Federal Trade Commission

Theoretical and Practical Observations on
Cartel and Merger Enforcement at the Federal Trade Commission

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This symposium focuses on cartels and mergers so I will direct my comments this morning to those topics. Before I get to the practical, however, I'd like to share with you some thoughts about behavioral economics and criminal cartel law enforcement.

I.

Arguably, the punishment system for criminal antitrust offenses in the United States is mostly concerned with deterrence and is largely based on the Chicago School assumption that people act rationally. That is to say, we assume that most people tempted to engage in price fixing will be deterred from doing so by the prospect of large fines and incarceration.

The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Darren Tucker, for his invaluable assistance preparing this paper.

Professor Stucke has also observed that people may justify price fixing by a higher goal.[2] That suggests that cartel activity may increase in economic downturns (as fighting a recession may be seen as a higher good) or when price fixing seems justified by safety considerations as in the Professional Engineers case.[3] Thus, law enforcement should be especially vigilant in those circumstances.

Professor Stucke has also noted that the duration of cartels has not decreased despite the amnesty program, which is designed to destabilize cartels by encouraging whistle-blowing and reducing trust among members.[4] Indeed, he says that "price fixers, like test subjects in other

cheating among their members."[8] That accords with my own observations representing clients from different cultures. They sometimes feared being labeled as turncoats more than they feared a big fine or incarceration. That suggests that we should be wary of trying to "export" our amnesty or leniency programs without warning that one size may not fit all or of trying to achieve convergence at any cost.

The limited number of studies of people that engaged or were tempted to engage in price fixing has convinced me that more such studies are needed. Our enforcement system could be

constituted per se unlawful horizontal price fixing.[10] The Court explained that the agreements "fit squarely into the horizontal price-fixing mold" because the member physicians were "independent competing entrepreneurs."[11]

The Court distinguished the medical groups from joint ventures in which the participants had pooled their resources and agreed to "share the risks of loss as well as the opportunities for profit," thereby becoming "a single firm competing with other sellers in the market."[12] As an example, the Court suggested that a group of providers that offered "complete medical coverage for a flat fee . . . would be perfectly proper."[13] The Court also drew a contrast with the blanket license arrangement in BMI, which the Court described as "entirely different from the product that any one composer was able to sell by himself."[14] The combination of physician groups in Maricopa, by contrast, did "not permit them to sell any different product."[15]

Since the Maricopa decision, the Commission has challe

same inflated prices, collectively negotiated with payers over fees or other terms, and/or threatened to boycott a health plan unless it met their collective fee demands. These enforcement efforts have demonstrated that "collective negotiations by health care professionals . . . have often sought fee increases of 20 percent or more."[17]

Let me give you two examples of our enforcement efforts in this area. In the Advocate Health Partners case, the Commission challenged several organizations representing more than 2,900 independent Chicago-area physicians for agreeing to fix prices and for refusing to deal with certain health plans except on collectively determined terms.[18] According to the complaint, Advocate Health Partners negotiated prices and other terms on which its members would deal with health plans but lacked any significant efficiency-enhancing integration of the provider practices. One of the effects of these practices was a 20 to 30 percent fee increase for one health plan.

Similarly, in the Minnesota Rural Health Cooperative case, the Commission's complaint alleged that competing hospitals, physicians, and pharmacies in rural southwestern Minnesota agreed to fix prices and collectively negotiate contracts with third party payers without any significant efficiency-enhancing integration.[19] The complaint charged that, through its collective negotiations and coercive tactics, the cooperative extracted highe

price-related terms from payers. As a result of these practices, one payer was coerced into paying the group's physicians 27% more, and its hospitals 10% more, than comparable physicians and hospitals in the region. Both of these cases were resolved with consent decrees prohibiting future anticompetitive conduct by these groups.

The courts have upheld the Commission's approach to physician groups. In May 2008, the U.S. Court of Appeals for the Fifth Circuit upheld a Commission opinion that North Texas Specialty Physicians, a group of independent competing physicians based in Fort Worth, violated Section 5 of the FTC Act by orchestrating a price agreement among its physicians, negotiating price terms in payer contracts on behalf of its physicians, and refusing to deal with payers except on collectively agreed-upon terms.

able to exercise market power, particularly in rural markets, and thereby increase health care costs.[23] FTC staff, in coordination with the Department of Justice, have been providing assistance to CMS as it prepares this rulemaking. Stay tuned.

