consumers might seek intervention and further delay the prompt determination of the suit. The expansion of the case would risk the confusion, costs, and possibility of error inherent in complex litigation. At the same time, however, it might serve little purpose because, as noted above, state regulatory law may provide appropriate relief to consumers even if they cannot sue under § 4. As in *Illinois Brick*, we continue to believe that “even if ways could be found to bring all potential plaintiffs together in one huge action, the complexity thereby introduced into treble-damages proceedings argues strongly for retaining the *Hanover Shoe* rule.” 431 U.S., at 731, n. 11.

C

We have maintained, throughout our cases, that our interpretation of § 4 must promote the vigorous enforcement of the antitrust laws. If we were convinced that indirect suits would secure this goal better in cases involving utilities, the argument to interpret § 4 to create the exception sought by the petitioners might be stronger. On balance, however, we do not believe that the petitioners can prevail in this critical part of the case. The petitioners assert that utilities, such as the respondent, lack the incentive to prosecute § 4 cases for two reasons. First, they state that utilities, by law, may pass on their costs to customers. Second, they surmise that utilities might have to pass on damages recovered in a § 4 action. In other words, according to the petitioners, utilities lose nothing if they do not sue and gain nothing if they do sue. In contrast, the petitioners maintain, the large aggregate claims of residential consumers will give state attorneys general ample motivation to sue in their capacity as parens patriae.

The petitioners' argument does not persuade us that utilities will lack incentives to sue overcharging suppliers. Utilities may bring § 4 actions in some instances for fear that regulators will not allow them to shift known and avoidable overcharges on to their customers. In addition, even if state law would require a utility to reimburse its customers for recovered overcharges, a utility may seek treble damages in a § 4 action. The petitioners have cited no authority indicating that a victorious utility would have to pay the entire exemplary portion of these damages to its customers.

Utilities, moreover, have an established record of diligent antitrust enforcement, having brought highly successful § 4 actions in many instances. The well-known group of actions from the 1960's involving overcharges for electrical generating equipment provides an excellent example. In these cases, which involved “a series of horizontal price-fixing conspiracies characterized as the most shocking in the history of the Sherman Act, plaintiff utilities ... recover[ed] in unprecedented sums” even though some of the utilities “passed on to their own customers whatever higher costs they incurred as a consequence of the alleged conspiracies.” Pollock, Standing to Sue, Remote Injury, and the Passing-On Doctrine, 32 A.B.A. Antitrust L.J. 5, 10-11 (1966). The courts in these suits, even before the *Hanover Shoe* and *Illinois Brick* decisions, considered the pass-on issue and held that the causes of action were for the utilities to assert. Various factors may have prompted these and other utility actions. For example, in addition to the reasons stated...
above, the respondent asserts that, like any business, an investor-owned utility has an interest in protecting its market. But whatever the motivation for their § 4 suits, this history makes us quite hesitant to take from the utilities the responsibility for enforcing the antitrust laws.

Relying on indirect purchaser actions in utility cases might fail to promote antitrust enforcement for other reasons. Consumers may lack the expertise and experience necessary for detecting improper pricing by a utility’s suppliers. Although state attorneys general have greater expertise, they may hesitate to exercise the parens patriae device in cases involving smaller, more speculative harm to consumers. And even when state attorneys general decide to bring parens patriae actions, they may sue only on behalf of resident natural persons. See 15 U.S.C. § 15c(a)(1). All others, including nonresidents and small businesses, might fail to enforce their claims because of the insignificance of their individual recoveries. For these reasons, we remain unconvinced that the exception sought by the petitioners would promote antitrust enforcement better than the current Illinois Brick rule.

D

The preceding conclusions bring us to a broader point. The rationales underlying Hanover Shoe and Illinois Brick will not apply with equal force in all cases. We nonetheless believe that ample justification exists for our stated decision not to “carve out exceptions to the [direct purchaser] rule for particular types of markets.” Illinois Brick, 431 U.S., at 744. The possibility of allowing an exception, even in rather meritorious circumstances, would undermine the rule. As we have stated:

“[T]he process of classifying various market situations according to the amount of pass-on likely to be involved and its susceptibility of proof in a judicial forum would entail the very problems that the Hanover Shoe rule was meant to avoid. The litigation over where the line should be drawn in a particular class of cases would inject the same ‘massive evidence and complicated theories’ into treble-damages proceedings, albeit at a somewhat higher level of generality.” Id., at 744-745.

In sum, even assuming that any economic assumptions underlying the Illinois Brick rule might be disproved in a specific case, we think it an unwarranted and counterproductive exercise to litigate a series of exceptions. Having stated the rule in Hanover Shoe, and adhered to it in Illinois Brick, we stand by our interpretation of § 4.

IV

The suggestion in Hanover Shoe and Illinois Brick that a departure from the direct purchaser rule may be necessary when an indirect purchaser buys under a pre-existing cost-plus contract does not justify an exception in this case. In Hanover Shoe, we stated:

“We recognize that there might be situations—for instance, when an overcharged buyer has a pre-existing ‘cost-plus’ contract, thus making it easy to prove that he has not been damaged—where the considerations requiring that the passing-on defense not be permitted in this case would not be present.” 392 U.S., at 494.

We observed further in Illinois Brick:

“In [a cost-plus contract] situation, the [direct] purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case.” 431 U.S., at 736.

The petitioners argue that the regulations and tariffs requiring the respondent to pass on its costs to the consumers place this case within the cost-plus contract exception. We disagree.

The respondent did not sell the gas to its customers under a pre-existing cost-plus contract. Even if we were to create an exception for situations that merely resemble those
governed by such a contract, we would not apply the exception here. Our statements above show that we might allow indirect purchasers to sue only when, by hypothesis, the direct purchaser will bear no portion of the overcharge and otherwise suffer no injury. That certainty does not exist here.

The utility customers made no commitment to purchase any particular quantity of gas, and the utility itself had no guarantee of any particular profit. Even though the respondent raised its prices to cover its costs, we cannot ascertain its precise injury because, as noted above, we do not know what might have happened in the absence of an overcharge. In addition, even if the utility customers had a highly inelastic demand for natural gas, the need to inquire into the precise operation of market forces would negate the simplicity and certainty that could justify a cost-plus contract exception. Thus, although we do not alter our observations about the possibility of an exception for cost-plus contracts, we decline to create the general exception for utilities sought by the petitioners.

V

The petitioners, in their final argument, contend that § 4C of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 15c, authorizes them to sue on behalf of consumers even though the consumers, as indirect purchasers, have no cause of action of their own. Section 4C(a)(1) provides in relevant part:

“Any attorney general of a State may bring a civil action in the name of such state as parens patriae on behalf of natural persons residing in such State ... to secure monetary relief as provided in this section for injury sustained by such natural persons to their property by reason of any violation of sections 1 to 7 of this title.” 15 U.S.C. § 15c(a)(1).

Because the Act, in their view, has the clear purpose of protecting consumers, the petitioners contend that it must allow the States to sue on behalf of consumers notwithstanding their status as indirect purchasers.

We have rejected this argument before. We stated in Illinois Brick that § 4C did not establish any new substantive liability. Instead, “[i]t simply created a new procedural device—parens patriae actions by States on behalf of their citizens—to enforce existing rights of recovery under § 4 [of the Clayton Act].” 431 U.S., at 734, n. 14. Section 4, as noted above, affords relief only to a person “injured in his business or property by reason of anything forbidden in the antitrust laws.” 15 U.S.C. § 15(a). State attorneys general may bring actions on behalf of consumers who have such an injury. But here the respondent is the injured party under the antitrust laws, and the predicate for a parens patriae action has not been established. We conclude that the petitioners may not assert any claims on behalf of the customers.

Affirmed.***

NOTES AND QUESTIONS

1. The simple fact pattern again. Return to the simple numerical damages example set out before Utilicorp United. In the hypothetical, the retailers as a group suffered no injury from the manufacturing cartel. In some sense, that is by construction; retailing was and remained competitive, and that meant that there would be zero (economic) profits in each situation. Yet the result that emerges from Hanover Shoe and Illinois Brick—and the result reaffirmed in Utilicorp United—is that the retailers are given standing to sue for damages and the indirect purchasers—the actual consumers—are barred from suing. It is as if one of us punched Joe and Sam was given standing to bring a tort suit. How can that make any sense?

2. The limits of pass through. Try this idea. Retailers observe the price jump at the wholesale level and instantly know that a manufacturing cartel has formed. With each purchase, they get the good in question plus they know that they are getting a future claim to recover the overcharge, trebled. How much of the goods should retailers buy? What determines an equilibrium? What price will consumers see if retailers are competing to sell goods to consumers so as to make sure that they can bring the future treble damages claim? Does that effectively achieve compensation for consumers? And do you believe that the pass-through

3. Pass-on and the states. Although the Supreme Court has refused to allow pass-on theory to be used offensively or defensively in federal antitrust cases, California v. ARC America Corp., 490 U.S. 93 (1989), presented the Court with the question whether state antitrust laws were similarly limited. Justice White, writing for a unanimous Court, held that the federal policies outlined in Hanover Shoe and Illinois Brick for federal antitrust laws did not preempt the states from allowing indirect purchasers to recover under state antitrust laws. The Court found that “Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies.” In the early 2000’s, more than half the states allowed indirect purchasers to sue for antitrust violations under state law. In 2007, the Antitrust Modernization Commission recommended that Congress overrule both Hanover Shoe and Illinois Brick. The Commission concluded that different federal and state standards have resulted in “wasteful, duplicative litigation,” involving potentially duplicative damage recoveries and inconsistent decisions.

