OPINION OF THE COMMISSION

BY MURIS, Chairman:

INTRODUCTION

***Nessun Dorma!* – None must sleep**!

This Puccini aria, sung by tenor Luciano Pavarotti in the recording at the heart of our case, announces the edict of the Chinese princess Turandot that no one in Peking may sleep until she solves her problem. The princess has made a bad judgment – agreeing to marry the first suitor who, at peril of death, can answer three riddles. Although this plan once had served her purposes, someone has now answered the riddles, and Turandot is encumbered with a product she neither wants nor can market. She grasps at one last chance to stop the wedding, by guessing the name of the suitor, and will stop at nothing to obtain the infor

[1] Comprehensive recent treatments of the relevant case law and commentary appear in ABA Antitrust Section, Monograph No. 23, The Rule of Reason (1999); VII Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶ 1500-12 (2d ed. 2003); *Symposium: The Future Course of the Rule of Reason*, 68 Antitrust L.J. 331 (2

price and non-price advertising); *Detroit Auto Dealers Ass'n, Inc.*, 111 F.T.C. 417 (1989) (condemning agreement among Detroit-area automobile dealers to close dealer showrooms on nights and weekends), *aff'd in part and rev'd in part*, 955 F.2d 457 (6th Cir.), *cert. denied*, 506 U.S. 973 (1992). In addition to developing doctrine through adjudication, the FTC has coauthored guidelines to help build the modern analytical framework for horizontal restraints. *See* Department of Justice and Federal Trade Commission, *Antitrust Guidelines for Collaborations Among Competit*

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Decca owned the copyright to the master recording of the first Three Tenors concert ("3T1"). IDF 14.

PolyGram Classics was the PolyGram operating company responsible for United States sales of classical music produced by PolyGram. PolyGram Classics was responsible for marketing, promoting, pricing, and advertising 3T1 in the United States. IDF 12, 15. PGD provided the distribution and sales force for PolyGram Classics in the United States and executed PolyGram Classics's marketing strategy at the retailer level. IDF 16.

PolyGram Holding is the parent company of Respondents UMG and UMVD, and provides services to its subsidiaries, including legal, financial, business affairs, and human resources services. PolyGram Holding negotiated the collaboration between PolyGram and Warner with regard to the third Three Tenors

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[5] Since 1990, audio and video recordings of 3T1 have been distributed in the United States by PGD and its successor UMVD. PGD was responsible for deciding the wholesale price and advertising strategy for 3T1 in the United States. IDF 17.

[6] In 1994, 3T2 was the no. 2 and 3T1 was the no. 3 best-selling classical album (CX 587); in 1995, 3T2 was no. 1 and 3T1 was no. 5 (CX 588); in 1996, 3T2 w

agreement dated December 17, 1997, Warner licensed to PolyGram the rights to exploit 3T3 outside of the United States, with Warner (through its affiliate Atlantic) retaining the rights to exploit 3T3 within the United States. The contract provided that PolyGram would reimburse Warner for 50% of the $18 million advance paid to Rudas, and that Warner and PolyGram would share 50-50 the profits and losses from the 3T3 project. IDF 59-60. The contract also provided that Warner and PolyGram would have the right to market a Greatest Hits album and/or a Boxed Set incorporating the 1990, 1994, and 1998 Three Tenors recordings, but the joint venture agreement did not include the marketing rights to the existing 1990 and 1994 Three Tenors albums. JX-10-F; JX 11 at UMG001790 (*in camera*). The contract also contained a limited covenant not to compete, which stated that neither PolyGram nor Warner would release another Three Tenors recording for four years following the release of 3T3, unless such release was pursuant to this agreement. The contract expressly provided, however, that PolyGram and Warner each could continue to exploit its older Three Tenors products. IDF 62-63. Thus, the relationship of 3T1 and 3T2 to the joint venture was clear: ownership and marketing rights for both were outside the joint venture.

The operating companies of both PolyGram and Warner began developing marketing campaigns for 3T1 and 3T2 in early 1998. They planned to capitalize on the upcoming Three Tenors concert and the new album as an opportunity to increase sales of their catalog Three Tenor products. IDF 102-05, 115-18.[10] PolyGram and Warner grew concerned, however, that competition from the catalog Three Tenors recordings would reduce the sales of the new Three Tenors album. As a result, they feared that they would not recoup their $18 million investment. Tr. 485; JX 9-E; JX 94 at 94, 96; JX 100 at 72-73 (*in camera*); JX 102 at 43; CX 202. In March 1998, executives of PolyGram and Warner met and agreed to refrain from advertising or reducing prices of 3T1 or 3T2 audio or video products in all markets in the weeks surrounding the release of 3T3. They called this agreement the "moratorium" agreement. IDF 90-101, 107-13. Warner's operating companies, however, continued with plans to launch a discounting campaign for 3T2 scheduled to run through December 1998. IDF 118. When PolyGram learned of this, it informed its operating companies that if Warner discounted 3T2, they were free to retaliate with price discounts on 3T1. IDF 119-

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[10] "Catalog" is a music industry term that refers to older albums that a record company continues to offer for sale. IDF 93.

they thought 3T3 would feature an all-new repertoire, and PolyGram and Warner lost millions of dollars on the project. Tr. 522-25.

In 1999, Decca agreed to waive its exclusive rights to the recording services of Pavarotti to allow him to record a Three Tenors album for Sony. In October 1999, Sony released the album – which consisted of Christmas songs derived from a performance of the Three Tenors in Vienna – with no restriction on marketing activities by PolyGram or Warner in support of their catalog Three Tenors albums. IDF 196-99.

D. The ALJ's Initial Decision

After pretrial discovery, ALJ James P. Timony conducted a one-week trial. Complaint Counsel called four live witnesses: Anthony O'Brien, from Atlantic; Rand Hoffman, from PolyGram Holding; Professor Catherine Moore, the director of the Music Business Program at New York University; and Dr. Stephen Stockum, an economist. Respondents called no live witnesses. Both parties introduced deposition testimony and numerous documents. The record closed on March 20, 2002. Following post-trial motions, Judge Timony issued an initial decision and a proposed order on June 20, 2002. Judge Timony's decision ruled that the moratorium agreement constituted an unfair method of competition in violation of Section 5 of the FTC Act.

The ALJ found that the moratorium agreement – created several months after the joint venture agreement between PolyGram and Warner – was not ancillary to the 3T3 joint venture because it was not an integral part of the joint venture or reasonably necessary to market the joint venture product. ID at 50-53. Instead, the ALJ found that the moratorium was a "naked agreement to fix prices and restrict output" that was properly subject to *per se* condemnation. ID at 54, 68.

The ALJ also evaluated the moratorium under an abbreviated (or "quick look") rule of reason analysis. He ruled that if the moratorium's anticompetitive effects were "obvious," the burden would shift to Respondents to show the procompetitive benefits of the restraint. ID at 54-55. Turning first to the agreement not to discount 3T1 and 3T2, the ALJ concluded that this arrangement constituted horizontal price fixing, which, as case law has recognized, "threatens

the efficient functioning of a market economy." ID at 56. The ALJ found that PolyGram and Warner previously had competed by reducing the price of 3T1 and 3T2 – to the benefit of consumers – and that such an agreement to forgo discounting had "obvious anticompetitive potential." ID at 56-57.

