



The Directors Roundtable Presents:

**ANTITRUST POLICY A YEAR INTO THE OBAMA
ADMINISTRATION**

WHAT HAVE WE LEARNED? WHAT'S NEXT?

Friday, March 19, 2010
8:30–10:30 A.M.
Santa Clara University
Benson Center
500 El Camino Real, Santa Clara CA



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AGENDA

- 8:00 am** **Registration and Breakfast**
- 8:30 am** **Welcome from Directors Roundtable**
- *Jack Friedman, Chairman of the Directors Roundtable*
- 8:35 am** **Opening Remarks and Introduction of Distinguished Panel**
- *Robert Rosenfeld, Partner, Global Antitrust and Competition Practice Group Leader, Orrick, Herrington & Sutcliffe LLP*
- 8:45 am-
10:30 am** **Antitrust Policy a Year Into the Obama Administration: What Have We Learned? What's Next?**
- *Carl Shapiro, Deputy Assistant Attorney General for Economics, Antitrust Division, U.S. Department of Justice*

- **Prof. Timothy Bresnahan**, Landau Professor in Technology and the Economy, Stanford University, Former Deputy Assistant Attorney General & Chief Economist, Antitrust Division, U.S. Department of Justice
- **Robert Freitas**, Partner, Global Antitrust and Competition Group, Orrick, Herrington & Sutcliffe LLP
- **Prof. Catherine Sandoval**, Assistant Professor of Law, Santa Clara University
- **Greg Sivinski**, Senior Attorney, LCA Antitrust Group, Microsoft Corporation
- **Robert Rosenfeld** (Moderator), Partner, Global Antitrust and Competition Practice Group Leader, Orrick, Herrington & Sutcliffe LLP

10:30 am End of Program

PROGRAM MATERIALS

TAB

1. **Speaker Biographies**
 - Carl Shapiro
 - Prof. Timothy Bresnahan
 - Robert Freitas
 - Prof. Catherine Sandoval
 - Greg Sivinski
 - Robert Rosenfeld
2. **Opening Remarks**
 - *Introductory Slides*, Robert Rosenfeld
3. **Additional Reference Materials**



DEPARTMENT OF JUSTICE

Updating the Merger Guidelines: Issues for the Upcoming Workshops

**Carl Shapiro
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice**

**Fall Forum
Antitrust Section, American Bar Association
Washington, D.C.**

12 November 2009

In September, Assistant Attorney General Christine Varney and Federal Trade Commission Chairman Jon Leibowitz announced that our two Agencies were initiating a process to review and possibly update the Horizontal Merger Guidelines (“Guidelines”). AAG Varney explained in a speech why we were undertaking this project,¹ and the Agencies invited outside input by posing a series of Questions for Public Comment (“Questions”).² The formal closing date for the public comments was this past Monday, November 9th, and we are just beginning the process of reviewing them. We continue to welcome thoughtful comments, which will be reviewed to the extent possible and hopefully will be useful to us as we think about possible revisions to the Guidelines.

We also announced that we will be holding a series of public workshops to explore the Guidelines, structured around the questions we have posed to the public and additional issues that may arise based on the comments we receive.³ Invitations to participate in the workshops will be made in part based on the quality of comments received by the deadline.

As the Economics Deputy AAG at the Antitrust Division, I am a member of the joint DOJ/FTC Working Group that is charged with reviewing the Guidelines. The Working Group includes my fellow Deputy AAGs Molly Boast and Phil Weiser on the DOJ side, and Joseph Farrell, Rich Feinstein, and Howard Shelanski on the FTC side. Now that we have received the public comments and the public workshops are approaching, I would like to take the opportunity afforded by the Fall Forum to continue the dialogue between the Agencies and the public regarding possible updates to the Guidelines. I hope my remarks today, which reflect the views of the Working Group, will help make the upcoming workshops as informative and productive as possible for the Agencies and the public.

¹ Christine A. Varney, “Merger Guidelines Workshops,” September 22, 2009, available at <http://www.justice.gov/atr/public/speeches/250238.htm>.

² See <http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf>.