4. Meanwhile in Europe. Lest one think that the indirect purchaser rule inevitably emerges in sophisticated antitrust systems, do note that the European Union has recently adopted the opposite rule in an October 24, 2014 directive. Article 12, on the passing-on of overcharges and the right to full compensation, provides that:

To ensure the full effectiveness of the right to full compensation as laid down in Article 3, Member States shall ensure that, in accordance with the rules laid down in this Chapter, compensation of harm can be claimed by anyone who suffered it, irrespective of whether they are direct or indirect purchasers from an infringer, and that compensation of harm exceeding that caused by the infringement of competition law to the claimant, as well as the absence of liability of the infringer, are avoided.

3. THE STATES AND PARENTS PATRIAE

Statutory Authority and Profile of Enforcement by State Attorneys General. Private actions are also available to states. A state may recover damages caused, for example, by overcharges to it resulting from price fixing or other cartel activity or, in its capacity as parens patriae, may seek injunctive relief without the need to show damage to its “business or property.”

In addition, in September 1976, Congress enacted the Hart–Scott–Rodino Act, which contained new parens patriae provisions. These permit state attorneys general to bring Sherman Act cases on behalf of natural persons (as opposed to business entities) residing in their states. The attorneys general may seek treble damages, costs, and attorney’s fees in addition to injunctive relief. Most important, in any action in which it has been determined that a defendant fixed prices in violation of the Sherman Act:

damages may be proved and assessed in the aggregate by statistical or sampling methods, by the computation of illegal overcharges, or by such other reasonable system of estimating aggregate damages as the court in its discretion may permit

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409 U.S. at 102.


without the necessity of separately proving the individual claim of, or amount of
damage to, persons on whose behalf the suit was brought.

Where price fixing has been found, the Act provides, in essence, for “fluid recoveries.”
Once aggregate damages have been awarded, each person in the attorney general’s class
may come forward and prove the extent of his or her injury. Monies not claimed by
individuals:

Shall (1) be distributed in such manner as the district court in its discretion may
authorize; or (2) be deemed a civil penalty by the court and deposited with the
State as general revenues.

Critics contended that the *parens patriae* provisions improperly focus on “ill-gotten
gains rather than on consumer compensation” and would result in unmanageable classes
and ruinous exposures. The report of the Senate Judiciary Committee responded:

The economic burden of most antitrust violations is borne by the consumer in the
form of higher prices for goods and services... When everyday consumer
purchases are involved (e.g., bread, dairy products, gasoline, etc.), the individual
dollar amounts are so small that, as a practical matter, an individual antitrust
lawsuit is out of the question. Similarly, consumers have found little relief under
the class action provisions of the Federal Rules...

The Committee believes that this title provides a practical remedy for consumers,
and that it is necessary to deter antitrust violations, to take the profit out of white
collar crime, and to dispense equal justice to the rich and poor alike. The predictions of ruinous liability made by opponents... [are unproven and must be
rejected].71

The *parens patriae* provisions of the Hart–Scott–Rodino Act and the general
contractions of antitrust enforcement at the federal level led, as the National Association
of Attorneys General describe it, to “a revolution in the patterns of enforcement” during
the 1980’s. In that decade, state attorney general enforcement:

experienced first renaissance and then an explosive increase in cases,
investigations, and legislative and other policy initiatives. To the traditional
attorney general role of *parens patriae* in local cases involving price-fixing and
bid-rigging was added a concern with the entire spectrum of competition law and
policy.72

During the 1990’s, with more aggressive enforcement by the Antitrust Division and
the FTC, the antitrust activity of state attorneys general somewhat receded. In the early
years of the 21st century, it appears that state antitrust enforcement increased and now
remains vigorous by any historic measure. Also, particularly in the late 1990’s, state
attorneys general worked effectively with the federal enforcement agencies through
cooperation agreements and joint proceedings (e.g., state attorneys general joined with
the Antitrust Division in the *Microsoft* case73 and with the FTC in a merger proceeding
against Exxon and Mobil).

Policy Issues Related to Actions by Private Parties and State Attorneys General. One
result of the increase in antitrust enforcement activity by private parties and state
attorneys general has been to change the balance of potential profit and risk for businesses
contemplating questionable conduct under the antitrust laws. Because the Antitrust
Division and the FTC have limited resources, allowing them to bring no more than
perhaps 100 to 150 cases even in well-funded years, as a practical matter it is often the
risk of private enforcement that causes business conduct to be informed by concerns about

72 National Association of Attorneys General, State Attorney General Antitrust Enforcement (i) (1989). The
*parens patriae* role of state attorneys general must be viewed in the light of the Supreme Court’s decisions in Illinois
Brick Co. v. Illinois, 431 U.S. 720 (1977), which may prevent consumers (often indirect purchasers) from proving
antitrust damage, and California v. ARC America Corp., 490 U.S. 93 (1989), which acknowledges the right of indirect
purchasers to recover under state antitrust statutes. See pp.__–__ infra. In general, state antitrust statutes, which
usually parallel the federal antitrust laws, are beyond the purview of this casebook.
73 See Chapter 8 infra.
compliance with the antitrust laws. And the risk of private enforcement often turns on whether there is a potential litigant (or a class of litigants) that has the resources and staying power to take its claim to the courts.

In a number of cases decided in 1982, the Supreme Court reemphasized its longstanding recognition of the important role played by private treble damage actions:

Congress sought to create a private enforcement mechanism that would deter violators and deprive them of the fruits of their illegal actions, and would provide ample compensation to the victims of antitrust violations. . . . Consistent with the congressional purpose, we have refused to engraft artificial limitations on the § 4 remedy. . . . [W]e have applied § 4 in accordance with its plain language and its broad remedial and deterrent objectives.


On the other hand, most commentators agree that some private damage claimants, attracted by the possibility of a treble damage “bonanza,” have instituted suits with little merit in the hope of at least extracting a settlement. Defendants are often hesitant to go to trial when faced with large damage exposures in complex antitrust litigation. Also, as the Supreme Court noted in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742–43 (1975), in the context of securities litigation:

[I]n this type of litigation. . . the mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, an entirely legitimate component of settlement value, but because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial. . . .

In addition, competitors sometimes have perverse (anticompetitive) reasons for challenging a practice or opposing a merger; and in antitrust class actions, the plaintiffs’ attorney is often the engine (with a large financial stake in the result) and primary direct beneficiary of the litigation. These incentives create the danger of overenforcement and, in comparison to a government action, leave little room for prosecutorial discretion in the public interest.

Similarly, actions by state attorneys general have been challenged as involving heavy political components or undue concern for special local interests. Nevertheless, during the past twenty-five years or so, a broad consensus appears to have developed in support of vigorous state attorney general action. For example, Charles F. Rule, the last Assistant Attorney in charge of the Antitrust Division during the Reagan years, stated:

In the ten years since the parens patriae remedy was enacted, state antitrust activity has increased greatly. Consumers likely have benefited from having their antitrust damage concerns addressed by those best able to identify and respond to them.

State attorneys general, being closer to their citizens injured by antitrust violations, have a greater incentive to bring consumer-based damage actions than would the federal government. State attorneys general have been steadily accumulating the expertise needed successfully to pursue complex antitrust damages actions, and are free to hire outside counsel when additional assistance is required. Furthermore, the state attorneys general have shown in several instances that, by coordinating their efforts, they can pursue antitrust actions of multi-state scope that approach the limits on the size of such consumer damage actions that successfully can be litigated.

The ABA 2001 Task Force, however, observed that [t]here “are many enforcers of the American antitrust laws -- federal antitrust agencies, state attorneys general, and multiple private attorneys general,” and that “our system generates large administrative costs, large legal fees, and haphazard results in terms of victim compensation.” It urged

74 Rule, Remarks at an ALI–ABA Course of Study 30 (May 6, 1988).
careful study of the problem. But in 2007, a bipartisan Antitrust Modernization Commission created by Congress recommended no statutory change “to the current role of the states in non-merger civil antitrust enforcement or “with respect to reviewing mergers.” The Modernization Commission encouraged federal and state antitrust enforcement agencies to “coordinate their activities and to seek to avoid subjecting companies to multiple and possibly inconsistent proceedings.”

D. CLASS ACTIONS

Rule 23 of the Federal Rules of Civil Procedure sets out the procedure applicable to class actions. This is not an advanced course in civil procedure or a specialized course on class actions, but class actions are sufficiently important in antitrust that some analysis is warranted. You might think of class actions as being particularly appropriate in two circumstances. The first is where injury occurs to many consumers but where the individual damages are small. In that situation, no individual plaintiff will want to mount a lawsuit on her own; and if no lawsuit can be brought, a bad firm can systematically inflict substantial injury in the aggregate even if each individual injury is small. The natural solution to that is to aggregate plaintiffs, and that is what a class action does. The second situation for a class action is where the relief sought isn’t money damages but is instead an injunction or some other type of equitable remedy that will apply to many people simultaneously. Given the necessarily aggregate nature of the remedy, an aggregate original action makes sense.

There is a common perception that class actions are just a tool for funneling money to lawyers. The accusation is made that actual consumers get small recoveries or coupons, while the lawyers walk away with millions of dollars. How you feel about that depends a little on what you think class actions are supposed to accomplish. If the class action is intended to be compensatory, then the small recoveries to actual consumers may be a problem even when we recognize that the individual injuries may be small as well. But if the focus switches from compensation to deterrence, then the money-damages class action may fare better. What matters is that there needs to be an effective device for getting defendants to write large checks to someone and where the money goes is a secondary consideration. Lawyers need to be incentivized to bring the suits, and this is typically done by the use of contingent fees—meaning that the lawyers get paid only if they win the lawsuit or obtain a settlement. That means that we will need largish payments to the lawyers to get the lawsuits in the first place.

