FEDERAL TRADE COMMISSION

I N D E X

June 5, 1997

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FEDERAL TRADE COMMISSION

In the Matter of:)
HEARINGS ON THE)
JOINT VENTURE PROJECT)

Thursday, June 5, 1997

Room 322
Federal Trade Commission
6th and Pennsylvania Ave., N.W.
Washington, D.C. 20580

The above-entitled matter came on for hearing, pursuant to notice, at 1:35 p.m.

BEFORE:

ROBERT PITOFSKY, Chairman
MARY L. AZCUENAGA, Commissioner
JANET D. STEIGER, Commissioner
ROSCOE B. STAREK, III, Commissioner
Federal Trade Commission
6th and Pennsylvania Avenue, N.W.
Washington, D.C. 20580-0000

ALSO PRESENT::

STEPHEN CALKINS, General Counsel

SUSAN S. DeSANTI, Director, Policy Planning

WILLIAM E. COHEN, Deputy Director, Policy Planning

MARK WHITENER, Deputy Director, Bureau of Competition

DAVID MEYER, Bureau of Economics

SPEAKERS:

JOSEPH KATTAN, ESQ., Morgan, Lewis & Bockius

ROBERT A. SKITOL, ESQ., Drinker Biddle & Reath

STEPHEN A. STACK, JR., ESQ., Deckert, Price & Rhoads

P R O C E E D I N G S

MR. KATTAN: Thank you. I want to thank you for the opportunity to address this panel today. I think these are very important hearings that the Commission is holding. And I hope that what emerges from these hearings is as great as what we saw in the last set of hearings, which was an outstanding set of recommendations.

The Commission issued a Federal Register notice in which it asked some very probing and appropriate questions about the issue of joint ventures. It is engaging in a fact-finding that, I think, is very important because it is my belief that a fact-finding effort will yield some very interesting answers.

And the reason I say that is because I think that the area of joint ventures is an area in which we have seen a great mythology built up. And that mythology is that the current state of joint venture law is a serious impediment to the formation of pro-competitive joint ventures.

I think it is important in the course of the hearing for the Commission to press those people who are pressing that point of view, who are saying that there is a problem, and to get real examples of situations in which uncertainty based on the current state of the law has really gotten in the way of the formation of joint ventures that everybody can agree would be pro-competitive.

I know there is a lot of theoretical stuff in the

literature, but in my experience I have not seen it. And in

venture independently, don't receive the statutory protection.

And when you have a transfer of trade secrets, you know how you usually need that kind of protection. Nevertheless, I think, it is not really a problem that is inhibiting the formation of joint ventures because I think everybody more or less knows the rules of the road.

And the rules of the road ask: Is it reasonably necessary? Does the restraint that you might want to impose to protect the trade secrets, are those reasonably necessary to accomplish the legitimate purposes of the collaboration?

technologies; for example, I make great copiers and you make great toner. If we both put our resources together, we can produce a knockout product. I see a lot of production joint ventures in the technology area.

For a while it seemed that every week there was a multi-billion dollar memory chip consortium being announced involving industry giants. You see lots of JV's in pharmaceuticals, see a lot of buying co-ops, lots of network joint ventures in the payment systems and financial interchange area. And obviously there are a lot of joint ventures in the health care area.

So I am not sure what is being deterred. And I do see a problem in any kind of effort to come up with some overarching global set of guidelines that has bright line standards because of the richness of the variations of all the different forms of competitor collaborations that exist out there.

I think it is impossible to have a one-size-fits-all approach. I think that's been tried and that's called the NCRPA.

And to the extent that one of the things that the Commission is considering is a set of guidelines, I think that if you do try to have bright line standards, my guess will be that you will wind up somewhere along the lines of the NCRP, which is a set of very well thought out but

reasonably conservative rules that don't provide a lot of added comfort precisely because they are so conservative and they need to be.

And I do have a concern about having special rules for joint ventures. I think, one, I think the greatness of contemporary antitrust is it is grounded in economic reasoning and not doctrine. If doctrine had precedence over economic logic, you would not have your lawyers down the block right now at this moment arguing the Staples case.

If you create doctrines, if you create special rules, you will find lawyers focusing their analysis on the issues of characterization instead of the economic impact of collaboration.

A few weeks ago I was involved in negotiating a collaboration, which was along the lines of what had been described earlier, one company producing a piece of equipment and another company producing the complementary good, a consumable good used in that piece of equipment.

And I found that the lawyers for the other side were really determined to call the collaboration a research and development joint venture, so that it could fit within all the different rubrics of the NCRPA. The clients were resisting. And at the end of the day everybody concluded that it really didn't matter what you called this thing because it didn't raise any significant antitrust issues.

But my sense is that when you create these doctrines and special rules that are based on characterizations, you will find lawyers engaging in efforts to characterize their endeavors in ways that meet the standards, rather than focusing on the economic effects.

Competitor collaborations take many different forms. They go all the way from very limited forms of cooperation to the complete merger of competing businesses into a single entity. To give an example, consider a common form of technical cooperation, whereby two companies are producing complementary goods in one form. The manufacturer will

ventures. But there is obviously a big difference between a joint venture in which there is a limited form of cooperation, and a joint venture where the two parties are combining their efforts all together.