The ALJ also concluded that the agreement to forgo advertising of 3T1 and 3T2 was presumptively anticompetitive. ID at 57. The ALJ explained that economic theory and empirical research showed that advertising restrictions result in higher prices to consumers, and that the evidence here showed that advertising was an important competitive tool used by PolyGram and Warner in marketing the Three Tenors products, creating additional demand and encouraging price discounting. ID at 57-58. The ALJ found that PolyGram and Warner intended that their advertising ban would conceal the better-value Three Tenors recordings so that consumers instead would purchase the higher-margin 3T3 release. Judge Timony concluded that the potential anticompetitive effect of this strategy was "obvious." ID at 58.

Turning next to Respondents' efficiency justifications, the ALJ found that the Respondents failed to meet their burden of identifying legitimate procompetitive justifications. ID at 58-65, 68-69. He found that the parties' principal motive for the moratorium was to shield 3T3 from competition to protect their profits, which he deemed to be an illegitimate justification. ID at 60. He also rejected Respondents' other proffered justifications, finding that they were implausible and, even if plausible, were invalid because they were unsupported by the evidence in this case. ID at 61-65.

Finally, the ALJ rejected Respondents' contention that PolyGram withdrew from the moratorium and thus should not be held liable. ID at 65-66.

The ALJ issued a cease and desist order enjoining Respondents for 20 years from again agreeing with a competitor to fix prices or to restrict advertising in connection with the sale of audio and video products, except under certain specified circumstances related to a joint venture.

II. LEGAL FRAMEWORK

Courts, enforcement agencies, and commentators long have strived to refine operational principles for applying the Sherman Act's command that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade . . . is declared to be illegal." 15 U.S.C. § 1. Jurisprudence, commentary, and enforcement experience concerning this prohibition provide the basic foundations for the Commission's evaluation of horizontal restraints under Section 5 of the FTC Act.[11] In this section we identify major aspects of the development of horizontal restraints doctrine and present the framework we will apply to the challenged restrictions in this matter.

A. The Law of Horizontal Restraints

The seemingly categorical language of Section 1 of the Sherman Act mentions none of the analytical concepts – "per se illegality," "ancillarity," "quick look," or "full-blown rule of reason" – that appear in U.S. horizontal restraints jurisprudence. These concepts have evolved under the antitrust common law that Congress contemplated when it cast the nation's antitrust commands in general terms and entrusted the federal courts and the FTC with developing the operational content for these provisions. Over time, the courts and the FTC have refined that

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[11] The Commission's authority under Section 5 of the FTC Act extends to conduct that violates the Sherman Act. *See, e.g., Federal Trade Commission v. Motion Picture Advertising Serv. Co.*, 344 U.S. 392, 394-95 (1953); *Fashion Originators' Guild of America, Inc. v. Federal Trade Commission*, 312 U.S. 457, 463-64 (1941). In the case at hand, our analysis under Section 5 is the same as it would be under Section 1 of the Sherman Act.

[12] *See State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) ("*State Oil*") (noting role of courts in antitrust law "in recognizing and adapting to changed circumstances and the lessons of accumulated experience"); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 732 (1988) (use of term "restraint of trade" in Section 1 of Sherman Act "invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890");

A number of tensions have marked the evolution of horizontal restraints doctrine and the pursuit of techniques for identifying restrictions that suppress competition. Perhaps most important, adjudicatory tribunals have struggled to attain an appropriate balance between achieving accuracy in individual cases, which generally requires fuller inquiry, and streamlining the law's administration, which usually involves making simplifying assumptions and forgoing elaborate analysis when the conduct at issue ordinarily poses grave competitive dangers.

In *Standard Oil Co. v. United States*, 221 U.S. 1 (1911), the Supreme Court made clear that Section 1 establishes a single, general principle governing trade restraints. The "rule of reason" is the touchstone for evaluating challenged conduct.[13] As stated in *Standard Oil* and reiterated later in the same decade in *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918), the purpose of courts in applying the rule of reason is to evaluate the impact of challenged behavior upon competition.[14]

National Society of Professional Engineers v. United States, 435 U.S. 679, 688 (1978) (in adopting Sherman Act, Congress "expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition").

[13] In *Standard Oil*, the Court explained:

> [T]he standard of reason . . . was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which [Sherman Act § 1] provided.

221 U.S. at 60. *See also State Oil*, 522 U.S. at 10 ("Although the Sherman Act, by its terms, prohibits every agreement in 'restraint of trade,' this Court has long recognized that Congress intended to outlaw only unreasonable restraints.").

[14] In *Chicago Board of Trade*, the Court said:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.

In articulating this principle, *Standard Oil* also endorsed a concept that earlier cases such as *United States v. Trans-Missouri Freight Ass'n,* 166 U.S. 290 (1897), and *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) ("*Addyston Pipe*"), had introduced and that retains vitality today: not all trade restraints require the same degree of fact-gathering and analysis. *Standard Oil*, 221 U.S. at 65. Within the general framework of the rule of reason, certain restraints might be recognized as being so inherently and commonly unreasonable that courts might dispense with an elaborate analysis and condemn them as illegal *per se*. *See id.* (noting that *Trans-Missouri Freight* and other precedent established that the "nature and character" of certain contracts create "a conclusive presumption" that the conduct violates the Sherman Act). Decisions about the appropriate form of inquiry would evolve over time as courts gained experience in evaluating specific business phenomena and accounted for commentary examining the rationale for and effects of various practices.[15]

Early decisions also yielded important analytical tools to help courts determine the appropriate form of inquiry for specific restraints. One of the most influential techniques appeared in *Addyston Pipe* in 1898. Seeking to avoid overinclusive application of Section 1, Judge (later Chief Justice) William Howard Taft introduced the concept of ancillarity. *Addyston Pipe*, 85 F. at 281-82. A simple ("naked") agreement by rivals to set prices, allocate customers, or divide sales territories would be condemned summarily, but the adoption of a uniform pricing schedule as part of the operation of a partnership, which could provide services beyond the capability of any single individual, warranted more tolerant consideration because it was "ancillary" to a legitimate transaction. Even in times when enthusiasm for *per se* rules of liability grew, ancillarity played a crucial roTD(Steel Co.)T

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246 U.S. at 238.

[15] *See State Oil*, 522 U.S. at 21 ("[T]his Court has reconsidered its decisions construing the Sherman Act when the theoretical underpinnings of those decisions are called into serious question."); *see also Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 344 (1982) ("Once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable.").