Our job here isn’t to set out a full explanation of class actions or to defend or criticize class actions as a whole. Instead, we turn to two recent Supreme Court decisions on class actions in antitrust. Do note that the Supreme Court has been especially active in deciding class action issues in recent year, so the law here has been in flux. In any event, to set up the first case we address, consider a contract with the following provision: “You hereby agree to waive all antitrust claims under U.S. law that might arise out of this contract or through behavior related to this contract.” Do you think that contract term is enforceable? Should it be? Take another step back: Under what circumstances do you think that a contract would contain that clause?

Switch the facts slightly. The contract in question says nothing about waiving antitrust claims. Instead, the contract contains two related provisions. The first calls for mandatory arbitration of all disputes under the contract. That type of clause isn’t unusual in contracts; and indeed there is an entire federal statute, the Federal Arbitration Act, which facilitates the enforcement of arbitration clauses. The second, related clause requires the claims under the contract to be addressed individually and as not part of a class action or other collective device. Should those provisions be enforceable? Are they somehow different from the pure-antitrust waiver clause, or do they in effect achieve the

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same end as the clause but by less transparent means? These issues are raised in the next case.

American Express Co. v. Italian Colors Restaurant
United States Supreme Court, 2013.
133 S. Ct. 2304.

**JUSTICE SCALIA,** delivered the opinion of the Court: We consider whether a contractual waiver of class arbitration is enforceable under the Federal Arbitration Act when the plaintiff’s cost of individually arbitrating a federal statutory claim exceeds the potential recovery.

I

Respondents are merchants who accept American Express cards. Their agreement with petitioners—American Express and a wholly owned subsidiary—contains a clause that requires all disputes between the parties to be resolved by arbitration. The agreement also provides that “[t]here shall be no right or authority for any Claims to be arbitrated on a class action basis.” In re American Express Merchants’ Litigation, 667 F.3d 204, 209 (CA2 2012).

Respondents brought a class action against petitioners for violations of the federal antitrust laws. According to respondents, American Express used its monopoly power in the market for charge cards to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards.1 This tying arrangement, respondents said, violated §1 of the Sherman Act. They sought treble damages for the class under §4 of the Clayton Act.

Petitioners moved to compel individual arbitration under the Federal Arbitration Act (FAA), 9 U.S.C. §1 et seq. In resisting the motion, respondents submitted a declaration from an economist who estimated that the cost of an expert analysis necessary to prove the antitrust claims would be “at least several hundred thousand dollars, and might exceed $1 million,” while the maximum recovery for an individual plaintiff would be $12,850, or $38,549 when trebled. The District Court granted the motion and dismissed the lawsuits. The Court of Appeals reversed and remanded for further proceedings. It held that because respondents had established that “they would incur prohibitive costs if compelled to arbitrate under the class action waiver,” the waiver was unenforceable and the arbitration could not proceed. In re American Express Merchants’ Litigation, 554 F.3d 300, 315-316 (CA2 2009).

We granted certiorari, vacated the judgment, and remanded for further consideration in light of Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp., 559 U.S. 662 (2010), which held that a party may not be compelled to submit to class arbitration absent an agreement to do so. American Express Co. v. Italian Colors Restaurant, 559 U.S. 1103 (2010). The Court of Appeals stood by its reversal, stating that its earlier ruling did not compel class arbitration. In re American Express Merchants’ Litigation, 634 F.3d 187, 200 (CA2 2011). It then sua sponte reconsidered its ruling in light of AT&T Mobility LLC v. Concepcion, 563 U.S. ___ (2011), which held that the FAA pre-empted a state law barring enforcement of a class-arbitration waiver. Finding AT&T Mobility inapplicable because it addressed pre-emption, the Court of Appeals reversed for the third time. 667 F.3d, at 213. It then denied rehearing en banc with five judges dissenting. In re American Express Merchants’ Litigation, 681 F.3d 139 (CA2 2012). We granted certiorari, 568 U. S. ___ (2012), to consider the question “[w]hether the Federal Arbitration Act permits courts . . . to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim,” Pet. for Cert. i.

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1 A charge card requires its holder to pay the full outstanding balance at the end of a billing cycle; a credit card requires payment of only a portion, with the balance subject to interest.
II

Congress enacted the FAA in response to widespread judicial hostility to arbitration. See AT&T Mobility, supra, at ___ (slip op., at 4). As relevant here, the Act provides:

“A written provision in any maritime transaction or contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2.

This text reflects the overarching principle that arbitration is a matter of contract. See Rent-A-Center, West, Inc. v. Jackson, 561 U.S. ___, ___ (2010) (slip op., at 3). And consistent with that text, courts must “rigorously enforce” arbitration agreements according to their terms, Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 221 (1985), including terms that “specify with whom [the parties] choose to arbitrate their disputes,” Stolt-Nielsen, supra, at 683, and “the rules under which that arbitration will be conducted,” Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989). That holds true for claims that allege a violation of a federal statute, unless the FAA’s mandate has been “overridden by a contrary congressional command.” CompuCredit Corp. v. Greenwood, 565 U.S. ___, ___ (2012) (slip op., at 2-3) (quoting Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 226 (1987)).

III

No contrary congressional command requires us to reject the waiver of class arbitration here. Respondents argue that requiring them to litigate their claims individually—as they contracted to do—would contravene the policies of the antitrust laws. But the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim. Congress has taken some measures to facilitate the litigation of antitrust claims—for example, it enacted a multiplied-damages remedy. See 15 U.S.C. §15 (treble damages). In enacting such measures, Congress has told us that it is willing to go, in certain respects, beyond the normal limits of law in advancing its goals of deterring and remediying unlawful trade practice. But to say that Congress must have intended whatever departures from those normal limits advance antitrust goals is simply irrational. “[N]o legislation pursues its purposes at all costs.” Rodriguez v. United States, 480 U.S. 522, 525-526 (1987) (per curiam).

The antitrust laws do not “evinc[e] an intention to preclude a waiver” of class-action procedure. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985). The Sherman and Clayton Acts make no mention of class actions. In fact, they were enacted decades before the advent of Federal Rule of Civil Procedure 23, which was “designed to allow an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.” Califano v. Yamasaki, 442 U.S. 682, 700-701 (1979). The parties here agreed to arbitrate pursuant to that “usual rule,” and it would be remarkable for a court to erase that expectation.

Nor does congressional approval of Rule 23 establish an entitlement to class proceedings for the vindication of statutory rights. To begin with, it is likely that such an entitlement, invalidating private arbitration agreements denying class adjudication, would be an “abridg[ment] or modification” of a “substantive right” forbidden to the Rules, see 28 U.S.C. §2072(b). But there is no evidence of such an entitlement in any event. The Rule imposes stringent requirements for certification that in practice exclude most claims. And we have specifically rejected the assertion that one of those requirements (the class-notice requirement) must be dispensed with because the “prohibitively high cost” of compliance would “frustrate [plaintiff’s] attempt to vindicate the policies underlying the antitrust” laws. Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 166-168, 175-176 (1974). One might respond, perhaps, that federal law secures a nonwaivable opportunity to vindicate federal policies by satisfying the procedural strictures of Rule 23 or invoking some other informal class mechanism in arbitration. But we have already rejected that proposition in AT&T Mobility, 563 U.S., at ___ (slip op., at 9).
Our finding of no “contrary congressional command” does not end the case. Respondents invoke a judge-made exception to the FAA which, they say, serves to harmonize competing federal policies by allowing courts to invalidate agreements that prevent the “effective vindication” of a federal statutory right. Enforcing the waiver of class arbitration bars effective vindication, respondents contend, because they have no economic incentive to pursue their antitrust claims individually in arbitration.

The “effective vindication” exception to which respondents allude originated as dictum in *Mitsubishi Motors*, where we expressed a willingness to invalidate, on “public policy” grounds, arbitration agreements that “operate[e] . . . as a prospective waiver of a party’s right to pursue statutory remedies.” 473 U.S., at 637, n. 19 (emphasis added). Dismissing concerns that the arbitral forum was inadequate, we said that “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function.” Id., at 637. Subsequent cases have similarly asserted the existence of an “effective vindication” exception, see, e.g., 14 Penn Plaza LLC v. Pyett, 556 U.S. 247, 273-274 (2009); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28 (1991), but have similarly declined to apply it to invalidate the arbitration agreement at issue.

And we do so again here. As we have described, the exception finds its origin in the desire to prevent “prospective waiver of a party’s right to pursue statutory remedies,” *Mitsubishi Motors*, supra, at 637, n. 19 (emphasis added). That would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights. And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable. But the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy. The class-action waiver merely limits arbitration to the two contracting parties. It no more eliminates those parties’ right to pursue their statutory remedy than did federal law before its adoption of the class action for legal relief in 1938. Or, to put it differently, the individual suit that was considered adequate to assure “effective vindication” of a federal right before adoption of class-action procedures did not suddenly become “ineffective vindication” upon their adoption.

Truth to tell, our decision in *AT&T Mobility* all but resolves this case. There we invalidated a law conditioning enforcement of arbitration on the availability of class procedure because that law “interfer[ed] with fundamental attributes of arbitration.” 563 U.S., at ___ (slip op., at 9). “[T]he switch from bilateral to class arbitration,” we said, “sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment.” Id., at ___ (slip op., at 14). We specifically rejected the argument that class arbitration was necessary to prosecute claims “that might otherwise slip through the legal system.” Id., at ___ (slip op., at 17).