I think the state of the current law, as I said at the outset, is quite good. The rule-of-reason analysis, which begins with an evaluation of market power, is applied to most joint ventures.

If you had had these hearings two years ago, I would have been a little bit less sanguine because the Commission was still using the Mass Board form of analysis, which dispensed with the market power evaluation in many cases, but last year the Commission issued its California Dentist opinion, and since then the Interpreter's opinion, and I think it has moved very much in the right direction in this area.

And even Mass Board was a product of a particular kind of a case, a trade association case which by definition involves the collaboration with relatively little economic integration. Regardless of whether it was right to apply in that context -- I think it was wrong, but I know very reasonable people disagree with me.

The Commission has never applied it in a situation where you had a true collaboration that involved the integration of productive resources or, indeed, on R&D to

create some product.

And another reason that I am very sanguine is that the Intellectual Property Guidelines that the Commission and the DOJ issued two years ago provide tremendously good guidance, not only in the area of intellectual property, but I think also in the area of joint ventures.

The Guidelines by definition deal with intellectual property, not with joint ventures, but their analytical framework works very, very well in the context of JV's.

I think there are two reasons why the Guidelines are good. First is that they set out an analytical framework. They don't prescribe rules of do's and don't's. And, secondly, basically get it right.

They set out in a clear and precise fashion the potential horizontal and vertical problems, theories of competitive harm associated with the restraints and intellectual property licensing activity, which I think are similar conceptually to joint venture descriptions.

And they also very nicely describe the various forms of efficiencies that may be promoted by these restraints. I find that it is hard to go wrong by following the guideline standards. Bearing in mind that there are some old cases on the books, which may have collected a fair amount of moss, but one has to pay attention to them and analyze the law in doctrinal terms, which is to say that the guidelines can't

always give you comfort, even if you agree with their form of analysis.

Now, we had the 1988 Guidelines for International Operations and those address joint ventures, intellectual property, as well as international antitrust. Since then we have had the IP Guidelines and we have had the International Guidelines, so that there is at least a vacuum that has not been filled in the area of joint ventures.

And to the extent that the Commission believes that there is a need for more guidance in the joint venture area, I think it can address the outstanding issues in new guidelines for joint ventures.

I would urge you to follow the IP Guidelines approach, which is one of setting out an analytical framework rather than attempting to establish bright line standards. And I think it would be hard to go wrong by translating the IP Guidelines into a joint venture context, rather than trying to do something altogether new or vary the form of analysis from that which exists in the IP Guidelines.

The two areas, if I had to express mild concerns, the two areas that I would have would be whether there is any possibility that a truncated Mass Board type of analysis might be reintroduced. I think that having abandoned Mass Board, the Commission should leave it dead and buried.

Second, I think the IP Guidelines deal exceedingly

well with the delineation of where the rule-of-reason ends and where per se liability begins. They lay out a sensible standard that applies the per se rule activities that have traditionally been analyzed as under per se standards and do not offer substantial, which is to say in that context, overwhelming efficiencies.

And I think that's a sensible standard. I think it is a workable standard. And unless there is persuasive evidence that the law as it is today is underdeterring patently anticompetitive conduct, I think the standard should stay that way, but on the whole I think that an objective examination of the current state of affairs with joint ventures would say that the state of affairs is quite, quite satisfactory.

And if the Commission can capture that state of affairs in a set of guidelines, I think that would be wonderful, but I don't think that there is a need for any kind of change of course. Thank you.

CHAIRMAN PITOFSKY: Thank you. Questions?

COMMISSIONER STEIGER: Joe, welcome back.

MR. KATTAN: Thank you.

COMMISSIONER STEIGER: Hearing you speak always makes me wonder why we ever let you out of the Federal Trade Commission. We have heard in the first set of these hearings, and we will hear again a plea for safe harbors in

the joint venture area.

I notice, however, in the written testimony you had pre-prepared for us that in the IP Guidelines that you praise so highly as a useful analytical tool, you consider the safe harbor virtually useless. Is there something generically wrong with safe harbors or is it just the IP safe harbors?

MR. KATTAN: Well, I think there is a tendency in creating safe harbors to draw the lines fairly conservatively, and that's understandable because as enforcers you don't want to give you up too much of your discretion.

I think what happened with the IP Guidelines was that the standard that was adopted for that particular safe harbor was very conservative in the sense that it is not an ironclad safe harbor, even if you meet its requirements.

The way that the safe harbor is set out is that if your market shares; that is, the market shares of the two parties in the transaction, is less than 20 percent, you get the benefit of the safe harbor, but that is not an examination which is fixed in time.

So I could enter into an agreement today as a bit player in the market with somebody else who is also a bit player, where combined market shares are 5 percent, but if ten years later or five years later our market share, our combined market share is 25 percent, the eligibility for the

safe harbor would be dependent on our market share at that time, not the time that we entered into the agreement. So I think that's a flaw with that particular safe harbor.

But I have seen very few safe harbors, to wit, on which people rely extensively. The one exception on which I have seen people rely a fair amount is the health care guidelines safe harbor for statistical information programs. And people in all sorts of industries, not just the health care industry, rely on that; partly because it is very clear and very understandable, where the law in that area is a little bit fuzzy.