[16] For example, in *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958) ("*Northern Pacific*

range of horizontal arrangements affecting prices,[17] the allocation of customers or territories,[18] and various concerted refusals to deal.[19] The Court's treatment of vertical restraints exhibited similar trends.[20]

The inability to recognize intermediate approaches posed difficulties in an important category of cases. In some instances, restraints resembled conduct subject to summary condemnation but also appeared to promote the attainment of valuable efficiencies. While declining to surrender the administrability benefits of *per se* tests, courts searched for ways to distinguish unambiguously harmful restraints from conduct that arguably served legitimate ends. Even early Supreme Court decisions that endorsed a literalist reading of Section 1's ban on "every" contract in restraint of trade disavowed any aim to bar all agreements that in some sense limited the commercial freedom of the parties but also generated important efficiencies.[21] As mentioned above, *Addyston Pipe* injected vital flexibility into

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[17] In *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) ("*Socony*"), the Court endorsed a broad conception of horizontal collaboration that would be deemed to constitute *per se* illegal price-fixing. The Court said that "[u]nder the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." *Id.* at 223. In a famous footnote, the Court explained that proof of actual anticompetitive effects was not necessary to establish illegality, noting that all price fixing arrangements are "banned because of their actual or potential threat to the central nervous system of the economy." *Id*. at 224 & n. 59.

[18] *United States v. Topco Associates, Inc.*, 405 U.S. 596, 608-10 (1972); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 597-98 (1951).

[19] *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 (1959).

[20] *Albrecht v. Herald Co.*, 390 U.S. 145, 152-54 (1968) (maximum resale price maintenance); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967) (vertical territorial restrictions); *Northern Pacific*, 356 U.S. at 5-6 (tying).

[21] *See United States v. Joint Traffic Ass'n*, 171 U.S. 505, 567-68 (1898) (Sherman Act not intended to proscribe all partnerships or the imposition of non-

competition covenants to facilitate the sale of good will in a business).

[22] *See* discussion of *Addyston Pipe* at p. 15-16,

[24] Applying this analysis, the Court concluded that the blanket license was necessary to achieve the efficiencies of integration of sales, monitoring, and enforcement against unauthorized copyright use; thus, a “more discriminating” rule of reason analysis – rather than *per se* condemnation – wa t the blankeon4.,le1.

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[25] *See also Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 295 (1985) ("*Northwest Wholesale Stationers*") (Court declined to apply *per se* rule to group boycott by a wholesale purchasing cooperative that expelled one of its members, noting that "such cooperative arrangements would seem to be 'designed to increase economic efficiency and render markets more, rather than less, competitive'" because "[t]he arrangement permits the participating retailers to achieve economies of scale . . ., and also ensures ready access to a stock of goods that might otherwise be unavailable on short notice") (quoting *BMI*, 441 U.S. at 20).

[26] When direct evidence of actual effects can be shown, elaborate market definition is unnecessary.

the Court held that “when there is an agreement not to compete in terms of price or output, ‘no elaborate industry analysis is requ

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to end, *i.e.*, truncate, its analysis”).

justification for such practices. There, the Court found that "'no elaborate industry analysis is required to demonstrate the anticompetitive nature of'" an agreement among dentists to withhold from their customers a desired service (providing x-rays to insurers in conjunction with insurance claim forms); accordingly, "[a]bsent some countervailing procompetitive virtue – such as, for example, the creation of efficiencies in the operation of a market or the provision of goods and services, . . . – such an agreement limiting consumer choice by impeding the 'ordinary give and take of the market place,' . . . cannot be sustained under the Rule of Reason." *Id.* at 459 (quoting *Professional Engineers*, 435 U.S. at 692).

Turning to IFD's justification – that allowing insurance companies to make coverage decisions on the basis of x-rays would harm the quality of care provided to patients – the Court found this argument legally and factually flawed:

> The argument is, in essence, that an unrestrained market in which consumers are given access to the information they believe to be relevant to their choices will lead them to make unwise or even dangerous choices. Such an argument amounts to 'not

> justification, to "restrict competition and decrease output"? . . . If the restraint is not inherently suspect, then the traditional rule of reason, with attendant issues of market definition and power, must be employed. But if it is inherently suspect, we must pose a *second* question: Is there a plausible efficiency justification for the practice?

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[28] 110 F.T.C. at 604 (emphasis in original). The Commission applied the *Mass. Board* framework the following year in *Detroit Auto Dealers Ass'n,* 111 F.T.C. 417, 492-501 (1989), and ruled that an agreement among Detroit automobile dealers to close dealer showrooms on nights and weekends unreasonably restrained trade. The Sixth Circuit rejected the Commission's conclusion that the restraint was "inherently suspect" as an improper application of the *per se* rule. *Detroit Auto Dealers Ass'n, Inc. v. Federal Trade Commission*, 955 F.2d 457, 470-71 (6th Cir. 1992). In particular, the court criticized the Commission's reliance on Robert Bork's argument (in his treatise, *The Antitrust Paradox* (1978)) that there is no economic difference between an agreement to limit shopping hours and an agreement to increase price. 955 F.2d at 470. The Commission's analysis, however, rested upon more than citations to Judge Bork's book. The Commission found ample record evidence demonstrating that showroom hours are an important basis on which dealers compete for customers. For example, it was undisputed that Detroit was the only metropolitan area in the country in which almost all dealers were closed on weekends. 111 F.T.C. at 497-98. Although it disagreed with the Commission's "inherently suspect" categorization, the court upheld the Commission's ruling that the limitation of showroom hours was an unreasonable restraint of trade, because hours of

operation are a basis of competition among automobile dealers, and because respondents failed to advance valid justifications for the restraint. 955 F. 2d at 471-72.

[29] These cases are better understood as being consistent with the view of Sherman Act Section 1 analysis articulated in *NCAA*, *IFD*, and *Mass. Board* – that the court must consider proffered efficiencies before condemning a particular restraint. In *SCTLA*, the Court considered and rejected claimed efficiencies and other justifications before concluding that the challenged conduct (a boycott to force an increase in the compensation of court-appointed counsel) was a naked restraint on price and output falling within the *per se* category. 493 U.S. at 423-24. In *Palmer*, the Court held that an agreement between competitors to divide markets and share revenues was *per se* illegal. The *Palmer* defendants did not argue that the agreement yielded procompetitive efficiencies or a new product. roduct.

[31] *CDA* was the first case since *BMI* in which the Court found that the evidence was insufficient to condemn a basic horizontal restraint. In the eleven years following *BMI*, the Court issued six consecutive opinions finding the evidence sufficient to condemn the restraint.

[32] The majority opinion used the word "professional" more than 20 times. Respondents' attempt to downplay the professional setting of *CDA* ignores this striking fact.

[33] Although the Court criticized the Ninth Circuit for prematurely shifting the evidentiary burden to CDA to "adduce hard evidence of the pro-competitive nature of its policy," 526 U.S. at 776, the Supreme Court's own discussion repeatedly reflects the premise that CDA had identified potential justifications that not only were plausible in theory but also had some grounding in actual experience. *See id.* at 771 ("The restrictions on both discount and nondiscount advertising are, at least on their face, designed to avoid false or deceptive

The Court remanded for a more extended examination of the "tendency of these professional advertising restrictions." *Id.* at 781. The Court specified that this did not necessarily call for the fullest market analysis. *Id.* at 780. "The truth," said the Court, "is that our categories of analysis of anticompetitive effect are less fixed than terms like '*per se*,' 'quick look,' and 'rule of reason' tend to make them appear." *Id.* at 779. Rather, the Court indicated that rule of reason analysis should be flexible:

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"failed to explain why it gave no weight to the countervailing, and at least equally plausible, suggestion that restricting difficult-to-verify claims about quality or patient comfort would have a procompetitive effect by preventing misleading or false claims that distort the market").