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The regime established by the Court of Appeals’ decision would require—before a plaintiff can be held to contractually agreed bilateral arbitration—that a federal court determine (and the parties litigate) the legal requirements for success on the merits claim-by-claim and theory-by-theory, the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success. Such a preliminary litigating hurdle would undoubtedly destroy the prospect of

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Who can disagree with the dissent’s assertion that “the effective-vindication rule asks about the world today, not the world as it might have looked when Congress passed a given statute”? Post. But time does not change the meaning of effectiveness, making ineffective vindication today what was effective vindication in the past. The dissent also says that the agreement bars other forms of cost sharing—existing before the Sherman Act—that could provide effective vindication. See post, at n. 5. Petitioners denied that, and that is not what the Court of Appeals decision under review here held. It held that, because other forms of cost sharing were not economically feasible (“the only economically feasible means for . . . enforcing [respondents’] statutory rights is via a class action”), the class-action waiver was unenforceable. 667 F.3d, at 218 (emphasis added). (The dissent’s assertion to the contrary cites not the opinion on appeal here, but an earlier opinion that was vacated. See *In re American Express Merchants’ Litigation*, 554 F.3d 300 (CA2 2009), vacated and remanded, 559 U.S. 1103 (2010). That is the conclusion we reject.
speedy resolution that arbitration in general and bilateral arbitration in particular was meant to secure. The FAA does not sanction such a judicially created superstructure.

The judgment of the Court of Appeals is reversed.

It is so ordered.

■ JUSTICE SOTOMAYOR took no part in the consideration or decision of this case.

■ JUSTICE THOMAS, concurring. I join the Court’s opinion in full. I write separately to note that the result here is also required by the plain meaning of the Federal Arbitration Act.

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■ JUSTICE KAGAN, with whom JUSTICE GINSBURG and JUSTICE BREYER join, dissenting: Here is the nutshell version of this case, unfortunately obscured in the Court’s decision. The owner of a small restaurant (ItalianColors) thinks that American Express (Amex) has used its monopoly power to force merchants to accept a form contract violating the antitrust laws. The restaurateur wants to challenge the allegedly unlawful provision (imposing a tying arrangement), but the same contract’s arbitration clause prevents him from doing so. That term imposes a variety of procedural bars that would make pursuit of the antitrust claim a fool’s errand. So if the arbitration clause is enforceable, Amex has insulated itself from antitrust liability—even if it has in fact violated the law. The monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse.

And here is the nutshell version of today’s opinion, admirably flaunted rather than camouflaged: Too darn bad.

That answer is a betrayal of our precedents, and of federal statutes like the antitrust laws. Our decisions have developed a mechanism—called the effective-vindication rule—to prevent arbitration clauses from choking off a plaintiff’s ability to enforce congressionally created rights. That doctrine bars applying such a clause when (but only when) it operates to confer immunity from potentially meritorious federal claims. In so doing, the rule reconciles the Federal Arbitration Act (FAA) with all the rest of federal law—and indeed, promotes the most fundamental purposes of the FAA itself. As applied here, the rule would ensure that Amex’s arbitration clause does not foreclose Italian Colors from vindicating its right to redress antitrust harm.

The majority barely tries to explain why it reaches a contrary result. It notes that we have not decided this exact case before—neglecting that the principle we have established fits this case hand in glove. And it concocts a special exemption for class-arbitration waivers—ignoring that this case concerns much more than that. Throughout, the majority disregards our decisions’ central tenet: An arbitration clause may not thwart federal law, irrespective of exactly how it does so. Because the Court today prevents the effective vindication of federal statutory rights, I respectfully dissent.

I

Start with an uncontroversial proposition: We would refuse to enforce an exculpatory clause insulating a company from antitrust liability—say, “ Merchants may bring no Sherman Act claims”—even if that clause were contained in an arbitration agreement. Congress created the Sherman Act’s private cause of action not solely to compensate individuals, but to promote “the public interest in vigilant enforcement of the antitrust laws.” Lawlor v. National Screen Service Corp., 349 U.S. 322, 329 (1955). Accordingly, courts will not enforce a prospective waiver of the right to gain redress for an antitrust injury, whether in an arbitration agreement or any other contract. See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637, and n. 19 (1985). The same rule applies to other important federal statutory rights. But its necessity is nowhere more evident than in the antitrust context. Without the rule, a company could use its monopoly power to protect its monopoly power, by coercing agreement to contractual terms eliminating its antitrust liability.

If the rule were limited to baldly exculpatory provisions, however, a monopolist could devise numerous ways around it. Consider several alternatives that a party drafting an arbitration agreement could adopt to avoid antitrust liability, each of which would have
the identical effect. On the front end: The agreement might set outlandish filing fees or establish an absurd (e.g., one-day) statute of limitations, thus preventing a claimant from gaining access to the arbitral forum. On the back end: The agreement might remove the arbitrator’s authority to grant meaningful relief, so that a judgment gets the claimant nothing worthwhile. And in the middle: The agreement might block the claimant from presenting the kind of proof that is necessary to establish the defendant’s liability—say, by prohibiting any economic testimony (good luck proving an antitrust claim without that!). Or else the agreement might appoint as an arbitrator an obviously biased person—say, the CEO of Amex. The possibilities are endless—all less direct than an express exculpatory clause, but no less fatal. So the rule against prospective waivers of federal rights can work only if it applies not just to a contract clause explicitly barring a claim, but to others that operate to do so.

And sure enough, our cases establish this proposition: An arbitration clause will not be enforced if it prevents the effective vindication of federal statutory rights, however it achieves that result. The rule originated in Mitsubishi, where we held that claims brought under the Sherman Act and other federal laws are generally subject to arbitration. 473 U.S., at 628. By agreeing to arbitrate such a claim, we explained, “a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.” Ibid. But crucial to our decision was a limiting principle, designed to safeguard federal rights: An arbitration clause will be enforced only “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum.” Id., at 637. If an arbitration provision “operated . . . as a prospective waiver of a party’s right to pursue statutory remedies,” we emphasized, we would “condemn[ ]” it. Id., at 637, n. 19. Similarly, we stated that such a clause should be “set[ ] aside” if “proceedings in the contractual forum will be so gravely difficult” that the claimant “will for all practical purposes be deprived of his day in court.” Id., at 632 (internal quotation marks omitted). And in the decades since Mitsubishi, we have repeated its admonition time and again, instructing courts not to enforce an arbitration agreement that effectively (even if not explicitly) forecloses a plaintiff from remedying the violation of a federal statutory right.

Our decision in Green Tree Financial Corp.-Ala. v. Randolph, 531 U.S. 79 (2000), confirmed that this principle applies when an agreement thwarts federal law by making arbitration prohibitively expensive.

Applied as our precedents direct, the effective-vindication rule furthers the purposes not just of laws like the Sherman Act, but of the FAA itself. That statute reflects a federal policy favoring actual arbitration—that is, arbitration as a streamlined “method of resolving disputes,” not as a foolproof way of killing off valid claims. Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 481 (1989). Put otherwise: What the FAA prefers to litigation is arbitration, not de facto immunity. The effective-vindication rule furthers the statute’s goals by ensuring that arbitration remains a real, not faux, method of dispute resolution. With the rule, companies have good reason to adopt arbitral procedures that facilitate efficient and accurate handling of complaints. Without it, companies have every incentive to draft their agreements to extract backdoor waivers of statutory rights, making arbitration unavailable or pointless. So down one road: More arbitration, better enforcement of federal statutes. And down the other: Less arbitration, poorer enforcement of federal statutes. Which would you prefer? Or still more aptly: Which do you think Congress would?

The answer becomes all the more obvious given the limits we have placed on the rule, which ensure that it does not diminish arbitration’s benefits. The rule comes into play only when an agreement “operate[s] . . . as a prospective waiver”—that is, forecloses (not diminishes) a plaintiff’s opportunity to gain relief for a statutory violation. Mitsubishi, 473 U.S., at 637, n. 19. *** And for almost three decades, courts have followed our edict that arbitration clauses must usually prevail, declining to enforce them in only rare cases. The effective-vindication rule has thus operated year in and year out without undermining, much less “destroy[ing],” the prospect of speedy dispute resolution that arbitration secures. Ante.
And this is just the kind of case the rule was meant to address. Italian Colors, as I have noted, alleges that Amex used its market power to impose a tying arrangement in violation of the Sherman Act. The antitrust laws, all parties agree, provide the restaurant with a cause of action and give it the chance to recover treble damages. Here, that would mean Italian Colors could take home up to $38,549. But a problem looms. As this case comes to us, the evidence shows that Italian Colors cannot prevail in arbitration without an economic analysis defining the relevant markets, establishing Amex’s monopoly power, showing anticompetitive effects, and measuring damages. And that expert report would cost between several hundred thousand and one million dollars. So the expense involved in proving the claim in arbitration is ten times what Italian Colors could hope to gain, even in a best-case scenario. That counts as a “prohibitive” cost, in Randolph’s terminology, if anything does. No rational actor would bring a claim worth tens of thousands of dollars if doing so meant incurring costs in the hundreds of thousands.

An arbitration agreement could manage such a mismatch in many ways, but Amex’s disdains them all. As the Court makes clear, the contract expressly prohibits class arbitration. But that is only part of the problem. The agreement also disallows any kind of joinder or consolidation of claims or parties. And more: Its confidentiality provision prevents Italian Colors from informally arranging with other merchants to produce a common expert report. And still more: The agreement precludes any shifting of costs to Amex, even if Italian Colors prevails. And beyond all that: Amex refused to enter into any stipulations that would obviate or mitigate the need for the economic analysis. In short, the agreement as applied in this case cuts off not just class arbitration, but any avenue for sharing, shifting, or shrinking necessary costs. Amex has put Italian Colors to this choice: Spend way, way, way more money than your claim is worth, or relinquish your Sherman Act rights.