COMMISSIONER STEIGER: As a follow-up, you note that there is no duration defined in the safe harbor in the IP Guides. Another point that we are hearing frequently is that one of the reasons that you need JV guidelines here is that the world has changed, that these joint ventures are now far more ephemeral and far looser and a lot of them seem to be of relatively short duration.

If they are correct, in your expert view, would you presume that a market share could increase rapidly enough that in a short venture, short duration JV, the falling out of a safe harbor would be a problem or is that just too hypothetical?

MR. KATTAN: Well, I think it depends on the nature of the collaboration. There are types of collaborations

which are designed by their nature to deal with a single product or with a single generation of products and those are the kind of ephemeral-type of joint ventures that you mentioned in your question.

I think, however, there are also joint ventures that are fairly common that are much more enduring, that are designed to last a long time. I have a little bit of a problem because I have never been entirely clear in my mind what a joint venture is, and that's a problem that's troubled a lot of people who have written in the area, but putting that aside, I think there are lots of joint ventures that are designed to be durable. It is also true that there are joint ventures that are confined to a single product generation and may last a year or two.

COMMISSIONER STEIGER: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PITOFSKY: Other questions or comments?

MS. DeSANTI: I have some questions. Joe, thank you very much. I find this very useful. And it is interesting to hear from someone who has been inside the agency and now has perspective from outside the agency as counsel.

One of the things I wanted to ask about in terms of your counseling experience is the extent to which you run into transactions where setting price jointly is a business purpose that your clients feel that they must achieve in

order to achieve the purposes of the collaboration?

The reason I am asking is that one of the things we have been hearing is that that is more common than it used to be. And I am just wondering to what extent you would counter that. That obviously raises the difficult issue of per se versus rule of reason. How often do you encounter that and how difficult a problem do you find it to deal with?

MR. KATTAN: I think it is probably the single most difficult problem I have encountered in the joint venture area in terms of trying to counsel people. It comes up. I mean, it is something that comes up from time to time. I can't say that it comes up in the majority of the cases. I don't believe that it does, but from time to time you do see collaborations where the parties want to market the product jointly and set the price jointly, and that can raise some difficult questions.

I wish I had easy answers to those questions, but it is a difficult question and does come up.

MS. DeSANTI: And in assessing whether the setting of price is reasonably necessary to achieve the purposes of the collaboration, how easy or hard do you find it to assess the efficiencies likely to be achieved by the collaboration and whether, in fact, this is reasonably -- joint price setting is reasonably necessary? What kind of criteria do you use in answering or asking those questions of your clients?

MR. KATTAN: I guess where I would begin that analysis is I think where the Commission does, which I think may be a little bit on the conservative side, and that is to ask whether there is a sharing of risks and profits, which is the standard that I think the Commission adopted based on the Maricopa case, but that's not the entire analysis.

You do need to examine whether it makes sense for the parties to market the products in competition with each other, whether there are any benefits to marketing the product in competition with each other, and w whieI129.6000 IET1.00

some of these high-tech areas where you have new products that are being created.

MR. KATTAN: That is certainly true that, to the extent there is an obstacle to applying the safe harbors that are based on market shares, that it comes in the area of market definition.

It may be because of uncertainty as to the contours of the market and you are dealing with unfamiliar products, but when you are dealing in that space, you are not terribly concerned with antitrust anyway, because by definition if you can't even tell what the product market is, you can't tell who the players are. It is going to be very difficult to say that you did something that screws up the market.

But even in more established markets, as we all know the issue of market definition can be answered rather easily in some cases, and takes much more searching inquiry in other cases. So you find that in some cases you can get a ballpark idea that you are satisfied with because you look at it and say: Well, looks and smells like a market and here are what the numbers are. And there are cases where trying to figure out what the market is is going to take too much of an

problems in a specific fact situation that raises difficult problems because I haven't encountered them and I have talked to enough people who work in the area to believe that my experience is not unusual.

CHAIRMAN PITOFSKY: I have a brief comment and a question about your remarks about Mass Board. As I understand it, you said it is dead and buried as a result of California Dental and that's a good thing.

Just for the record here, the majority opinion didn't say it was dead and buried. It took an agnostic position. And I do hope that the hearings will address the question, the same questions that Mass Board addressed, but let me ask you this: You say dead and buried and that's a good thing.

Is that because you think it got to the wrong result, or do you think the whole effort to try to structure a quick look rule-of-reason with respective responsibilities of government and respondent, you know, step 1, step 2, step 3, et cetera, do you think that's doomed to failure or do you think it could be done but Mass Board got it wrong?

MR. KATTAN: I don't think that Mass Board got it wrong. I think that the nature of the process leads people to take shortcuts. And my experience was that people, because of the availability of Mass Board, tried to take advantage of Mass Board, because if you can bring yourself within the contours of Mass Board, which is to say identify a

restraint as inherently suspect, you relieve yourself of a fairly substantial and tedious task of going through issues of market definition, market power, and competitive effects.