³ See <http://www.ftc.gov/bc/workshops/hmg/>.

1. The Upcoming Workshops

We are now in the process of organizing five workshops that will take place during December and January. All workshops are open to the public and will be webcast.

The first workshop will take place here in Washington, at the FTC, on Thursday December 3rd, just three weeks from today. We are planning a number of panels that will discuss the use of direct evidence to assess competitive effects (Question 2), market definition and the hypothetical monopolist test (Questions 3, 4, 5, and 6), and unilateral effects and product differentiation (Question 10), among other topics. We also envision an overview panel that will discuss the role played by the Guidelines. Rich Feinsein and I are organizing this workshop.

The second workshop will be held at New York University on Tuesday December 8th. We are planning panels on market concentration and the structural presumption (Questions 7 and 9), failing firms and minority interests (Questions 16 and 17), remedies (Question 18) and working with international and state authorities. Howard Shelanski and Phil Weiser are organizing this workshop.

The third workshop will be held at Northwestern University in Chicago on Thursday December 10th. We are planning panels on the use of direct evidence of competitive effects (Question 2), unilateral effects and differentiated products (Question 10), entry and repositioning (Question 13), and efficiencies (Question 14), among other topics. Molly Boast and Rich Feinsein are organizing this workshop.

After a break for the holidays, we will resume with a workshop on Thursday January 14th at Stanford University. We are planning panels on the use of direct evidence of competitive effects (Question 2), unilateral effects and differentiated products (Question 10), price discrimination and large buyers (Questions 11 and 12), and market dynamics and innovation (Questions 8 and 15). Joseph Farrell and I are organizing this workshop.

The final workshop will be held back here in Washington on Tuesday January 26th. We plan panels on market concentration and the structural presumption (Questions 7 and 9), price discrimination and large buyers (Questions 11 and 12), entry and repositioning (Question 13), and remedies (Question 18), as well as a wrap-up panel. Howard Shelanski and Phil Weiser are organizing this workshop.

2. Scope of the Review

Let me now turn to the substantive issues that will be addressed during these workshops. Perhaps the best place to begin is by making clear the outer bounds of the Guidelines review project envisioned by the Agencies. In particular, if the Guidelines are revised, we anticipate:

- retaining the basic “hypothetical monopolist” test used to ensure that antitrust markets are not unduly narrowly defined;
- continuing to use the Herfindahl-Hirschman Index (HHI) to measure levels of and changes in market concentration;
- continuing to apply the same basic structural presumptions;
- retaining the basic “timeliness, likelihood, sufficiency” approach to entry analysis;
- retaining the fundamental approach to efficiencies; and
- retaining the basic approach to the failing firm defense.

Nonetheless, a number of meaningful revisions could be made while retaining these basic aspects of the Guidelines. For a number of topics, possible revisions are anticipated in the “Commentary on the Horizontal Merger Guidelines,” issued by the Agencies in March 2006 (“Commentary”).⁴

3. Overview

It is no secret that the structural presumption in merger law has weakened considerably during the 46 years since the Supreme Court issued its ruling in *Philadelphia National Bank*.⁵ And the Guidelines have evolved to reflect this long-term trend. The 1968 Guidelines were heavily focused on market concentration, and the 1982 Guidelines continued to place great weight on market shares. The 1984 Guidelines put more emphasis on a variety of additional factors relevant to assessing a merger’s competitive effects.

⁴ See <http://www.justice.gov/atr/public/guidelines/215247.htm>.

⁵ 374 U.S. 321 (1963).

The 1992 Guidelines placed less weight on market concentration than their predecessors. However, the exercise of defining the relevant market and measuring market shares remains central. In the Overview (Section §0.2) the Guidelines state:

The Guidelines describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger. First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely, and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means.

In some contrast, the 2006 Commentary emphasizes that the Agencies take a flexible and integrated approach to evaluating competitive effects, using whatever evidence and methodologies are informative:

“At the center of the Agencies’ application of the Guidelines, therefore, is competitive effects analysis. That inquiry directly addresses the key question that the Agencies must answer: Is the merger under review likely substantially to lessen competition?” Commentary, p. 2.