[34] On remand before the Ninth Circuit, the Commission argued that citations in the *CDA* record to a small fraction of the economic evidence relevant to the effects of the advertising restrictions provided an adequate basis to condemn the restraints at issue, and alternatively sought a remand to the FTC to develop a fuller record. The Ninth Circuit concluded that such evidence was not adequate to establish the likelihood of anticompetitive effects in this context, and declined to allow the Commission a "second bite at the apple" by remanding. *California Dental Ass'n v. Federal Trade Commission*, 224 F.3d 942, 950-52, 958 (9th Cir. 2000). In contrast to *CDA*, the record in the instant case contains a full discussion of the relevant economic literature. *See infra* note 52 and accompanying text.

[35] The Court focused on the restraint itself, identifying "the *likelihood* of anticompetitive effects"

approach in *Mass. Board*, and it provides guidance about how that approach should be pursued.

B. Synthesis

As embodied most recently in *CDA* and in our *Collaboration Guidelines*, the development of modern horizontal restraints jurisprudence suggests an analytic framework that proceeds by several identifiable steps. These steps reflect the general principle that antitrust law proscribes only conduct that is likely to harm consumers. In most cases, conduct cannot be adjudged illegal without an analysis of its market context to determine whether those engaged in the conduct or restraint are likely to have sufficient power to harm consumers. In a smaller but significant category of cases, scrutiny of the restraint itself is sufficient to find liability without consideration of market power.[37]

A plaintiff may avoid full rule of reason analysis, including the pleading and proof of market power, if it demonstrates that the conduct at issue is inherently suspect owing to its likely tendency to suppress competition. Such conduct ordinarily encompasses behavior that past judicial experience and current economic learning have shown to warrant summary condemnation. If the plaintiff makes such an initial showing, and the defendant makes no effort to advance any competitive justification for its practices, then the case is at an end and the practices are condemned.

If the challenged restrictions are of a sort that generally pose significant competitive hazards and thus can be called inherently suspect, then the defendant can avoid summary condemnation only by advancing a legitimate justification for those practices. Such justifications may consist of plausible reasons why practices that are competitively suspect as a general matter may not be expected to have adverse consequences in the context of the particular market in question; or they may consist of reasons why the practices are likely to have beneficial effects for consumers.

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[37] This synthesis addresses the analytical steps when the plaintiff seeks to avoid pleading and proving market power. It does not address the analysis when market power is at issue.

[38] Although it has earlier roots, the concept of cognizability as a principle limiting the types of justifications has been clearly articulated at least since *Professional Engineers*, where the Supreme Court endorsed the view that certain types of defenses or justifications did not warrant consideration:

> We are faced with a contention that a total ban on competitive

of trade on the ground that the prices the conspirators set were reasonable,[39] that competition itself is unreasonable or leads to socially undesirable results,[40] or that price increases resulting from a trade restraint would attract new entry.[41] Of particular relevance here, the Supreme Court has recognized that a defendant cannot justify curbing access to a more-desired product to induce consumers to purchase larger amounts of a less-desired product. *See NCAA*, 468 U.S. at 116-17. Such justifications are not cognizable and require no further analysis.

The second necessary element of legitimacy is plausibility. To be legitimate, a justification must plausibly create or improve competition. A justification is plausible if it cannot be rejected without extensive factual inquiry. The defendant, however, m ifications are not c s would prom

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[39] *See, e.g.*, *Socony*, 310 U.S. at 224 & n. 59 ("Whatever economic justification particular price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness."); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397-98 (1927) ("The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. . . . [I]n the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend on so uncertain a test as whether prices are reasonable . . . .").

[40] *See IFD*, 467 U.S. at 463-64 (confirming that, even in markets for professional services such as dentistry and engineering, there is no reason to believe that informed consumers will make unwise tradeoffs between quality and price); *Professional Engineers*, 435 U.S. at 696 ("[T]he Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.").

[41] *See Catalano*, 446 U.S. at 649 (refusing to recognize defense based on argument that limits on credit terms would promote new entry by raising price of product).

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[44] In *CDA*

stage, the defendant's burden to respond will likely depend in individual cases upon the quality and amount of evidence that the plaintiff has produced to illuminate the competitive dangers of the defendant's conduct.[46] The defendant also has the burden of producing factual evidence in support of its contentions, including documents within its control.

The existence of a joint venture or other collaboration is simply one

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cases), *cert. denied*, 525 U.S. 822 (1998).

[46] *Cf. United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990) (applying this principle in merger case).

[47] The DOJ/FTC *Collaboration Guidelines*, *supra* note 2, draw upon the case law discussed above in providing an analytical structure for evaluating joint venture activity. The Agencies' analysis "begins with an examination of the nature of the relevant agreement." *Collaboration Guidelines*, at § 1.2. First, the Agencies ask whether the agreement is potentially *per se* illegal – *i.e.*, is "of a type that always or almost always tends to raise price or reduce output." *Id.* at § 3.2. If the answer is yes, then the Agencies consider proffered justifications. An agreement will escape *per se* challenge if it "is reasonably related to [efficiency-enhancing] integration and reasonably necessary to achieve its procompetitive benefits." *Id.* The *Collaboration Guidelines* explain that before accepting proffered justifications, the Agencies undertake a limited factual inquiry to determine whether claimed justifications that are plausible in theory are plausible in the context of a particular collaboration, and that "[s]ome claims – such as those premised on the notion that competition itself is unreasonable – are insufficient as a matter of law." *Id.*

Following *CDA*, the *Collaboration Guidelines* specify that rule of reason analysis "entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances." *Id.* at § 3.3 (citations omitted). The *Collaboration Guidelines* also recognize that full rule of reason analysis may not be required: "[W]here the likelihood of anticompetitive harm is evident from the nature of the agreement, . . . then, absent overriding benefits that

introduction of innovative products or the achievement of production efficiencies, then such benefits are a proper part of the antitrust analysis. But proffered justifications still must be analyzed under the framework stated above, and will entitle the defendant to a fuller review only if they are cognizable and are factually supported to the degree necessary in light of the plaintiff's demonstration of likely anticompetitive effects.

Our intended contribution in this synthesis is to specify more fully the analytical principles that we perceive to be embedded in the case law and our own guidelines and to refine the methodology for applying those principles in practice. Our synthesis thus responds to the need in modern competition policy to devise analytical tests that are sound in substance, transparent in revealing their operational criteria, and administrable in the routine analysis of antitrust disputes.