So contra the majority, the court below got this case right. Italian Colors proved what the plaintiff in Randolph could not—that a standard-form agreement, taken as a whole, renders arbitration of a claim “prohibitively expensive.” 531 U.S., at 92. The restaurant thus established that the contract “operate[s] . . . as a prospective waiver,” and prevents the “effective[ ] . . . vindicat[ion]” of Sherman Act rights. Mitsubishi, 473 U.S., at 637, and n. 19. I would follow our precedents and decline to compel arbitration.

II

The majority is quite sure that the effective-vindication rule does not apply here, but has precious little to say about why. It starts by disparaging the rule as having “originated as dictum.” Ante. But it does not rest on that swipe, and for good reason. As I have explained, the rule began as a core part of Mitsubishi: We held there that federal statutory claims are subject to arbitration “so long as “ the claimant “effectively may vindicate its [rights] in the arbitral forum.” 473 U.S., at 637 (emphasis added). The rule thus served as an essential condition of the decision’s holding. And in Randolph, we provided a standard for applying the rule when a claimant alleges “prohibitive costs” ***, and we then applied that standard to the parties before us. So whatever else the majority might think of the effective-vindication rule, it is not dictum.

The next paragraph of the Court’s decision (the third of Part IV) is the key: It contains almost the whole of the majority’s effort to explain why the effective-vindication rule does not stop Amex from compelling arbitration. The majority’s first move is to describe Mitsubishi and Randolph as covering only discrete situations: The rule, the majority asserts, applies to arbitration agreements that eliminate the “right to pursue statutory remedies” by “forbidding the assertion” of the right (as addressed in Mitsubishi) or imposing filing and administrative fees “so high as to make access to the forum impracticable” (as addressed in Randolph). Ante. Those cases are not this case, the majority says: Here, the agreement’s provisions went to the possibility of “proving a statutory remedy.” Ante.

But the distinction the majority proffers, which excludes problems of proof, is one Mitsubishi and Randolph (and our decisions reaffirming them) foreclose. Those decisions establish what in some quarters is known as a principle: When an arbitration agreement
prevents the effective vindication of federal rights, a party may go to court. That principle, by its nature, operates in diverse circumstances—not just the ones that happened to come before the Court. It doubtless covers the baldly exculpatory clause and prohibitive fees that the majority acknowledges would preclude an arbitration agreement’s enforcement. But so too it covers the world of other provisions a clever drafter might devise to scuttle even the most meritorious federal claims. Those provisions might deny entry to the forum in the first instance. Or they might deprive the claimant of any remedy. Or they might prevent the claimant from offering the necessary proof to prevail, as in my “no economic testimony” hypothetical—and in the actual circumstances of this case. The variations matter not at all. Whatever the precise mechanism, each “operate[s] . . . as a prospective waiver of a party’s [federal] right[s]”—and so confers immunity on a wrongdoer. *Mitsubishi*, 473 U.S., at 637, n. 19. And that is what counts under our decisions.

Nor can the majority escape the principle we have established by observing, as it does at one point, that Amex’s agreement merely made arbitration “not worth the expense.” Ante. That suggestion, after all, runs smack into *Randolph*, which likewise involved an allegation that arbitration, as specified in a contract, “would be prohibitively expensive.” 531 U.S., at 92. Our decision there made clear that a provision raising a plaintiff’s costs could foreclose consideration of federal claims, and so run afoot of the effective-vindication rule. The expense at issue in *Randolph* came from a filing fee combined with a per-diem payment for the arbitrator. But nothing about those particular costs is distinctive; and indeed, a rule confined to them would be weirdly idiosyncratic. Not surprisingly, then, *Randolph* gave no hint of distinguishing among the different ways an arbitration agreement can make a claim too costly to bring. Its rationale applies whenever an agreement makes the vindication of federal claims impossibly expensive—whether by imposing fees or proscribing cost-sharing or adopting some other device.

That leaves the three last sentences in the majority’s core paragraph. Here, the majority conjures a special reason to exclude “class-action waiver[s]” from the effective-vindication rule’s compass. Ante. Rule 23, the majority notes, became law only in 1938—decades after the Sherman Act. The majority’s conclusion: If federal law in the interim decades did not eliminate a plaintiff’s rights under that Act, then neither does this agreement.

But that notion, first of all, rests on a false premise: that this case is only about a class-action waiver. *** It is not, and indeed could not sensibly be. The effective-vindication rule asks whether an arbitration agreement as a whole precludes a claimant from enforcing federal statutory rights. No single provision is properly viewed in isolation, because an agreement can close off one avenue to pursue a claim while leaving others open. In this case, for example, the agreement could have prohibited class arbitration without offending the effective-vindication rule if it had provided an alternative mechanism to share, shift, or reduce the necessary costs. The agreement’s problem is that it bars not just class actions, but also all mechanisms—many existing long before the Sherman Act, if that matters—for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses. See supra. And contrary to the majority’s assertion, the Second Circuit well understood that point: It considered, for example, whether Italian Colors could shift expert expenses to Amex if its claim prevailed (no) or could join with merchants bringing similar claims to produce a common expert report (no again). See 554 F.3d 300, 318 (2009). It is only in this Court that the case has become strangely narrow, as the majority stares at a single provision rather than considering, in the way the effective-vindication rule demands, how the entire contract operates.5

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5 In defense of this focus, the majority quotes the Second Circuit as concluding that “the only economically feasible means” for Italian Colors to enforce its statutory rights “is via a class action.” Ante, at n. 4 (quoting 667 F.3d, at 218; internal quotation marks omitted; emphasis added by the Court). But the Court of Appeals reached that conclusion only after finding that the agreement prohibited all other forms of cost-sharing and cost-shifting. See 554 F.3d 300, 318 (2009). (That opinion was vacated on other grounds, but its analysis continued to inform—indeed, was essential to—the Second Circuit’s final decision in the case. See 667 F. 3d, at 218.) The Second Circuit therefore did exactly what the majority refuses to do—look to the agreement as a whole to determine whether it permits the vindication of federal rights.
In any event, the age of the relevant procedural mechanisms (whether class actions or any other) does not matter, because the effective-vindication rule asks about the world today, not the world as it might have looked when Congress passed a given statute. Whether a particular procedural device preceded or post-dated a particular statute, the question remains the same: Does the arbitration agreement foreclose a party—right now—from effectively vindicating the substantive rights the statute provides? This case exhibits a whole raft of changes since Congress passed the Sherman Act, affecting both parties to the dispute—not just new procedural rules (like Rule 23), but also new evidentiary requirements (like the demand here for an expert report) and new contract provisions affecting arbitration (like this agreement’s confidentiality clause). But what has stayed the same is this: Congress’s intent that antitrust plaintiffs should be able to enforce their rights free of any prior waiver. See supra; Mitsubishi, 473 U.S., at 637, n. 19.

The effective-vindication rule carries out that purpose by ensuring that any arbitration agreement operating as such a waiver is unenforceable. And that requires courts to determine in the here and now—rather than in ye olde glory days—whether an agreement’s provisions foreclose even meritorious antitrust claims.

Still, the majority takes one last stab: “Truth to tell,” it claims, AT&T Mobility LLC v. Concepcion, 563 U.S. ___ (2011), “all but resolves this case.” Ante. In that decision, the majority recounts, this Court held that the FAA preempted a state “law conditioning enforcement of arbitration on the availability of class procedure.” Ibid.; see 563 U.S., at ___ (slip op., at 9). According to the majority, that decision controls here because “[w]e specifically rejected the argument that class arbitration was necessary.” Ante.

Where to begin? Well, maybe where I just left off: Italian Colors is not claiming that a class action is necessary—only that it have some means of vindicating a meritorious claim. And as I have shown, non-class options abound. See supra. The idea that AT&T Mobility controls here depends entirely on the majority’s view that this case is “class action or bust.” Were the majority to drop that pretense, it could make no claim for AT&T Mobility’s relevance.

And just as this case is not about class actions, AT&T Mobility was not—and could not have been—about the effective-vindication rule. Here is a tip-off: AT&T Mobility nowhere cited our effective-vindication precedents. That was so for two reasons. To begin with, the state law in question made class-action waivers unenforceable even when a party could feasibly vindicate her claim in an individual arbitration. The state rule was designed to preserve the broad-scale “deterrent effects of class actions,” not merely to protect a particular plaintiff’s right to assert her own claim. 563 U.S., at ___ (slip op., at 3). Indeed, the Court emphasized that the complaint in that case was “most unlikely to go unresolved” because AT&T’s agreement contained a host of features ensuring that “aggrieved customers who filed claims would be essentially guaranteed to be made whole.” Id., at ___ (slip op., at 17-18) (internal quotation marks and brackets omitted). So the Court professed that AT&T Mobility did not implicate the only thing (a party’s ability to vindicate a meritorious claim) this case involves.

And if that is not enough, AT&T Mobility involved a state law, and therefore could not possibly implicate the effective-vindication rule. When a state rule allegedly conflicts with the FAA, we apply standard preemption principles, asking whether the state law frustrates the FAA’s purposes and objectives. If the state rule does so—as the Court found in AT&T Mobility—the Supremacy Clause requires its invalidation. We have no earthly interest (quite the contrary) in vindicating that law. Our effective-vindication rule comes into play only when the FAA is alleged to conflict with another federal law, like the Sherman Act here. In that all-federal context, one law does not automatically bow to the other, and the effective-vindication rule serves as a way to reconcile any tension between them. Again, then, AT&T Mobility had no occasion to address the issue in this case. The relevant decisions are instead Mitsubishi and Randolph.

**

The Court today mistakes what this case is about. To a hammer, everything looks like a nail. And to a Court bent on diminishing the usefulness of Rule 23, everything looks like a class action, ready to be dismantled. So the Court does not consider that Amex’s
agreement bars not just class actions, but “other forms of cost-sharing . . . that could provide effective vindication.” Ante, at n. 4. In short, the Court does not consider—and does not decide—Italian Colors’s (and similarly situated litigants’) actual argument about why the effective-vindication rule precludes this agreement’s enforcement.