And my experience was that because this crutch was available, if you will, people used it. And what we saw again and again and again is an effort to label restrictions as inherently suspect and then condemn them on the basis of the absence of plausible efficiencies.

And, in fact, when you look at the cases, and they are mostly consent orders, in which Mass Board was relied upon, there are many cases where the efficiency for the restrictions that were condemned by the Commission are not inherently obvious and probably absent.

But I think it is also fair to say that there were some cases that were brought under Mass Board where irrespective of whether efficiencies existed, it was difficult to see where the anticompetitive harm would lie also.

CHAIRMAN PITOFSKY: That's very useful.

COMMISSIONER STAREK: I just wanted to follow up on that. So what you are really saying then is what you didn't like about Mass Board analysis was the fact that people took shortcuts in the analysis and you didn't necessarily have to have a market power screen?

MR. KATTAN: Well, if you look at the history of the

truncated rule-of-reason, I think it is fair to say that it was developed in the context of violations that had traditionally been analyzed under the rule of reason.

You had cases like BMI and NCAA, where rather than saying we are going to condemn these restrictions as price fixing without looking at them, the court said: We will take a look at them and see whether there is some great efficiencies that might otherwise save them. In BMI, they did. And in NCAA, they didn't.

In the way that Mass Board was applied, given the fact that the term "inherently suspect" was not very clearly defined -- and in fairness the Commission did not have too many opportunities to define it because that was a period when virtually nothing was litigated -- that concept became fairly elastic. And I think it is fair to say that restrictions that the Board narrowly would have been analyzed under the rule of reason, were analyzed under Mass Board, so something that had been developed as a way of cutting back on the per se rule, in fact, was then transported to rule-of-reason territory.

COMMISSIONER STAREK: I agree with you, and I think you are familiar with the dissents in some of the cases that were analyzed under Mass Board where the restraints didn't present any competitive problem, at least from my view, so, I mean, I agree that there was that tendency, but I am not so

useful exchange.

Our next participant is Bob Skitol, partner in the Litigation Department of the Washington office of Drinker, Biddle & Reath, where he specializes in antitrust and trade regulation. Before joining the firm he was a partner at Pepper, Hamilton & Scheetz.

From 1970 to '71 Mr. Skitol served as Attorney Advisor for the Chairman of the Federal Trade Commission, and then for a year as Special Assistant to the Director of the Bureau of Consumer Protection, who was me at that time. He has written and lectured extensively on antitrust law, and recently served as the Special Consultant on Competition Policy for the Government of Jamaica.

This little summary here doesn't indicate Bob's most important historical contribution. He was a student in my class at NYU when I came down to Washington to help write the Kirkpatrick report. Bob wrote most of that report. I've tried to explain that all the critical stuff was written by Bob Skitol and, in any event, he did a spectacular job and it is a pleasure to welcome you back.

MR. SKITOL: Thank you, Mr. Chairman. It is an honor to be back and have this opportunity.

I find myself wanting to agree and, in fact, agreeing with almost every individual observation that Joe Kattan has made, which is a good thing because it is always dangerous to

attempt to disagree with Joe, but even though I agree with almost every individual observation, I disagree with the ultimate conclusion.

I think it is certainly the case that those of us in the antitrust bar who specialize in antitrust don't have particular difficulty understanding the general thrust of joint venture law today as applied, certainly not as applied by this agency, but that by itself doesn't lead to a conclusion that there is no role for new clarifying joint venture guidelines.

I think there is a whole wide world of people out there in the business world and the bar, which are also part of the constituency of this agency, and for whom current joint venture law is a bit mysterious. And there is some public interest to my mind in demystifying the subject.

I heartily endorse the idea of new joint venture guidelines with three audiences in mind. And the first is business leaders in some industries, particularly in the high technology sector, for whom antitrust law and policy remain a bit foreign and even a bit bizarre as applied to their markets; second, a great many members of the bar who are deeply involved in the negotiation of increasingly common kinds of collaboration but who do not live and breathe antitrust stuff on a daily basis, and; third, the whole world of federal district court judges out there who preside over

private antitrust challenges, who might be forgiven for misapplication of decades-old decisions -- Topco comes to mind -- old decisions out of sync with current thinking and who might well find this agency's 1998 guidelines in this area useful input into decision-making at the critical summary judgment stage.

But even for antitrust sophisticates, if you will, or those of us who specialize in antitrust, there is room for clarification in some important respects. There are areas where the antitrust bar disagrees a great deal among themselves, where antitrust standards are unclear today, and where a clarification would be highly desirable.

I would like to offer one example in particular involving high technology ventures. One particular contentious issue and debate that comes up in my experience over and over again in the last couple of years in the negotiation of multi-competitor collaborations in the high technology sector, the perspective participants may share a commitment to some existing technology along with a vision for its evolution into next generation products for a whole range of emerging markets. Everybody involved talks about open standards as part of the vision, but they don't necessarily interpret that idea in a common way.

One of the first questions that comes up is just how open or not so open should be the door to participation in

promote creative thinking about some middle ground between the two opposite kinds of exposure. The parties may have good reasons relating to manageability of the undertaking, the maximum efficiency in developing the technology and quickest time to market, concerns of that sort, to limit the parties involved in the collaboration, and their interest in doing so warrants considerable deference.