“Each of the Guidelines’ sections identifies a distinct analytical element that the Agencies apply in an integrated approach to merger review. The ordering of these elements in the Guidelines, however, is not itself analytically significant, because the Agencies do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets.” Commentary, p. 2.

“Application of the Guidelines as an integrated whole to case-specific facts--not undue emphasis on market share and concentration statistics--determines whether the Agency will challenge a particular merger.” Commentary, p. 15.

The Commentary gives a more accurate picture of how the Agencies currently conduct merger investigations. In cases where the relevant market is fairly clear, measuring shares in that market is a simple and informative first step in screening transactions. However, many investigations focus, at least initially, on evidence about likely competitive effects that is not based on inferences drawn from increases in market concentration. These investigations do not start by defining the relevant market and measuring the level and post-merger change in the HHI.

“In some investigations, before having determined the relevant market boundaries, the Agencies may have evidence that more directly answers the ‘ultimate inquiry in merger analysis,’ i.e., ‘whether the merger is likely to create or enhance market power or facilitate its exercise.’ Guidelines § 0.2.” Commentary, p. 10.

The workshops will explore whether the Guidelines should be updated to reflect the fact that investigations often do not begin with, or focus on, market definition and concentration. This was the intent behind our Question 1.

Notwithstanding the decline of the structural presumption, the Agencies continue to rely on measures of market concentration, both to decide which mergers warrant the additional scrutiny associated with a second request, and to decide which mergers to challenge. We do not anticipate changing this basic reliance on the structural presumption in the foreseeable future. Nonetheless, as the importance of market concentration in merger law has declined over the decades, our investigations have focused more on direct evidence of competitive effects, and in some cases we infer the relevant market using the same evidence that leads us to conclude there are likely to be adverse competitive effects. Overall, this reflects a healthy trend towards more effective, more sophisticated, and hopefully more accurate merger enforcement. We hope the workshops will provide useful information on whether the Guidelines should be updated to reflect the more flexible approach taken, with its greater emphasis on such direct evidence of competitive effects. We also are very interested in obtaining further input on how such evidence is best evaluated, as reflected in Question 2.

4. Guidelines from Other Jurisdictions

Several other jurisdictions have revised their merger guidelines in recent years. The European Commission issued new guidelines in 2004.⁶ Canada also issued new guidelines in 2004.⁷ The U.K. is in the process of updating its guidelines, having issued new draft guidelines in April 2009,⁸ and having received public input into that process. We hope to learn from these agencies about the benefits, and hazards, of modernizing merger guidelines.

In addition, members of the OECD regularly share their experience with merger review through the auspices of Working Party 3,⁹ and the ICN Merger Working Group, currently co-

⁶ “Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations Among Undertakings,” February 2004, available at

⁷ “Merger Enforcement Guidelines,” Canadian Competition Bureau, available at

⁸ “Merger Assessment Guidelines,” Office of Fair Trading and Competition Commission, Consultation Document, April 2009, available at

⁹ For example, one of the topics for discussion at the June 2009 OECD meetings was the standard for review used for horizontal mergers in different jurisdictions.

chaired by our very own Phil Weiser, provides another venue where officials and practitioners from various jurisdictions can share best practices.¹⁰

We have invited a number of foreign officials to participate in the upcoming workshops. We also have invited a representative of the National Association of Attorneys General to participate. We welcome their input on how updating our Guidelines might facilitate the more effective handling of mergers that are reviewed by multiple jurisdictions.

I now turn to a number of specific areas where we have posed Questions for Public Comment. My remarks today do not address in a comprehensive manner all the areas where we seek public comment or might make revisions. I do not explicitly address here issues of geographic market definition (Question 6), price discrimination markets (Question 11), dynamic markets and innovation (Questions 8 and 15), efficiencies (Question 14), minority interests (Question 16), the failing firm defense (Question 17), or remedies (Question 18), though we will be looking at all of these issues.