As a result, Amex’s contract will succeed in depriving Italian Colors of any effective opportunity to challenge monopolistic conduct allegedly in violation of the Sherman Act. The FAA, the majority says, so requires. Do not be fooled. Only the Court so requires; the FAA was never meant to produce this outcome. The FAA conceived of arbitration as a “method of resolving disputes”—a way of using tailored and streamlined procedures to facilitate redress of injuries. Rodriguez de Quijas, 490 U.S., at 481 (emphasis added). In the hands of today’s majority, arbitration threatens to become more nearly the opposite—a mechanism easily made to block the vindication of meritorious federal claims and insulate wrongdoers from liability. The Court thus undermines the FAA no less than it does the Sherman Act and other federal statutes providing rights of action. I respectfully dissent.

NOTES AND QUESTIONS

1. Antitrust originalism. Justice Scalia noted that the class action as such didn’t exist in federal law when the Sherman Act and Clayton Act were passed. Congress, the thought goes, must not have thought that collective resolution of antitrust claims was essential to the enforcement of those statutes. That means, says Justice Scalia, that a contract that limits the scope of class actions in antitrust shouldn’t be thought to be inconsistent with the antitrust regime. Does that make too much of the particular sequence of events here? After all, on the whole, the FRCP aren’t domain specific, and the drafters of the rules have created a set of procedures thought to be sensible across all federal areas.

2. Buying a pass from public law. There is a public interest in enforcement of the antitrust laws that cannot be waived or extinguished by private agreement. Suppose that an agreement to waive the right to proceed by collective or class action meant that most or all antitrust claims that the promisor might have could as a practical matter not be litigated. In that event, should the class action waiver be unenforceable on the ground that it is in effect no different from an unenforceable waiver of rights under the antitrust laws? What about an agreement to arbitrate antitrust disputes, if arbitration were shown to provide less effective antitrust redress than litigation in federal court?

As you might guess, there is a fair amount of pure doctrine in class action law. Our goal here isn’t to set out that doctrine, but rather to give you enough of a window into it to appreciate what is at stake. FRCP 23(a) sets out four prerequisites for any class action, and there is a class-action short-hand for those: numerosity, commonality, typicality and adequacy. Those terms should be suggestive of what is at stake. In bringing together many different claims, there is a basic question about whether all of those claims can be litigated together in an efficient manner. Are these really all apples, even if some are Galas while others are Fujis, or are we really talking about apples and oranges that should be dealt with separately?

The next case matters for antitrust law because it makes clear the way in which pleading choices in an antitrust complaint may matter for whether the FRCP 23(a) standards can be met. There is the spaghetti-throwing approach to complaint drafting: list any possible theory of liability and let the judge sort out which one actually sticks to the wall. After all, you just need one to work and you may not care that much about which theory of antitrust liability is attractive to a judge, so long as it least one is. The next case makes clear that there are real costs to that approach for drafting antitrust complaints.
Comcast Corp. v. Behrend
United States Supreme Court, 2013.
569 U.S. ___.

JUSTICE SCALIA, delivered the opinion of the Court: The District Court and the Court of Appeals approved certification of a class of more than 2 million current and former Comcast subscribers who seek damages for alleged violations of the federal antitrust laws. We consider whether certification was appropriate under Federal Rule of Civil Procedure 23(b)(3).

I

Comcast Corporation and its subsidiaries, petitioners here, provide cable-television services to residential and commercial customers. From 1998 to 2007, petitioners engaged in a series of transactions that the parties have described as “clustering,” a strategy of concentrating operations within a particular region. The region at issue here, which the parties have referred to as the Philadelphia “cluster” or the Philadelphia “Designated Market Area” (DMA), includes 16 counties located in Pennsylvania, Delaware, and New Jersey. Petitioners pursued their clustering strategy by acquiring competitor cable providers in the region and swapping their own systems outside the region for competitor systems located in the region. For instance, in 2001, petitioners obtained Adelphia Communications’ cable systems in the Philadelphia DMA, along with its 464,000 subscribers; in exchange, petitioners sold to Adelphia their systems in Palm Beach, Florida, and Los Angeles, California. As a result of nine clustering transactions, petitioners’ share of subscribers in the region allegedly increased from 23.9 percent in 1998 to 69.5 percent in 2007.

The named plaintiffs, respondents here, are subscribers to Comcast’s cable-television services. They filed a class-action antitrust suit against petitioners, claiming that petitioners entered into unlawful swap agreements, in violation of §1 of the Sherman Act, and monopolized or attempted to monopolize services in the cluster, in violation of §2. Ch. 647, 26 Stat. 209, as amended, 15 U.S.C. §§1, 2. Petitioners’ clustering scheme, respondents contended, harmed subscribers in the Philadelphia cluster by eliminating competition and holding prices for cable services above competitive levels.

Respondents sought to certify a class under Federal Rule of Civil Procedure 23(b)(3). That provision permits certification only if “the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members.” The District Court held, and it is uncontested here, that to meet the predominance requirement respondents had to show (1) that the existence of individual injury resulting from the alleged antitrust violation (referred to as “antitrust impact”) was “capable of proof at trial through evidence that [was] common to the class rather than individual to its members”; and (2) that the damages resulting from that injury were measurable “on a class-wide basis” through use of a “common methodology.” 264 F.R.D., at 154.2

Respondents proposed four theories of antitrust impact: First, Comcast’s clustering made it profitable for Comcast to withhold local sports programming from its competitors, resulting in decreased market penetration by direct broadcast satellite providers. Second, Comcast’s activities reduced the level of competition from “overbuilders,” companies that build competing cable networks in areas where an incumbent cable company already operates. Third, Comcast reduced the level of “benchmark” competition on which cable customers rely to compare prices. Fourth, clustering increased Comcast’s bargaining power relative to content providers. Each of these forms of impact, respondents alleged, increased cable subscription rates throughout the Philadelphia DMA.

The District Court accepted the overbuilder theory of antitrust impact as capable of classwide proof and rejected the rest. Id., at 165, 174, 178, 181. Accordingly, in its

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2 Respondents sought certification for the following class: “All cable television customers who subscribe or subscribed at any times since December 1, 1999, to the present to video programming services (other than solely to basic cable services) from Comcast, or any of its subsidiaries or affiliates in Comcast’s Philadelphia cluster.” App. 35a.
certification order, the District Court limited respondents’ “proof of antitrust impact” to “the theory that Comcast engaged in anticompetitive clustering conduct, the effect of which was to deter the entry of overbuilders in the Philadelphia DMA.” App. to Pet. for Cert. 192a-193a.3

The District Court further found that the damages resulting from overbuilder-deterrence impact could be calculated on a classwide basis. To establish such damages, respondents had relied solely on the testimony of Dr. James McClave. Dr. McClave designed a regression model comparing actual cable prices in the Philadelphia DMA with hypothetical prices that would have prevailed but for petitioners’ allegedly anticompetitive activities. The model calculated damages of $875,576,662 for the entire class. As Dr. McClave acknowledged, however, the model did not isolate damages resulting from any one theory of antitrust impact. Id., at 189a-190a. The District Court nevertheless certified the class.

A divided panel of the Court of Appeals affirmed. On appeal, petitioners contended the class was improperly certified because the model, among other shortcomings, failed to attribute damages resulting from overbuilder deterrence, the only theory of injury remaining in the case. The court refused to consider the argument because, in its view, such an “attack on the merits of the methodology [had] no place in the class certification inquiry.” 655 F.3d 182, 207 (CA3 2011). The court emphasized that, “[a]t the class certification stage,” respondents were not required to “tie each theory of antitrust impact to an exact calculation of damages.” Id., at 206. According to the court, it had “not reached the stage of determining on the merits whether the methodology is a just and reasonable inference or speculative.” Ibid. Rather, the court said, respondents must “assure us that if they can prove antitrust impact, the resulting damages are capable of measurement and will not require labyrinthine individual calculations.” Ibid. In the court’s view, that burden was met because respondents’ model calculated “supra-competitive prices regardless of the type of anticompetitive conduct.” Id., at 205.

We granted certiorari. 567 U.S. ___ (2012).4

II

*** The provision at issue here is Rule 23(b)(3), which requires a court to find that “the questions of law or fact common to class members predominate over any questions affecting only individual members.” *** If anything, Rule 23(b)(3)’s predominance criterion is even more demanding than Rule 23(a). Amchem Products, Inc. v. Windsor, 521 U.S. 591, 623-624 (1997). Rule 23(b)(3), as an “adventuresome innovation,” is designed for situations “in which “class-action treatment is not as clearly called for.”’” Wal-Mart, supra, at ___ (slip op., at 22) (quoting Amchem, 521 U.S., at 614-615). That explains Congress’s addition of procedural safeguards for (b)(3) class members beyond those provided for (b)(1) or (b)(2) class members (e.g., an opportunity to opt out), and the court’s duty to take a “close look” at whether common questions predominate over individual ones. Id., at 615.

3 The District Court did not hold that the three alternative theories of liability failed to establish antitrust impact, but merely that those theories could not be determined in a manner common to all the class plaintiffs. The other theories of liability may well be available for the plaintiffs to pursue as individual actions. Any contention that the plaintiffs should be allowed to recover damages attributable to all four theories in this class action would erroneously suggest one of two things—either that the plaintiffs may also recover such damages in individual actions or that they are precluded from asserting those theories in individual actions.