On the other hand, with a view to maximizing defenses against any challenge by an excluded competitor, the parties might consider various commitments to make the plan public and to do the same with developments at key interim points.

Nonparticipants could be invited to offer some input on an informal basis. The parties might also bring to the effort a neutral consultant, perhaps a widely respected expert in the relevant technology from academia.

The parties might commit at the outset in a public sort of way to some form of open licensing to jointly developed intellectual property at the end of the Egibs, recognizing that 00 fi1cmvmocmy1

imperatives involved. And in some cases this hostility may be warranted.

My belief, though, is that suggestions along these lines do make sense for those collaborations where an excluded party's future gripe may not appear totally baseless to a reviewing enforcement agency or court and where the facts governing assessment of the gripe are not only unclear at the outset but will be unclear at the future fact-finding stage.

I would, accordingly, urge some thoughtful input about middle-ground steps of this sort in neveli8stful input

showing of expected efficiencies in the form of reduced variable as well as fixed costs, the 1997 revision to the efficiencies section of the Merger Guidelines would suggest revisio

broader role, a substantially broader role for efficiency considerations in merger enforcement policy, the new section is seen, rightly or wrongly, it is seen as a reinforcement of long-standing barriers to justifying a merger on this ground.

And, conversely, such a venture may well promise substantial efficiencies of a character and magnitude likely to enhance the ability and incentive of both parties to compete in the affected downstream market in the years ahead. Indeed, there could be a greater likelihood that resulting efficiencies ultimately inure to the benefit of downstream consumers than would be the case if one party acquired the totality of the other.

In this context, I would suggest, the agencies can readily accept a broader array of efficiencies and afford more generous treatment to them as offsetting competitive risks than might be appropriate in the review of a full-scale merger.

This is a rather simple notion that I think is implicit in agency actions and FTC actions of various sorts in recent years. I think it would be desirable now to make it explicit and elaborate upon it in new guidelines addressing the particular kind of joint venture that I have been talking about.

The agencies discuss efficiencies as a factor in rule-of-reason assessments of some forms of competitor collaborations in both the IP Guidelines -- I certainly agree with Joe that the IP Guidelines are an excellent template for a broader set of collaboration guidelines. Efficiencies are discussed also as a factor in rule-of-reason analysis in the

such, let's say, a preagreement-agreement should come forth?

MR. SKITOL: What I would think is welcome and would have a good effect is nothing more ambitious than guidelines that signify agency encouragement of a middle ground idea, where the agency officially acknowledges what antitrust counselors attempt to convey to their clients all the time with mixed results, which is that when you come to us and ask us some okay or not okay, this new technology collaboration that we have in mind, tell us either yes or no, and we have to tell them: Well, it is not quite that simple, there is a dilemma here. And you are subject to opposite kinds of antitrust risk, and nobody has got a crystal ball.

Here it is at the outset, you have got a vision, you may end up producing a standard that comes to control the next generation of this market. And if that's the way this ends up, and the insiders that have created it end up the winners and some innovative looking outsiders have been left out in the cold, there is going to be trouble.

And, on the other hand, if you just say: Well, let's let everyone in, the agencies may -- you may eliminate the potential private antitrust plaintiff, but you may be walking right into a public enforcement agency issue. The agencies may wonder: Well, gee, if you had limited the participation, maybe we would have ended up with two or three rival camps that would have ended up -- we would have ended up with more

innovation, rather than less in the future, so it is kind of no win.

Well, it doesn't have to be "no win." There are ways of striking a balance. There are ways of mitigating the potential anticompetitive impact in both directions. And when the antitrust lawyers come in at the outset and say to their clients there is a potential problem with your excluding X, Y, and Z, and so we recommend that -- we think it is fine if you do this among yourselves and leave them out, but you ought to make a public commitment at the outset to open licensing at the end. That advice is sometimes very unwelcome.

And the clients, the businesspeople and the other lawyers to whom the advice is given will say: Well, show us where the Federal Trade Commission or the Justice Department has ever said that that's a good idea or that that's a necessary idea.

COMMISSIONER STEIGER: Maybe there is reason why we haven't, though. Thank you very much.

CHAIRMAN PITOFSKY: Thank you. Other questions?

COMMISSIONER AZCUENAGA: Yes. Bob, I was interested in your ideas, particularly about the audiences for proposed guidelines because, like you, I agreed with almost everything Joe Kattan said, including initially, but with an open-minded conclusion, but waiting to hear instances where we could

clarify and usefully clarify the law because I very much am in favor of that where it is needed and where we are able to do it.

Antitrust is an extremely sophisticated field and depends, of course, on highly fact-specific analysis, both mergers and rule-of-reason cases generally. Can you think of particular instances in which -- sophisticated counsel like our panelists, you could know the answer after they work with it for a while. They can come up with as good an answer to the question as I can, if not better, and working with clients, can come up with the best arguments usually for efficiencies. Although that's actually another subject where I do think work ought to be done on efficiencies.

Can you think of particular examples where, recent examples where the courts and juries have come to the wrong conclusion based on misunderstanding about competition policies?