III. ANALYSIS OF THE CHALLENGED RESTRAINTS

Respondents argue that because the moratorium was "ancillary to a procompetitive joint venture, that agreement cannot be deemed 'presumptively anticompetitive,'" Respondents' Opening Brief at 41, and their practices cannot be held illegal without evidence of actual anticompetitive effect. *Id.* at 32. Respondents also argue that their identification of plausible procompetitive justifications means that their practices cannot be held illegal unless the actual, net effect of the restraint is proven to be anticompetitive. *Id.* at 42-44. In terms of the synthesis of horizontal restraints jurisprudence just discussed, Respondents appear to argue that this case falls toward the fuller end of the rule of reason spectrum – if not in fact requiring the fullest, or "plenary," review. To decide whether Respondents are correct, we first must determine whether the agreement between PolyGram and Warner to forgo discounting and advertising of 3T1 and 3T2 falls within the category of restraints that are likely, absent countervailing procompetitive justifications, to have anticompetitive effects – *i.e.*, to lead to higher prices or reduced

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could offset the competitive harm, the Agencies challenge such agreements without a detailed market analysis." *Id.* (citations omitted). The *Collaboration Guidelines* indicate that the underlying issue is the extent to which a challenged restraint in fact likely assists the parties in achieving efficiencies in the market circumstances at issue. *Id.* at § 3.36.

[48] The Supreme Court has indicated that both sources of insight – the results of case-by-case adjudication and commentary – are relevant as antitrust tribunals form judgments about the competitive significance of observed b

Tr. 583-85. Respondents' own economic expert, Dr. Ordover, agreed that a naked agreement between competitors to restrict price competition has "clearly pernicious effects on competition and consumers." R

[50] Respondents' expert witnesses did not testify at trial, and thus were not subject to cross-examination. Our references to the statements of Respondents' experts are to their expert reports and deposition testimony.

[51] As the Supreme Court stated in *Socony*, "the amount of interstate or foreign trade involved is not material . . ., since § 1 of the [Sherman] Act brands as illegal the character of the restraint not the amount of commerce affected." 310 U.S. at 224 n. 59.

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difficult for consumers to find a lower price and for [suppliers] to compete on the basis of price"); *see also Morales*, 504 U.S. at 388; *Bates*, 433 U.S. at 377-78. These principles apply not just to price advertising, but also to information about qualitative aspects of goods and services. "[A]ll elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers." *Professional Engineers*, 435 U.S. at 695.

Complaint Counsel's economic expert testified that an agreement among competitors not to advertise is likely to harm consumers and competition by raising consumers' search costs and reducing sellers' incentives to lower prices. Tr. 587-92; JX 104-C. One reason a restriction on advertising may reduce a seller's incentives to lower prices is that, absent an ability to advertise, lower per-unit prices may not be sufficiently offset by higher volume. Tr. 589-90; JX 105-I ¶ 41; JX 90 at 49-50. Dr. Stockum relied on several empirical studies that have found that advertising restrictions result in consumers' paying higher prices. Tr. 592-600; JX 104-D (citing studies).[52] One of these studies, for example, showed

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[52] The studies relied on by Dr. Stockum, as well as other empirical literature concerning the impact of advertising restrictions, are in the record at Appendix A to Complaint Counsel's Findings of Fact, Conclusions of Law, Memorandum of Law in Support Thereof and Order. *See* Lee Benham, *The Effect of Advertising on the Price of Eyeglasses*, 15 J.L. & Econ. 337 (1972) (restricting the advertising of eyeglasses raised the average retail price by $7.48); Lee Benham & Alexandra Benham, *Regulating Through the Professions: A Perspective on Information Control*, 18 J.L. & Econ. 421 (1975) (prices were 25-40% higher in markets with greater professional information controls, including advertising restrictions); Ronald S. Bond et al., *Staff Report on Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry* (Executive Summary), Bureau of Economics, Federal Trade Commission (Sept. 1980) (price for combined eye exam and glasses was $29 less in cities with least restrictive advertising regimes); John F. Cady, *An Estimate of the Price Effects of Restrictions on Drug Price Advertising*, 14 Econ. Inquiry 493 (1976) (states restricting the advertising of prescription drugs have prices that are 2.9% higher than states that do not restrict advertising); Steven R. Cox et al., *Consumer Information and the Pricing of Legal Services*, 30 J. Indus. Econ. 305 (1982) (attorneys who advertised had lower fees than those who did not advertise); Roger

that even a short-lived restraint on advertising can lead to higher prices. Tr. 599-600; IDF 247. On the basis of economic theory and empirical studies, Dr. Stockum concluded that, absent an efficiency justification, Respondents' agreement not to advertise or promote the catalog Three Tenors albums is very

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Advertising Lower Consumer Prices?, 37 J. Marketing 19 (Oct. 1973) (advertising resulted in lower toy prices to the consumer).

[53] In contrast to the situation in *CDA*, Respondents here make no argument that the particular industry context renders normal economic conclusions about the competitive impact of price and advertising restrictions inapplicable. This failure is unsurprising, because the present case arises in a conventional *commercial* context, rather than the professional context that so influenced the Supreme Court's approach to *CDA*. *See* note 32 and accompanying text, *supra*. In any event, as discussed in Part III.C, *infra*, the present record amply shows the likely anticompetitive effects of such restraints in the particular context of the recording industry.

[54] Respondents also assert, in passing, that the moratorium prevented the PolyGram and Warner operating companies from using "confidential marketing plans developed by the joint venture partners." Respondents' Opening Brief at 44. However, Respondents do not develop this argument further and cite to no record evidence indicating that the moratorium was intended to protect against the misuse of confide

marketing rights to 3T1 and 3T2 were held not by the joint venture but, rather, independently by the parties to the venture. RX 716 ¶ 31. *See supra* Part I.C.[56]

Respondents draw our attention to cases in which courts have declined to condemn restrictions that co-venturers have imposed upon each other when the restrictions were justified, at least in part, as reasonable means to control free-riding by the co-venturers. These cases are readily distinguishable from the case at hand. The restraints upheld in the "free-riding" cases Respondents rely upon were limited to the products of the joint venture or other single economic entity involved. For example, in *Polk Bros., Inc. v. Forest City Enterprises, Inc.*, 776 F.2d 185 (7th Cir. 1985), two retail chains whose offerings were largely complementary, but which were at least potential competitors, agreed to open a new store offering, side by side, the full range of their goods. To protect their respective economic interests and make the new venture possible, they agreed to refrain from carrying competing goods *at that location.* 776 F.2d at 187. The venturers did not agree to restrict competition between their other stores. *Id.*

In *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) ("*Rothery*"), *cert. denied*, 479 U.S. 1033 (1987), Atlas, a national van line that contracted with numerous local agent-carriers, altered its previously more flexible arrangement by generally requiring that any moving company doing business as its agent cease interstate carriage on its own account and provide such carriage exclusively in conjunction with Atlas (although competition by wholly independent affiliates was allowed in some circumstances). 792 F.2d at 213, 217. Atlas's restriction simply required agent-carriers to bring [illegible]
joint venture all of their interstate carriage that used Atlas's equipment, uniforms, services, or other assets of the Atlas network. Because Atlas demonstrated that this restraint was reasonably necessary to eliminate free-riding ered itl

[56] Had this case involved a merger to create a single entity with rights to market all Three Tenors products, a different analysis would have been required – *i.e.*, one that would weigh potential anticompetitive effects against the prospect of integrative and other efficiencies, under the standards of Section 7 of the Clayton Act, 15 U.S.C. § 18.