4 The question presented reads: “Whether a district court may certify a class action without resolving whether the plaintiff class had introduced admissible evidence, including expert testimony, to show that the case is susceptible to awarding damages on a class-wide basis.” 567 U.S., at ___. Respondents contend that petitioners forfeited their ability to answer this question in the negative because they did not make an objection to the admission of Dr. McClave’s testimony under the Federal Rules of Evidence. See Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993). Such a forfeit would make it impossible for petitioners to argue that Dr. McClave’s testimony was not “admissible evidence” under the Rules; but it does not make it impossible for them to argue that the evidence failed “to show that the case is susceptible to awarding damages on a class-wide basis.” Petitioners argued below, and continue to argue here, that certification was improper because respondents had failed to establish that damages could be measured on a classwide basis. That is the question we address here.
III

Respondents’ class action was improperly certified under Rule 23(b)(3). By refusing to entertain arguments against respondents’ damages model that bore on the propriety of class certification, simply because those arguments would also be pertinent to the merits determination, the Court of Appeals ran afoul of our precedents requiring precisely that inquiry. And it is clear that, under the proper standard for evaluating certification, respondents’ model falls far short of establishing that damages are capable of measurement on a classwide basis. Without presenting another methodology, respondents cannot show Rule 23(b)(3) predominance: Questions of individual damage calculations will inevitably overwhelm questions common to the class. This case thus turns on the straightforward application of class-certification principles; it provides no occasion for the dissent’s extended discussion, post, (GINSBURG and BREYER, JJ., dissenting), of substantive antitrust law.

A

We start with an unremarkable premise. If respondents prevail on their claims, they would be entitled only to damages resulting from reduced overbuilder competition, since that is the only theory of antitrust impact accepted for class-action treatment by the District Court. It follows that a model purporting to serve as evidence of damages in this class action must measure only those damages attributable to that theory. If the model does not even attempt to do that, it cannot possibly establish that damages are susceptible of measurement across the entire class for purposes of Rule 23(b)(3). Calculations need not be exact, see Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563 (1931), but at the class-certification stage (as at trial), any model supporting a “plaintiff’s damages case must be consistent with its liability case, particularly with respect to the alleged anticompetitive effect of the violation.” ABA Section of Antitrust Law, Proving Antitrust Damages: Legal and Economic Issues 57, 62 (2d ed. 2010); see, e.g., Image Tech. Servs. v. Eastman Kodak Co., 125 F.3d 1195, 1224 (CA9 1997). And for purposes of Rule 23, courts must conduct a “rigorous analysis” to determine whether that is so. Wal-Mart, supra, at ___ (slip op., at 10).

The District Court and the Court of Appeals saw no need for respondents to “tie each theory of antitrust impact” to a calculation of damages. 655 F.3d, at 206. That, they said, would involve consideration of the “merits” having “no place in the class certification inquiry.” Id., at 206-207. That reasoning flatly contradicts our cases requiring a determination that Rule 23 is satisfied, even when that requires inquiry into the merits of the claim. Wal-Mart, supra, at ___, and n. 6 (slip op., at 10-11, and n. 6). The Court of Appeals simply concluded that respondents “provided a method to measure and quantify damages on a classwide basis,” finding it unnecessary to decide “whether the methodology [was] a just and reasonable inference or speculative.” 655 F. 3d, at 206. Under that logic, at the class-certification stage any method of measurement is acceptable so long as it can be applied classwide, no matter how arbitrary the measurements may be. Such a proposition would reduce Rule 23(b)(3)’s predominance requirement to a nullity.

B

There is no question that the model failed to measure damages resulting from the particular antitrust injury on which petitioners’ liability in this action is premised.5 The scheme devised by respondents’ expert, Dr. McClave, sought to establish a “but for” baseline—a figure that would show what the competitive prices would have been if there

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5 The dissent is of the view that what an econometric model proves is a “question of fact” on which we will not “undertake to review concurrent findings . . . by two courts below in the absence of a very obvious and exceptional showing of error.” Post, (quoting United States v. Virginia, 518 U.S. 515, 589, n. 5 (1996) (SCALIA, J., dissenting) (internal quotation marks omitted)). To begin with, neither of the courts below found that the model established damages attributable to overbuilding alone. Second, while the data contained within an econometric model may well be “questions of fact” in the relevant sense, what those data prove is no more a question of fact than what our opinions hold. And finally, even if it were a question of fact, concluding that the model here established damages attributable to overbuilding alone would be “obviously and exceptionally erroneous.”
had been no antitrust violations. Damages would then be determined by comparing to that baseline what the actual prices were during the charged period. The “but for” figure was calculated, however, by assuming a market that contained none of the four distortions that respondents attributed to petitioners’ actions. In other words, the model assumed the validity of all four theories of antitrust impact initially advanced by respondents: decreased penetration by satellite providers, overbuilder deterrence, lack of benchmark competition, and increased bargaining power. At the evidentiary hearing, Dr. McClave expressly admitted that the model calculated damages resulting from “the alleged anticompetitive conduct as a whole” and did not attribute damages to any one particular theory of anticompetitive impact.

This methodology might have been sound, and might have produced commonality of damages, if all four of those alleged distortions remained in the case. But as Judge Jordan’s partial dissent pointed out:

“[B]ecause the only surviving theory of antitrust impact is that clustering reduced overbuilding, for Dr. McClave’s comparison to be relevant, his benchmark counties must reflect the conditions that would have prevailed in the Philadelphia DMA but for the alleged reduction in overbuilding. In all respects unrelated to reduced overbuilding, the benchmark counties should reflect the actual conditions in the Philadelphia DMA, or else the model will identify ‘damages’ that are not the result of reduced overbuilding, or, in other words, that are not the certain result of the wrong.” 655 F. 3d, at 216 (internal quotation marks omitted).

The majority’s only response to this was that “[a]t the class certification stage we do not require that Plaintiffs tie each theory of antitrust impact to an exact calculation of damages, but instead that they assure us that if they can prove antitrust impact, the resulting damages are capable of measurement and will not require labyrinthine individual calculations.” Id., at 206. But such assurance is not provided by a methodology that identifies damages that are not the result of the wrong. For all we know, cable subscribers in Gloucester County may have been overcharged because of petitioners’ alleged elimination of satellite competition (a theory of liability that is not capable of classwide proof); while subscribers in Camden County may have paid elevated prices because of petitioners’ increased bargaining power vis-à-vis content providers (another theory that is not capable of classwide proof); while yet other subscribers in Montgomery County may have paid rates produced by the combined effects of multiple forms of alleged antitrust harm; and so on. The permutations involving four theories of liability and 2 million subscribers located in 16 counties are nearly endless.

In light of the model’s inability to bridge the differences between supra-competitive prices in general and supra-competitive prices attributable to the deterrence of overbuilding, Rule 23(b)(3) cannot authorize treating subscribers within the Philadelphia cluster as members of a single class. Prices whose level above what an expert deems “competitive” has been caused by factors unrelated to an accepted theory of antitrust harm are not “anticompetitive” in any sense relevant here. “The first step in a damages study is the translation of the legal theory of the harmful event into an analysis of the economic impact of that event.” Federal Judicial Center, Reference Manual on Scientific Evidence 432 (3d ed. 2011) (emphasis added). The District Court and the Court of Appeals ignored that first step entirely.

The judgment of the Court of Appeals for the Third Circuit is reversed.

It is so ordered.

■ JUSTICE GINSBURG and JUSTICE BREYER, with whom JUSTICE SOTOMAYOR and JUSTICE KAGAN join, dissenting: Today the Court reaches out to decide a case hardly fit for our consideration. On both procedural and substantive grounds, we dissent.

I

This case comes to the Court infected by our misguided reformulation of the question presented. For that reason alone, we would dismiss the writ of certiorari as improvidently
granted. *** [B]y resolving a complex and fact-intensive question without the benefit of full briefing, the Court invites the error into which it has fallen.

II

While the Court’s decision to review the merits of the District Court’s certification order is both unwise and unfair to respondents, the opinion breaks no new ground on the standard for certifying a class action under Federal Rule of Civil Procedure 23(b)(3). In particular, the decision should not be read to require, as a prerequisite to certification, that damages attributable to a class-wide injury be measurable “on a class-wide basis.”

To gain class-action certification under Rule 23(b)(3), the named plaintiff must demonstrate, and the District Court must find, “that the questions of law or fact common to class members predominate over any questions affecting only individual members.” This predominance requirement is meant to “test[t] whether proposed classes are sufficiently cohesive to warrant adjudication by representation,” Amchem Products, Inc. v. Windsor, 521 U.S. 591, 623 (1997), but it scarcely demands commonality as to all questions. In particular, when adjudication of questions of liability common to the class will achieve economies of time and expense, the predominance standard is generally satisfied even if damages are not provable in the aggregate.*

Recognition that individual damages calculations do not preclude class certification under Rule 23(b)(3) is well nigh universal. *** Antitrust cases, which typically involve common allegations of antitrust violation, antitrust impact, and the fact of damages, are classic examples. See In re Visa Check/MasterMoney Antitrust Litigation, 280 F.3d 124, 139-140 (CA2 2001). As this Court has rightly observed, “[p]redominance is a test readily met” in actions alleging “violations of the antitrust laws.” Amchem, 521 U.S., at 625.

The oddity of this case, in which the need to prove damages on a classwide basis through a common methodology was never challenged by respondents, see Brief for Plaintiffs-Appellees in No. 10-2865 (CA3), pp. 39-40, is a further reason to dismiss the writ as improvidently granted. The Court’s ruling is good for this day and case only. In the mine run of cases, it remains the “black letter rule” that a class may obtain certification under Rule 23(b)(3) when liability questions common to the class predominate over damages questions unique to class members.