Another area where the FTC has cartel-like respons

criminal proceedings against attempted cartel conduct, such as bid rigging.[27]

years.[33] Despite the increased workload in FY 2010, the agencies granted early termination of the waiting period more often than in the prior year.[34]

The report also provides merger enforcement statistics for each agency. On the surface,

issued more second requests (26 versus 20). One characteristic that both agencies share is that there was a high enforcement rate for transactions that received a second request.

Do these statistics mean that the DOJ is more aggressive than the FTC in terms of issuing

ability to affect the price or output of the relevant product in the long run.[39] Since General Dynamics, the courts have taken differing approaches as to how much consideration to give a firm's weakened financial condition in a Section 7 analysis.[40]

Notwithstanding the mixed treatment of the defense in the case law, our staff gives serious consideration to such arguments when presented by merging parties. I will say, however, that we often find the arguments to be poorly developed or that outside counsel put too much emphasis on these claims. The fact that a company has had a year or two of losses or that its operating capacity has fallen below the industry average simply isn't enough to justify a problematic transaction. Parties need to explain and present evidence that their financial difficulties are serious and durable, will adversely affect their long-term competitiveness, and can only be resolved by the proposed merger. The weakened firm defense tends to be more effective when it is presented in conjunction with other credible reasons to believe that a transaction will not substantially lessen competition, rather than as the sole, or principal, defense to a transaction.

A related trend we have seen recently is greater consideration by merging parties of alternative means of combining operations. We sometimes learn that one or both parties seriously considered a joint venture or other structure short of a merger. Given the need for efficiencies to be merger specific to be cognizable under the Merger Guidelines, is that game, set, and match against consideration of the transaction's purported efficiencies? Not necessarily.

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[39] United States v. General Dynamics Corp., 415 U.S. 486, 503 (1974).

[40] Compare FTC v. Nat'l Tea Co., 603 F.2d 694, 699-701 (8th Cir. 1979) (permitting merger to proceed where target company suffered from years of losses, had poor site locations, and had little prospects for a turnaround, with the result that absent the merger it "would probably be

Otherwise, a party's consideration of alternative transaction structures such as joint ventures would always void an efficiencies defense. Furthermore, a merger may indeed yield efficiencies that would not occur in a less fully-integrated structure; this may be the reason why an alternative structure was considered and rejected. That said, however, the fact that the parties seriously considered a joint venture casts doubt on the assertions of a party that a full-blown merger was essential in order to achieve pro-competitive efficiencies. It may also have bearing on the viability of a failing or flailing firm defense.

A third recent trend is that the FTC is giving greater consideration to the risk of coordinated effects.[41] In fact, nearly all of our recent litigated cases have involved this theory of

inputs and output, widespread availability of competitive information, repeated attempts by the industry to reduce supply, and use of signaling by competitors.[44]

The CSL case involved coordinated effects concerns but not unilateral effects concerns. Other recent FTC cases have involved both concerns. For example, in the FTC's pending challenge to the merger between LabCorp and Westcliff, two of the three principal providers of

What is the reason for the Commission's recent emphasis on coordinated effects? Speaking for myself, the answer is simple: CCC/Mitchell. That case, which was litigated by one of the co-sponsors of this event, involved the proposed merger of two of the three leading suppliers of automobile damage estimation software used by insurance companies and body shops. The Commission had reason to believe that the transaction would result in both coordinated and unilateral effects. Even though most of the evidence presented at trial by the FTC went to the unilateral effects issue, the district court judge rejected this claim due to a lack of reliable data showing the degree of competition between the merging parties and because of the ability of the remaining principal competitor to reposition.[48] On the other hand, the court did find that the transaction increased the risk of coordinated effects, albeit modestly, and that the FTC was therefore entitled to a preliminary injunction.[49]

My takeaway from the CCC/Mitchell case is that when our staff goes into court, it makes sense to allege both unilateral and coordinated theories of harm, assuming we have a plausible basis for each claim. Some cases, such as CSL/Talecris, may fit so squarely into one mold that alleging both theories would not make sense. But given the uncertainties of the litigation process, my general expectation is that we should allege both theories of harm, even if one appears to be less likely to succeed.

While we are on the subject of coordinated effects, I should say that I have always felt that some economists take too cramped a view of the anticompetitive coordinated effects that may result from a merger. An argument I often hear from economists is that as long as pricing is opaque, there is little or no danger of coordinated effects from a merger. That, however, ignores other types of coordinated effects, such as tacit customer or territorial allocation agreements,

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[48] FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 67-72 (D.D.C. 2009).