MR. SKITOL: Well, the example that comes immediately to mind, Joe mentioned one sort of nightmare. At least it was a nightmare for our clients. The Addamax versus Open Software Foundation lawsuit, which ended up the right way at least from my client's standpoint, but only after five years of messy, expensive, intrusive, bad litigation.

It was a case where summary judgment was denied a couple of years ago because the judge could not quite decide

whether it was okay or not okay for one particular faction of UNIX vendors to get together to try to develop a new UNIX world different from and competitive with the old or other UNIX world, couldn't quite decide whether that was a good form of competition or a bad kind of exclusion.

When cases of this sort go beyond summary judgment stage, there is no doubt that it has a very chilling effect. I know, I can tell you without disclosing confidences, so I am not going to give you specifics, but I can assure you that throughout the pendency of the Addamax litigation there were joint ventures of various kinds being formed where one or another of the defendants to that suit was invited to join where there was a great deal of debate and agony internally over whether or not to join.

And inevitably one or another of the counselors to the client would say: Well, this could end up being another Addamax. And look what we are going through in Addamax. The pendency, the vulnerability of a joint venture to litigation of this sort surviving the summary judgment stage, it is far worse than the millions of dollars of litigation expense. It is what it does to the willingness of the parties to take further steps and jump into other ventures.

So it is not simply -- I think the relevant question is not are there important joint ventures that never happened because of uncertainty about joint venture law; it is are

there joint ventures that came about but that ended up being less effective than they might have been because of higher degree of concern than was necessary.

COMMISSIONER AZCUENAGA: A follow-up question to that. Beyond what you have already testified to, can you think of specific advice that we could offer to cover the Addamax situation that would apply in all situations and not unduly impede our analysis and openness to reasonable arguments in other cases?

MR. SKITOL: Well, I can tell you again, and I was involved at the inception of the Open Software Foundation -- which was probably one of the best lawyer enterprises. There were so many parties involved, the cream of the antitrust bar was all over the place in structuring that venture. And yet there was also quite an array of businesspeople involved and lots of suggestions from the antitrust lawyers about let's put this antitrust related safeguard into the bylaws of this one or that one or that one.

And inevitably there was one or another of the main founding parties that said, no, if you can't show me why we need that, why we absolutely need that, then I don't want it. And so you end up with a least common denominator kind of structure. You end up structuring ventures with less antitrust sensitivity and less safeguards than might otherwise be ideal.

And when it comes around to when the lawsuit comes and you are at the summary judgment -- you are at the summary judgment stage, it is easy to say this with the benefit of hindsight, but one could well imagine that if in defending

if the same, essentially the same transaction were structured as a joint venture, same assets are consolidated, but the parties undertake to competitively market the off-put.

You talk about this competitive rules, joint ventures, that I guess each agency had some experience with a few years ago.

What do you think would be the circumstances or the conditions in which the antitrust agencies ought to be prepared, assuming that the underlying merger analysis really did indicate there was a significant competitive issue.

When would it be appropriate to signal that restructuring the transaction as a combination with separate sale and marketing of the product would be permissible? How do we distinguish the situation where it would be appropriate to do that as opposed to one where you basically have the same transaction over time with just a parent face to it?

MR. SKITOL: Well, if you take the example of just -- I guess to make it easy, I think this makes it easy, indisputably designing a distressed industry, demand is just going down steadily because of some technology changes and a customer base or whatever, there is no doubt that it is a steady decline, there is substantial existing excess capacity that will inevitably increase over time, it is clear that a merger -- oh, and let's make it easy, it is a four-firm industry, that's it, and two of the four want to merge.

And they have got a good story to tell that, look, our capacity utilization would immediately switch from, I don't know, 40 percent to 75 percent; and fixed costs and variable costs can go way down.

Well, at the same time you are changing the structure from a four-firm industry to a three-firm industry. And in the balance of effects, this agency would appropriately conclude that there is a major risk of coordinated interaction and prices going up. And, on the one hand, we accept your showing of major cost savings, and, on the other hand, we think there is a high likelihood of coordinated interaction and low likelihood of any of those cost savings ever being translated down to benefit consumers because there is going to be markedly, markedly less interfirm competition.

So there the balance -- to me it is perfectly understandable that the agency would strike the balance against that merger because on balance it is unlikely that consumers would see -- would ever see a direct benefit.

On the other hand, if you don't simply merge the firms but you do allow them to combine their production facilities, you allow one of them to shut down its 40 percent of capacity factory and to contract with the other to produce its output, and you were satisfied that it was structured in a way that protected against -- you have firewalls and so

forth, so that you were reasonably confident that the parties would continue meaningfully competing downstream, then I think the balance comes out exactly the other way.

And it is equally easy to reach the opposite conclusion because, on the one hand, the basic structure of the industry hasn't changed. There were four firms competing downstream before the joint venture and there will be four afterwards. And, on the other hand, two of the four firms achieve major cost savings overnight. And since there will still be four firms competing downstream, there is every reason to expect the ability and incentive of those two firms to cut price, to pass the savings downstream.

CHAIRMAN PITOFSKY: Thank you. Other questions?