III

Incautiously entering the fray at this interlocutory stage, the Court sets forth a profoundly mistaken view of antitrust law. And in doing so, it relies on its own version of the facts, a version inconsistent with factual findings made by the District Court and affirmed by the Court of Appeals.

A

To understand the antitrust problem, some (simplified) background discussion is necessary. Plaintiffs below, respondents here, alleged that Comcast violated §§1 and 2 of the Sherman Act. See 15 U.S.C. §§1, 2. For present purposes, the §2 claim provides the better illustration. A firm is guilty of monopolization under §2 if the plaintiff proves (1) “the possession of monopoly power in the relevant market” and (2) “the willful acquisition or maintenance of that power[,] as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.” United States v. Grinnell Corp., 384 U.S. 563, 570-571 (1966). A private plaintiff seeking damages must also show that (3) the monopolization caused “injur[y].” 15 U.S.C. §15. We have said that antitrust injuries must be “of the type the antitrust laws were intended to prevent and that flo[w] from that which makes defendants’ acts unlawful.” Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 334 (1990) (quoting Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977)).

* A class may be divided into subclasses for adjudication of damages. Fed. Rule Civ. Proc. 23(c)(4)-(5). Or, at the outset, a class may be certified for liability purposes only, leaving individual damages calculations to subsequent proceedings. Further, a certification order may be altered or amended as the case unfolds. Rule 23(c)(1)(C).
As plaintiffs below, respondents attempted to meet these requirements by showing that (1) Comcast obtained a 60% or greater share of the Philadelphia market, and that its share provides it with monopoly power; (2) Comcast acquired its share through exclusionary conduct consisting of a series of mergers with competitors and “swaps” of customers and locations; and (3) Comcast consequently injured respondents by charging them supra-competitive prices.

If, as respondents contend, Philadelphia is a separate well-defined market, and the alleged exclusionary conduct permitted Comcast to obtain a market share of at least 60%, then proving the §2 violation may not be arduous. As a point of comparison, the government considers a market shared by four firms, each of which has 25% market share, to be “highly concentrated.” Dept. of Justice & Federal Trade Commission, Horizontal Merger Guidelines §5.3, p. 19 (2010). A market, such as the one alleged by respondents, where one firm controls 60% is far worse. See id., §5.3, at 18-19, and n. 9 (using a concentration index that determines a market’s concentration level by summing the squares of each firm’s market share, one firm with 100% yielding 10,000, five firms with 20% each yielding 2000, while a market where one firm accounts for 60% yields an index number of at least 3,600). The Guidelines, and any standard antitrust treatise, explain why firms in highly concentrated markets normally have the power to raise prices significantly above competitive levels.

So far there is agreement. But consider the last matter respondents must prove: Can they show that Comcast injured them by charging higher prices? After all, a firm with monopoly power will not necessarily exercise that power by charging higher prices. It could instead act less competitively in other ways, such as by leading the quiet life. See J. Hicks, Annual Survey of Economic Theory: The Theory of Monopoly, 3 Econometrica 1, 8 (1935) (“The best of all monopoly profits is a quiet life.”).

It is at this point that Dr. McClave’s model enters the scene. His model first selects a group of comparable outside-Philadelphia “benchmark” counties, where Comcast enjoyed a lower market share (and where satellite broadcasting accounted for more of the local business). Using multiple regression analysis, McClave’s model measures the effect of the anticompetitive conduct by comparing the class counties to the benchmark counties. The model concludes that the prices Philadelphia area consumers would have paid had the Philadelphia counties shared the properties of the benchmark counties (including a diminished Comcast market share), would have been 13.1% lower than those they actually paid. Thus, the model provides evidence that Comcast’s anticompetitive conduct, which led to a 60% market share, caused the class to suffer injuriously higher prices.

The special antitrust-related difficulty present here stems from the manner in which respondents attempted to prove their antitrust injuries. They proffered four “non-exclusive mechanisms” that allegedly “cause[d] the high prices” in the Philadelphia area. App. 403a. Those four theories posit that (1) due to Comcast’s acquisitions of competitors, customers found it more difficult to compare prices; (2) one set of potential competitors, namely Direct Broadcast Satellite companies, found it more difficult to obtain access to local sports broadcasts and consequently decided not to enter the Philadelphia market; (3) Comcast’s ability to obtain programming material at lower prices permitted it to raise prices; and (4) a number of potential competitors (called “overbuilders”), whose presence in the market would have limited Comcast’s power to raise prices, were ready to enter some parts of the market but decided not to do so in light of Comcast’s anti-competitive conduct. 264 F.R.D. 150, 161-162 (ED Pa. 2010).

For reasons not here relevant, the District Court found the first three theories inapplicable and limited the liability-phase proof to the “overbuilder” theory. It then asked the parties to brief whether doing so had any impact on the viability of McClave’s model as a measure of classwide damages. See 264 F.R.D., at 190. After considering the parties’
arguments, the District Court found that striking the three theories “does not impeach Dr. McClave’s damages model” because “[a]ny anticompetitive conduct is reflected in the [higher Philadelphia] price [which Dr. McClave’s model determines], not in the [the model’s] selection of the comparison counties, [i.e., the lower-price ‘benchmark counties’ with which the Philadelphia area prices were compared].” Id., at 190-191. The court explained that “whether or not we accepted all [four] . . . theories . . . is inapposite to Dr. McClave’s methods of choosing benchmarks.” Ibid. On appeal, the Third Circuit held that this finding was not an abuse of discretion. 655 F. 3d 182, 207 (2011). 2

The Court, however, concludes that “the model failed to measure damages resulting from the particular antitrust injury on which petitioners’ liability in this action is premised.” Ante. To reach this conclusion the Court must consider fact-based matters, namely what this econometric multiple-regression model is about, what it proves, and how it does so. And it must overturn two lower courts’ related factual findings to the contrary.

We are normally “reluctant to disturb findings of fact in which two courts below have concurred.” United States v. Doe, 465 U.S. 605, 614 (1984). Here, the District Court found McClave’s econometric model capable of measuring damages on a classwide basis, even after striking three of the injury theories. 264 F.R.D., at 190-191. Contrary to the Court’s characterization, see ante, at n. 5, this was not a legal conclusion about what the model proved; it was a factual finding about how the model worked. Under our typical practice, we should leave that finding alone.

In any event, as far as we can tell, the lower courts were right. On the basis of the record as we understand it, the District Court did not abuse its discretion in finding that McClave’s model could measure damages suffered by the class—even if the damages were limited to those caused by deterred overbuilding. That is because respondents alleged that Comcast’s anticompetitive conduct increased Comcast’s market share (and market power) by deterring potential entrants, in particular, overbuilders, from entering the Philadelphia area market. By showing that this was so, respondents’ proof tends to show the same in respect to other entrants. The overbuilders’ failure to enter deprives the market of the price discipline that their entry would have provided in other parts via threat of the overbuilders’ expansion or that of others potentially led on by their example. Indeed, in the District Court, Comcast argued that the three other theories, i.e., the three rejected theories, had no impact on prices. See 264 F.R.D., at 166, 176, 180-181. If Comcast was right, then the damages McClave’s model found must have stemmed exclusively from conduct that deterred new entry, say from “overbuilders.” Not surprisingly, the Court offers no support at all for its contrary conclusion, namely, that the District Court’s finding was “obviously and exceptionally erroneous.” Ante, at n. 5 (quoting Virginia, 518 U.S., at 589, n. 5 (SCALIA, J., dissenting)).

We are particularly concerned about the matter because the Court, in reaching its contrary conclusion, makes broad statements about antitrust law that it could not mean to apply in other cases. The Court begins with what it calls an “unremarkable premise” that respondents could be “entitled only to damages resulting from reduced overbuilder competition.” Ante. In most §2 cases, however, the Court’s starting place would seem remarkable, not “unremarkable.”

Suppose in a different case a plaintiff were to prove that Widget, Inc. has obtained, through anticompetitive means, a 90% share of the California widget market. Suppose the plaintiff also proves that the two small remaining firms—one in Ukiah, the other in San Diego—lack the capacity to expand their widget output to the point where that possibility could deter Widget, Inc. from raising its prices. Suppose further that the plaintiff introduces a model that shows California widget prices are now twice those in every other State, which, the model concludes is (after accounting for other possible reasons) the result of lack of competition in the California widget market. Why would a court hearing that case restrict damages solely to customers in the vicinity of Ukiah and San Diego?

Like the model in this example, Dr. McClave’s model does not purport to show precisely how Comcast’s conduct led to higher prices in the Philadelphia area. It simply
shows that Comcast’s conduct brought about higher prices. And it measures the amount of subsequent harm.

* * *

Because the parties did not fully argue the question the Court now answers, all Members of the Court may lack a complete understanding of the model or the meaning of related statements in the record. The need for focused argument is particularly strong here where, as we have said, the underlying considerations are detailed, technical, and fact-based. The Court departs from our ordinary practice, risks inaccurate judicial decision making, and is unfair to respondents and the courts below. For these reasons, we would not disturb the Court of Appeals’ judgment and, instead, would dismiss the writ as improvidently granted.

NOTES AND QUESTIONS

1. Basis for liability. The original complaint had four theories of possible antitrust liability. What were those four theories? How do they match to the theories of liability that we have seen in this book?

2. Rewriting the complaint. Justice Scalia states that “[t]he permutations involving four theories of liability and 2 million subscribers located in 16 counties are nearly endless.” How does he get from four theories to endless permutations? And why does that matter for whether one or more class actions can be maintained? Given the approach taken in the Court’s opinion, how would you rewrite the complaint to ensure class action status for the case?

3. Certification vs. merits. Note the role that the expert opinion is playing in this case. Does introducing complex economic analysis at the class-certification stage frontload costs in a way that could discourage class actions from being brought? Is there any way to avoid this additional layer of costs?