[49] Id. at 60-67.

output restrictions, and non-price forms of competition. Indeed, the CCC/Mitchell case involved a concern regarding customer allocation.

Another recent trend I have seen is the "merging" – if you will forgive the pun – of multiple investigations into the same company. This can occur in different ways. It occasionally happens that our staff investigates a company simultaneously for a proposed transaction and certain business practices. Sometimes a single consent decree can resolve both sets of issues. Or, we may unearth other problematic conduct in the course of our investigation of a merger. The concerns can be related to the merger itself – such as gun jumping or covenants not to compete – or separate from the merger, such as price fixing or failure to notify a prior HSR-reportable transaction.

A recent example appears to be the DOJ's challenge to Blue Cross Blue Shield of Michigan's use of MFN clauses with Michigan hospitals.[50] Specifically, the DOJ alleged that Blue Cross-Michigan had MFN agreements with the majority of hospitals in Michigan. The DOJ alleged that the effect of these provisions was higher hospital prices, higher entry barriers, and a reduction of competition.

I don't think it's a coincidence that before this case, the DOJ had investigated a proposed merger involving Blue Cross-Michigan.[51] In a speech given shortly after Blue Cross-Michigan abandoned its proposed merger, Assistant Attorney General Christine Varney alluded to the inability of potential entrants to develop networks of hospitals, physicians, and other health care

providers at rates comparable to Blue Cross-Michigan.[52] This may have been a reference to the MFN provisions. In any event, it seems likely that as part of its investigation of the proposed merger, the DOJ uncovered the MFN clauses that were later subject to a separate investigation and ultimately challenged.

A final observation is that market definition remains as important as ever in Section 7 litigation. This may seem counterintuitive, given the treatment of market definition in the 2010 Merger Guidelines. However, three recent cases illustrate the continued importance of the antitrust agencies alleging and proving a relevant market when they go into court.

Last year, the Department of Justice challenged in federal court Dean Foods Company's April 2009 acquisition of a division of Foremost Farms. The Department asserted that the merger eliminated competition between the two companies in the sale of fluid milk to schools, grocery stores, convenience stores and other retailers in Illinois, Michigan, and Wisconsin.

In response, Dean Foods filed a motion to dismiss part of the complaint, arguing that the DOJ did not sufficiently plead a relevant geographic market.[53] The court denied the motion, but not before closely examining the sufficiency of the DOJ's allegations under the Twombly-Iqbal standard. The court criticized the "lack of specificity" in the complaint and noted that the allegations were "not well structured."[54]

[52] Christine A. Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Antitrust and Healthcare, Remarks as Prepared for the ABA/American Health Lawyers Association Antitrust in Healthcare Conference 4-5 (May 24, 2010), available at http://www.justice.gov/atr/public/speeches/258898.pdf.

[53] Dean Food argued that, in the alternative, the court should require plaintiffs to submit a more definite statement as to the geographic market.

[54] Order, United States v. Dean Foods Company, Case No. 10-CV-59 (E.D. Wis. Apr. 7, 2010), available athttp://www.justice.gov/atr/cases/f257500/257536.htm

The second case is the FTC's challenge to Ovation Pharmaceuticals' January 2006 acquisition of the drug NeoProfen. This acquisition put into one company's hands the only two pharmaceutical treatments for a serious and potentially deadly congenital heart defect affecting more than 30,000 babies born prematurely each year in the United States. The Commission was particularly concerned about the transaction because Ovation raised the price of Indocin nearly

relevant market should also include clinical laboratory services provided under fee-for-service contracts to the same physician groups.[56]

These cases together reaffirm the importance of market definition in Section 7 cases, particularly that the antitrust agencies must (1) carefully consider what the relevant market is before going into court, (2) provide adequate factual support in the complaint such that the alleged relevant market is plausible, and (3) adduce sufficient evidence at trial to demonstrate the relevant market, even when the agency appears to have a compelling story of how the merger will harm consumers. But, as I have said on other occasions, that does not mean that upfront market definition is necessary in most cases. Direct evidence that an acquisition may create, enhance, or facilitate the exercise of market power may enable one to "back into" the relevant market.

Thank you. I would be happy to take questions.

[56] Dissenting Statement of Commissioner J. Thomas Rosch, In the Matter of Laboratory Corp of America, Docket No. 9345, File No. 101-0152 (Nov. 30, 2010), available at http://www.ftc.gov/os/adjpro/d9345/101201lapcorpdisstatement.pdf.