MS. DeSANTI: Yes. Bob, can I just ask you a follow-up on that scenario? Have you thought about the types of safeguards that would be required in that situation to limit the potential anticompetitive effects?

And, if so, could you give us examples of some of the things that you have thought about?

MR. SKITOL: Yes. I think that there is good learning on safeguards in that context from ten years ago from the Alcan/Arco joint venture the way that was structured. And, similarly, in the GM and Toyota joint venture and consent order that this agency entered into -- I guess it was in 1984.

You would certainly want -- you will want provisions relating to control and management of the commonly owned capacity to ensure incentives to expand output, to ensure that one partner did not have the ability to constrain the other partner's decision-making about expanding output, and you would certainly want a serious firewall regarding competitively sensitive information.

CHAIRMAN PITOFSKY: Other questions?

MR. COHEN: Just one quick one. Returning to your first example, the hybrid, could you just elaborate a little bit as to what you're thinking of when you are talking about using a neutral consultant, how this would help to mitigate competitive concerns?

MR. SKITOL: You have a group of rivals coming together to jointly develop technology of some direction and they are going to choose various components -- they are going to collectively select components from among competing providers.

You have the group deciding that they will collectively use X, Y, Z kind of software as input or X, Y, Z kind of chip. And they collectively choose competitor A's product instead of competitor B's product. Competitor B thinks he has got an antitrust suit against the group.

Indeed, there have been some suits of that sort. And that's an example where I would encourage the idea of rather

antitrust law.

Mr. Stack will offer a brief preliminary statement and then will join in the discussion. Welcome to these proceedings.

MR. STACK: Thank you. It is a pleasure to be here.

I have a client who has on his wall posted something that you probably have seen in some various forms or some of you have seen in some various forms: The Six Stages of a Joint Venture.

Stage No. 1 is wild enthusiasm. Stage No. 2 is complications. Stage No. 3 is disillusionment. Stage No. 4, search for the guilty. Stage No. 5, punishment of the innocent. Stage No. 6, promotion of those who did nothing.

(Laughter)

I am going to talk about those latter stages, and I am going to follow up on what Bob is talking about. Unlike Joe, who seems to be on the sunrise of these ventures, gets involved with many which are in their sunrise of new products, if you will, the context in which I see many joint ventures is in the twilight of product life. And the issues here are quite different.

There is more along the lines of the scenario that Bob made of distressed industries, but I will say at the outset it is not limited to distressed industries. I think you find a tremendous pressure on internal corporate managers

to get assets off their books any time the returns for a particular product in a mature business fall below the company's internal criteria for reinvestment.

And one of the principal assets that people look at are their manufacturing facilities. Can we do this more cheaply? Can we get this asset off our books and thereby improve our return on net assets?

In that situation, I agree with Bob. I think the critical antitrust issue and a place that we all have to start when faced with that kind of a request from a client to analyze a transaction, I would like to, in that context, to look at the efficiencies, make sure they are real, make sure they are meaningful.

On the other hand, I do think that we are just starting to get from the enforcement agencies some help in that area. And I think we are yet to get it from the courts, but I suppose over time that we will.

I am not sure we still don't have some fears on the per se side. I hope they are unwarranted, but I can tell you that they cause a lot of anxiety even among veteran antitrust practitioners.

Take a situation where two major players in an industry, such as I described, decided it would be a lot better for each of them to take a plant and focus the production and each have one plant and they would like to

focus the production of large sizes in one plant, let's say small sizes in another plant.

Is that a market allocation agreement? Some people may think it is. I have had situations in which, with

saying that you are just simply paying to get a competitor out of the business, but that's not really what is happening.

And from the standpoint of sound antitrust result, if, in fact, that transaction does occur, I would think what you would want to have happen is to have the exiting manufacturer have as much leverage as possible and be able to utilize that argument so that their cost of goods would be as low as possible and, therefore, they will be better able to pass it on.

I think these are areas in which perhaps we don't need guidelines, but some statement out there, some analysis of how difficult these kinds of transactions can be when you actually negotiate them and look at them would be very helpful.

Bob talked a little bit about the benefits of having let's say the kind of consolidation to manufacturing level which does not eliminate competition at the marketing level. I think one key question in that situation, which I have wrestled with in the past long and hard, is are there any constraints on the manufacturing joint venture in their wboue the earketi riele,you are jss,ntuflly neoordnateng pricing to each of the individual now competing marketers.

If you allow that joint venture to chargET13 6igh

their pricing at the downstream level.

that we talked about. And that leads to my final point. I think the issues that are addressed or are trying to be avoided when you come up with one of these hybrid joint ventures with combined manufacturing and do not combine marketing are issues that you should face right up front if you were going to analyze the merger in that context.

I think it is a halfway solution, and the real issue ought to be shouldn't you be allowed to simply merge in that context. My experience is a bit different, maybe, from Bob's or at least different from what the analytics might expect you to think.

In that situation -- and I deal with intermediate products. These are not consumer products. But in that situation, where very few, if any, of the competitors are making a substantial amount of money, the customers are trading off two things, really. They are trading off, No. 1, do I care if the price of my input goes up? And, two, do I want a healthy supplier industry that is reinvesting in the business and continuing to innovate and helping me improve my product?