In the present case, however, Respondents and Warner did not bring all of their Three Tenors products into a single, integrated joint venture; indeed, the joint venture agreement expressly provided that PolyGram and Warner could continue to exploit 3T1 and 3T2. JX 10-V. Nor did Respondents and Warner limit the restrictive effects of the moratorium to the product within the joint venture – *i.e.*, 3T3. Rather, they left each of the three Three Tenors products in the hands of an independent economic entity, yet agreed to restrict competition by two of those entities – Respondents with respect to the marketing of 3T1 and Warner with respect to the marketing of 3T2.[57] Thus, the issue here is whether a joint venture can claim the "efficiency" of limiting "free-riding" from competing products the joint venture neither owns nor otherwise legally controls.

The sort of behavior that Respondents disparage as "free-riding" – *i.e.*, taking advantage of the interest in competing products that promotional efforts for one product may induce – is an essential part of the process of competition that occurs daily throughout our economy. For example, when General Motors ("GM") creates a new sport utility vehicle ("SUV") and promotes it, through price discounts, advertising, or both, other SUVs can "free ride" on the fact that GM's promotion inevitably stimulates consumer interest, not just in GM's SUV, but in the SUV category itself.[58] Our antitrust laws exist to protect this response, because it is in reality the competition that drives a market economy to benefit consumers. There is no doubt that GM's SUV will likely be more profitable if its competitors do not respond. Promoting profitability, however, is not now, nor has

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[57] Prior to the moratorium agreement, these independent entities had planned to conduct marketing campaigns for 3T1 and 3T2 during the release of 3T3. IDF 102-05, 115-18. Moreover, Respondents were concerned that it would be difficult for PolyGram and Warner to implement the moratorium consistently on a worldwide basis, because they did not have complete control over the prices for 3T1 and 3T2 charged by their operating companies. IDF 126. Ultimately, however, PolyGram and Warner succeeded in enforcing the moratorium. *See supra* Part I.C.

[58] As discussed in Part III.C.3., *infra*, the record reveals that this phenomenon is common in the music industry. JX 91 at 126-27; JX 97 at 46; CX 609 at 71-73, 83-84; CX 610 at 52-54. It is common in many other industries, as well.

it ever been, recognized as a basis to restrain interbrand competition under the antitrust laws. *See Catalano*, 446 U.S. at 649;[59] *Law,* 134 F.3d at 1023 ("mere profitability or cost savings have not qualified as a defense under the antitrust laws"); *Chicago Prof'l Sports Ltd. Partnership v. National Basketball Ass'n*, 754 F. Supp. 1336, 1359 (N.D. Ill. 1991), *aff'd*, 961 F.2d 667 (7th Cir. 1992).

During the oral argument, Respondents in effect conceded this flaw in their argument in their response to a hypothetical positing that Sony had received the rights for 3T3 and then Sony had entered into the same moratorium agreement with Warner and PolyGram restricting price discounting and advertising of 3T1 and 3T2 during the 3T3 release period.[60] This hypothetical assumes that the same benefits to the Three Tenor "brand" exist that Respondents assert exist in their joint venture. Respondents conceded that for Sony to enter into such an agreement with Warner and PolyGram would be *per se* illegal,

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[59] The *Catalano* Court stated:

> [I]n any case in which competitors are able to increase the price level or to curtail production by agreement, it could be argued that the agreement has the effect of making the market more attractive to potential new entrants. If that potential justifies horizontal agreements among competitors . . . it would seem to follow that the more successful an agreement is in raising the price level, the safer it is from antitrust attack. Nothing could be more inconsistent with our cases.

446 U.S. at 649.

[60] As mentioned above, *see supra* Part I.C., Sony released a Three Tenors Christmas album in 1999.

[61] The transcript of the oral argument reads "*per se* legal" (Transcript of Nov. 4, 2002 Oral Argument at 74:24), but it is clear from the surrounding discussion of the Sony hypothetical that Respondents' counsel actually said (or meant) "*per se* illegal."

To allow such an "efficiency" to justify an agreement between competitors to restrict promotion of competing products is to displace market forces with collusive decisions by competitors regarding what new products consumers ought to be offered.[63]

Indeed, the argument Respondents advance here is remarkably similar to a justification that the *NCAA* Court considered and rejected as antithetical to the antitrust laws. There, addressing the NCAA's argument that restrictions on television broadcasts of college football games were necessary to protect live attendance at games, the Court stated:

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[63] Respondents' reliance on Example 10 in Section 3.36(b) of the *Collaboration Guidelines* is misguided. That example addresses the analysis of restrictions imposed by co-venturers in the development of new word processing software products – including, potentially, the cessation of sales of preexisting, competing products. The example makes clear, however, that such restraints may be justified only if they achieve "*cognizable* efficiency goals." *Id.* (emphasis added). Specifically, the example indicates that such restrictions might be justified if they were necessary for the activities of the joint venture itself, as for monitoring the venturers' contributions of assets or preventing one participant from misappropriating assets the other contributed. The example does not support the notion that a restraint on the marketing of non-venture products can be justified simply because it would increase sales opportunities for the joint venture product. On the contrary, the *Guidelines* make clear that claims "premised on the notion that competition itself is unreasonable . . . are insufficient as a matter of law." *Collaboration Guidelines*, at § 3.2. Moreover, as discussed in Example 9 of the *Guidelines*, cost savings from depriving consumers of information useful to their decision making (like the advertising restrictions at issue here) amounts to a service reduction, not a cognizable efficiency.

Further, unlike the joint venture in Example 10, the collaboration at issue here was merely a marketing venture. PolyGram and Warner did not create a novel product. They did not produce the 1998 Three Tenors concert; that was done independently by concert promoter Rudas. Instead, PolyGram and Warner merely collaborated to distribute the audio and video recordings of the 1998 concert. *See supra* Part I.C.

At bottom the NCAA's position is that ticket sales for most college games are unable to compete in a free market. The television plan protects ticket sales by limiting output – just as any monopolist increases revenues by reducing output. By seeking to il2Au

Brothers, as discussed above. Similarly, in *BMI*, the Court upheld the joint setting of prices for the joint venture product (blanket music licenses) because it "accompanie[d] the integration of sales, monitoring, and enforcement against unauthorized copyright use." 441 U.S. at 20. Significantly, the pricing arrangement approved in *BMI* did not include products outside the joint venture – *i.e.*, licenses on individual compositions – which remained available and were not subject to restraints. *Id.* at 23-24; *see* XI Hovenkamp, *Antitrust Law* ¶ 1908e, at 237-38. Respondents have not cited any cases, nor are we aware of any, in which restraints on the sales of non-joint-venture products have been upheld as "ancillary" to the production of efficiencies by the joint venture itself. On the contrary, the Commission has long recognized that restraints on activities "outside the ambit of the joint venture" cannot be hidden under its cloak. *See Brunswick Corp.*, 94 F.T.C. 1174, 1277 (1979), *aff'd sub nom. Yamaha Motor Co., Ltd. v. Federal Trade Commission*, 657 F.2d 971, 981 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982).

In the present case, Respondents and Warner chose to retain control over their respective existing Three Tenors products and to form a joint venture limited to 3T3 and specified follow-on products (*i.e.*, a possible "Greatest Hits" recording and a Boxed Set). They cannot claim the integrative efficiencies that could conceivably have been brought about by combining the production and marketing of all Three Tenors products. Accordingly, the restrictions on the marketing of 3T1 and 3T2 cannot be considered "ancillary" to the present joint venture, *as a matter of law*, because they are not related to the efficiencies the joint venture was created to produce.[64]

Thus, we hold that the Respondents' "free-riding" argument is simply an attempt to shield themselves from legitimate interbrand competition. As such, the proffered justification is not cognizable under antitrust law.[65] This conclusion,

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[64] As discussed in Part III.C.3, *infra*, the restraints on the marketing of 3T1 and 3T2 also fail to qualify as ancillary *as a matter of fact*, in that the record shows that such restrictions were not actually necessary to ensure the introduction and vigorous promotion of 3T3 and any covered follow-on products.

[65] Accordingly, we have no need to determine whether Respondents' proffered justification is "plausible" in a purely factual sense. Because it is not

C. A More Detailed Factual Analysis

Our analysis could properly end at this point. Respondents' only proffered justification is not cognizable as a matter of law, and therefore triggers no need to go beyond the analysis presented above. Even if we concluded, however, that Respondents had offered a cognizable and plausible justification and that a more elaborate analysis were therefore needed, analysis of the facts here would only reconfirm our ultimate conclusion. The extensive factual record regarding practices in the recording industry and Respondents' own prior course of conduct establishes that the harm to competition not only is inferable from the nature of the conduct but is established as a matter of fact. And the record likewise shows that Respondents' proffered justification regarding free riding and the supposed need to ensure the vigorous promotion of 3T3 would fail as a factual matter, even if it were legally cognizable.

1. Competitive Effect of Respondents' Discounting Restrictions

The record evidence shows that the moratorium's price restraint not only was inherently suspect, but also actually harmed competition and consumers. In the sale of recorded music, as in other industries, price discounting is an important dimension of competition. IDF 238-42. Executives from PolyGram and Warner testified that their companies commonly offer price discounts to retailers, on catalog products as well as new releases, and that such discounts increase sales. IDF 239. PolyGram and Warner also commonly provide retailers with cooperative advertising funds, which function as a discount from the wholesale price.[67] IDF

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[67] Cooperative advertising is a monetary commitment that the record label makes to retailers to support both out-of-store advertising (*e.g.*, print, radio, and television advertising) and in-store promotion (*e.g.*, posters and floor displays). Out-of-store advertising is intended to draw customers into the store by informing them where a recording may be purchased and at what price. In-store advertising is designed to increase the likelihood that, once inside the store, the consumer buys a specific recording. JX 105-F; Tr. 48-54, 58-60, 194-96. When PolyGram provides cooperative advertising funds, the retailer provides the advertising and then deducts the value of the cooperative advertising from the amount it pays for the product it purchases from PolyGram. Cooperative advertising thus functions as a price discount. IDF 217-18. Indeed, industry participants

recognize that cooperative advertising funds are a form of discount, because they

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[69] For example, Warner's 1994 marketing plan for 3T2 stated:

> In order to counter the perceived threat of competitive imitation products which will aim to satisfy demand in the period directly around the concert using similar repertoire and perceptually identical artists, the concept of the genuine or "real thing" will underpin all local implementation of the [marketing strategy].

CX 259 at 3TEN00011109.

In 1998, PolyGram and Warner operating companies began to plan advertising campaigns for their respective catalog Three Tenors products in connection with the upcoming Paris concert. IDF 102-03, 105, 115-18, 255-58. PolyGram and Warner subsequently instructed their operating companies that, because of the moratorium agreement, advertising of 3T1 and 3T2 had to end before 3T3 was released. IDF 107, 147-49. The ban on advertising was intended to protect sales of 3T3 by withholding information from consumers about the nature and price of competing products. As one Warner executive explained at trial, the companies did not want consumers to "start comparing the repertoire along with the price and make a determination that, you know, the '94 concert is just fine for a few dollars less." Tr. 487. We agree with the ALJ that the anticompetitive effect of this strategy is obvious. IDF 224-34.

3. Inadequacy of Respondents' Free-Rider Defense

The foregoing analysis shows that the price and advertising restrictions Respondents imposed were inherently suspect as a matter of economic theory and also were demonstrably anticompetitive in the particular industry context in which they were imposed. Although we have found it unnecessary to engage in "the fullest market analysis," *CDA*, 526 U.S. at 779, we have examined evidence of industry practice and the past practices of the very participants in the present scheme, as well as the consistent economic literature regarding the likely effects of such practices. By any standard, this is an enquiry "meet for the case," allowing us to arrive at a "confident conclusion" about the anticompetitive nature of these restraints. *Id.* at 781. An antitrust defendant can avoid liability in these circumstances only by making a concrete showing of "countervailing procompetitive virtue." *See IFD*, 476 U.S. at 459. Respondents have failed to make such a showing.

As discussed above, Respondents' only proffered justification is impermissible as a matter of law, because the supposed "efficiency" of restraining competition in the offering of products outside of a joint venture to enhance market opportunities for a new joint venture product is not cognizable under the antitrust laws. Nevertheless, in this section we examine the record evidence on these restraints and conclude that, *even if* Respondents could propec99sTD(We agr)Tj40.8000 (

to ensure the vigorous marketing of 3T3, the record simply does not support that argument as a factual matter.

The joint venture unquestionably would have proceeded and the new product would have been brought to market without the moratorium. Initially, Warner planned to market and distribute 3T3 on its own, without any collaboration from PolyGram. IDF 52. Furthermore, PolyGram and Warner were contractually committed to the formation of the joint venture and the creation of 3T3 months before discussions of the moratorium began. IDF 263. Although the timing of the moratorium is not dispositive, it is certainly relevant to an assessment of whether the moratorium was reasonably necessary to achieve the procompetitive benefits of the collaboration. At trial, a Warner executive testified that even if PolyGram and Warner had not agreed to the moratorium, Warner was committed to distribute 3T3 in the United States. Tr. 446-47. Moreover, the fact that the joint venture agreement itself expressly contemplated that PolyGram and Warner would remain free to exploit the earlier Three Tenors albums strongly suggests that the parties did not view a ban on competition from these products as important to the efficient operation of the joint venture. JX-10-J-K.