And it isn't always the lower price that carries the day with these people. Very often what they will say is I would love to have both. I would love to have a transaction in which I know my price isn't going to go up, but if the price of that is that I'm not going to have a supplier base

that's going to reinvest in my input, I will choose the latter and forego that short-term benefit because I am in my business for the long haul and I want to make sure my suppliers are too.

CHAIRMAN PITOFSKY: Thank you. Questions? Comments?

COMMISSIONER AZCUENAGA: I have a couple questions. You, like Bob, Steve, you have posed some difficult situations that I think really merit thinking about in terms of further guidance.

And one of the things that I was worried about as we are considering possible clarification of the law here is something that's already been alluded to once you do that, do you create other problems or do you focus so much attention on the new guidance that that becomes the only issue, whether it fits or doesn't fit?

And one thing, I think, an area where I think all of us can agree, we have talked about Mass Board, that is that the Mass Board analysis was a problem at the time the Commission overruled it, and there are different ways you can deal with it, but one way would be for the Commission to take it in hand and not allow the shortcuts and taking advantage of it, and another way is to overrule it, but, in any event, it was a problem because it had created opportunities for focusing the analysis on something other than what the

analysis should be.

So as we look at drafting new guidance, I think the important thing is to look at where that guidance is most needed. Can you think -- actually I pose this to all the panelists.

Can you think of one or two things that we can say in new guidelines that would be most important in terms of the need for clarification for some of the very difficult situations that you have encountered?

MR. STACK: I can.

COMMISSIONER STEIGER: Before you answer that, I want to put a sub-question in. I am afraid that I hear echoes in your presentation of a return to the "flailing firm" defense or possibly the "flailing division" defense. And I am going to challenge you to tell me I am wrong, as you answer Mary.

MR. STACK: I think on the question of whether guidelines on the whole are beneficial or not, I don't think they are needed. I guess it is difficult for me in the areas where I think we need the most guidance, I am not sure guidelines are the way to do it. All I can tell you is the issues that I struggle with the most.

One is ancillary restraints. I think that once your clients are told that they can put something together and start to collaborate at some point for some area, any ancillary restraints that deal with that area are difficult

again?

If the answer to that is yes, I guess I would like to know that that's the kind of thing the government is thinking about doing. I suspect that it is not.

If the issue is a particular ancillary restraint that I am worried about, then probably the relief that's going to come is going to be some modification of that ancillary restraint, and I could probably live with that.

So beyond that, I really have a hard time thinking of something that a guideline can particularly accomplish. I will say, I said this in the outline of my remarks, although they are not public, that I think the Commission SKF decision was wrong at the time, is now even more obviously wrong, and in the application of per se rule and facts of that case ought not to have been appropriate and is not appropriate. And to the extent it retains any viability at the Commission, I think somebody ought to put it to rest.

Now, the sub-question, flailing division? I don't know whether -- I get these in situations where it is not a flailing division, it is not unprofitable, it is just simply not making money at a level at which reinvestment would occur.

I think that should be part of the antitrust analysis generally because I think ultimately what you are going to get is no investment and exit from the business, whether it

transaction, but we don't think that's a bad thing because they are so severely depressed that people are not reinvesting in the industry.

COMMISSIONER STEIGER: When you finish your paper on that slippery slope, please, I want an autographed copy.

CHAIRMAN PITOFSKY: Let me go back to Bob Skitol's comments, but I would like all three panelists to think about it. Bob, I thought I heard you say maybe we ought to treat efficiencies more generously with respect to joint ventures, because the efficiencies were more likely to be passed along by a joint venture than a merger.

It is a very original thought. I hadn't seen it before. Why do you think that would be the case?

MR. SKITOL: Because the premise is that the joint venture partners continue to compete downstream. You haven't changed the structure of the downstream market, same number of competitors with the same downstream incentives exist.

CHAIRMAN PITOFSKY: I didn't understand that. Okay. Other questions or comments?

MR. COHEN: Let me throw one question back to Bob, based on something we just heard from Steve. In the type of setting you are talking about, production joint venture with separate market, are we able to analyze that without getting enmeshed in the issue of transfer pricing?

MR. SKITOL: Transfer pricing? Well, you would have

to -- it is the second best choice. The alternative of not allowing it at all because of -- well, let's say because of -- well, I don't think the agency needs to get into transfer pricing in that situation. I would say the agency should pass, should clear the venture without any attempt to regulate it. You don't need a consent order.

You can satisfy yourselves that on balance the post-joint-venture world will be better for consumers than the pre-joint-venture world. And that's because there will be major cost savings and reason to expect at least a significant portion of those savings to end up being passed on to consumers.

And if there is some transfer pricing effect as well, the likelihood is net/net, that even after taking account of that impact, there will still be a net benefit to consumers downstream.

And if you compare it longer term, it is entirely possible you could conclude that if you disallow the venture and the blood letting continues, that more likely than not five years later it will be a three-firm industry downstream as well as upstream, instead of a four-firm; whereas if you allow the joint venture now, there is a likelihood that the industry could continue being a four-firm competitor downstream industry for many years to come.

CHAIRMAN PITOFSKY: Thank you.