The evidence in this case shows that the prospect that PolyGram and Warner operating companies would discount and advertise 3T1 and 3T2 during the 3T3 release period did not diminish Warner's incentives to promote 3T3 in the United States. Respondents' marketing expert, Dr. Wind, acknowledged in his deposition that firms commonly capitalize on the promotional activities of their competitors, and sellers generally respond to this challenge by using advertising and other marketing tools to create a distinct identity for the target product. JX 91 at 125-29, 133-34; IDF 277-79. In particular, within the recorded music industry, the diversion of sales identified by Respondents is commonplace, and advertising intended to benefit one album often leads to sales of competing albums, including catalog albums by the same artist. IDF 280; Tr. 87-88, 264-65; JX 89 at 33-35; JX 87 at 69-72; JX 101 at 183-84; JX 102 at 114-15; JX 609 at 71-73. As the president of WMI wrote when informed that the moratorium agreement would prevent his operating companies from implementing their plans to promote and discount 3T2 when 3T3 was released:

> There is nothing sinister nor underhanded in marketing catalog on the back of a significant related event or new release. In fact, as you well know, this is the normal and traditional practice of our industry.

JX 8.[70]

Complaint Counsel's music industry marketing expert testified, and the parties' executives confirmed, that the prospect of a new album's losing sales to competing catalog products typically does not lead record companies to curtail their marketing of a new album. Tr. 88-90; JX 105-H; CX 610 at 54-55; CX 609 at 71-80, 85-86. For example, when Warner released 3T2 in 1994, it anticipated that PolyGram would take advantage of the promotional opportunity arising from the release of 3T2 to advertise and discount 3T1. IDF 202. But Warner did not cut back on its marketing of 3T2. To the contrary, it launched an aggressive and expensive international marketing campaign in support of 3T2, competing by creating a distinct identity for 3T2. Tr. 89-98; IDF 201, 203-09.

The evidence here shows that marketing activities in support of 3T3 would not have been curtailed on account of the promotion of 3T1 and 3T2. IDF 288-91. Witnesses representing both Warner and PolyGram testified that 3T3 would have been appropriately promoted without the moratorium, and that the moratorium had no effect on the resources for advertising and promoting 3T3. Tr. 490; JX 94 at 87-89; JX 95 at 89-90; JX 101 at 85-86; IDF 288-91. Indeed, in June 1998, when it appeared that the moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. IDF 129.

Respondents fail to point to any convincing countervailing evidence that "opportunistic" behavior by PolyGram and Warner operating companies would have led Warner to reduce its level of marketing of 3T3 in the United States. Even Respondents' economic expert, Dr. Ordover, was unable to conclude that promotion of 3T1 and 3T2 was a significant concern in the United States; rather, he found that the moratorium was motivated by concerns about promotion of 3T1 and

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[70] In economic terms, one reason for this practice is that, for certain consumers, prior recordings are apparently complements, not substitutes. That is, for these consumers a new recording can increase the attractiveness of previous recordings.

3T2 in Europe. JX 90 at 36-37; IDF 294-96. Even if the evidence supported a conclusion that promotional activities by the operating companies in Europe were a concern, this would not justify a ban on discounting and advertising in the United States. *See Rothery*, 792 F.2d at 224 ("If [a restraint] is so broad that part of the restraint suppresses competition without creating efficiency, the restraint is, to that extent, not ancillary."). Moreover, although Dr. Ordover opined that the moratorium was "reasonably necessary" to avoid free-riding, he defined "reasonably necessary" as meaning not obviously pretextual. IDF 297-98. This meaning of "reasonably necessary" is contrary to the case law. *See Rothery*, 792 F.2d at 224 (restraint "must be subordinate and collateral to a separate, legal transaction" *and* "related to the efficiency sought to be achieved"). Dr. Wind, Respondents' marketing expert, opined that the moratorium plausibly benefitted consumers because it provided incentives for PolyGram and Warner to produce 3T3 and invest in promoting the album, but he could not identify any record evidence that supported his opinion. JX 91 at 111-15, 117-18. Accordingly, we agree with the ALJ that the opinions of Respondents' experts are entitled to little weight. ID at 58-59, n. 25.

Respondents also fail to point to any convincing evidence to support their contention that the moratorium increased the likelihood that the parties would release a Three Tenors Boxed Set and a Greatest Hits album. Although aggressive promotion of 3T1 and 3T2 during the launch of 3T3 might have diverted some sales of 3T3 to the other products (with consumers benefitting from lower prices), presumably there would have been at least as many total units sold during that period. This scenario may well have been less profitable for the joint venture, but it is not apparent that the parties' possible decision in the future to release these

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At most, Respondents' record citations suggest that some PolyGram and Warner executives harbored vague concerns that discounting and advertising of 3T1 and 3T2 during the launch of 3T3 might have "devalued" the Three Tenors "brand" (jeopardizing future demand for Three Tenors products) or resulted in customer confusion (leading customers to purchase a different album than intended or perhaps not purchase anything at all). JX 89 at 57-58; JX 94 at 80-82. Respondents, however, offer no evidence indicating that these are valid concerns.[71] In 1994, PolyGram responded to the release of 3T2 by discounting and aggressively promoting 3T1; and during the Three Tenors world tours in 1996 and 1997, both companies mounted promotional campaigns, which included discounting in many markets. *See supra* Part I.C. There is no evidence that any of these promotional activities "devalued" the Three Tenors "brand," unduly confused consumers, or otherwise threatened Three Tenors output.

IV. REMEDY

Having found a violation of Section 5 of the FTC Act, the Commission is empowered to enter an appropriate order to prevent a recurrence of the violation. The Commission has wide discretion in its choice of a remedy. *Federal Trade Commission v. National Lead Co.*, 352 U.S. 419, 428 (1957); *Jacob Siegel Co. v. Federal Trade Commission*, 327 U.S. 608, 611 (1946). "[T]he Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past," but "must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity." *Federal*
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[71] Respondents' argument about consumer confusion – that eliminating the "clutter and confusion" of competing products was "in the customer's best interest," JX 94 at 80 (Saintilan Dep.) – is similar to a justification that the Supreme Court rejected in *IFD*. *See* p. 22, *supra*.

[72] Respondents claim, without citing authority for the proposition, that this provision improperly reverses the substantive and procedural burdens under the antitrust laws. We disagree. Requiring Respondents to demonstrate a

> For every major release in any record company there is always an element of anxiety because of big investment, because of big expectations, to make sure that everything is set up to deliver the quantities to make money on that project. There was not any difference on this one.

JX 97 at 42-43.

Recording artists often release material on more than one record label during their careers. Music labels often release an exclusive artist to a competing company for a particular project. Thus, many artists have catalog albums that appear on a label different from the label that releases the artist's new record. IDF 331-32. In addition, a music label may release an artist from an exclusive recording contract in return for a royalty on the artist's first album on a new label, giving the companies a shared financial interest in the success of a particular album. IDF 333. In such circumstances, Respondents will likely have the same incentives and opportunity to restrict the pricing or advertising of the artist's catalog albums that led PolyGram and Warner to enter into the Three Tenors moratorium agreement.