5. Market Definition

The hypothetical monopolist test has been part of the Guidelines since 1982. Under this test, a market is defined as a set of products for which a hypothetical, profit-maximizing monopolist would impose at least a small but significant non-transitory increase in price (SSNIP) on at least some of the products sold by the merging firms. As noted above, we do not anticipate fundamentally changing this basic component of the Guidelines. There are, however, a number of aspects of the test that warrant a fresh look and may benefit from alterations.

A. Implications of the Hypothetical Monopolist Test

While the hypothetical monopolist test is well established in antitrust circles, its implications for relevant antitrust markets, especially those involving differentiated products, are

¹⁰ One of this group's projects for 2009-10 is convergence on substantive merger analysis, including the development of additional recommended practices on market definition and the analysis of failing firms and exiting assets.

not widely appreciated. Updated Guidelines could explain more clearly the implications of the test, which may be counter-intuitive.

Updated Guidelines could make more explicit that the hypothetical monopolist test often leads to properly defined relevant antitrust markets that do not include the full range of functional substitutes from which customers can choose. Question 3 addresses this issue. Again, the Commentary anticipates an important concept that might be included in updated Guidelines:

“Defining markets under the Guidelines’ method does not necessarily result in markets that include the full range of functional substitutes from which customers choose. . . . The Agencies frequently conclude that a relatively narrow range of products or geographic space within a larger group describes the competitive arena within which significant anticompetitive effects are possible.” Commentary, p. 6.

“The description of an ‘antitrust market’ sometimes requires several qualifying words and as such does not reflect common business usage of the word ‘market.’ Antitrust markets are entirely appropriate to the extent that they realistically describe the range of products and geographic areas within which a hypothetical monopolist would raise price significantly and in which a merger’s likely competitive effects would be felt.” Commentary, p. 12.

“Even when no readily apparent gap exists in the chain of substitutes, drawing a market boundary within the chain may be entirely appropriate when a hypothetical monopolist over just a segment of the chain of substitutes would raise prices significantly.” Commentary, p. 15.

Updated Guidelines could explain these important points, which continue to cause confusion.

Likewise, updated Guidelines could explain more clearly that relevant antitrust markets identified using the hypothetical monopolist test do not neatly partition products into various markets. To the contrary, the test generates one relevant market starting from each product sold by the merging firms, and these markets need not be the same: they can overlap, they can be nested, or they can be disjoint. (Remember those Venn diagrams from high school?). For example, suppose Firm A sells Product A, Firm B sells Product B, Firm C sells Product C, and all three of these products compete directly against each other. If Firms A and B propose to merge, the Agencies construct the relevant market starting with Product A and the relevant market starting with Product B. Call these “Market A” and “Market B.” These may well be different markets. Likewise, if Firms B and C propose to merger, the Agencies will construct “Market B” and “Market C.” If Market A and Market C are quite distinct, the structural analysis associated with the first merger can differ a great deal from that associated with the second merger, despite the fact that Products A, B, and C all compete against each other, which might, intuitively, suggest that a single relevant market containing all three products would apply to both mergers. This feature of the test is quite counter-intuitive and can create confusion,

especially in markets with differentiated products. These ideas could be developed using real-world or hypothetical examples. We hope to learn more at the workshops about whether updating the Guidelines could help clarify this implication of the hypothetical market test, perhaps using hypothetical or real-world examples.

B. Implementation of the Hypothetical Monopolist Test

The hypothetical monopolist test is sometimes implemented using “critical loss analysis.” This method calculates the magnitude of lost sales necessary to make a price increase *unprofitable* for the hypothetical monopolist, which is the so-called “critical loss.” Critical loss analysis then seeks to determine whether the sales that would actually be lost due to the price increase, the so-called “actual loss,” are greater or less than the critical loss. As usually practiced, this method is best suited to markets in which the various suppliers have roughly equal price/cost margins.

The Guidelines are silent on critical loss analysis as such. This is unsurprising, since critical loss analysis was just emerging as a method when the current Guidelines were drafted.¹¹ But the method has often been used over the intervening years, and addressing it in the Guidelines might be beneficial. Question 3 raises this issue.

Critical loss analysis is often performed by asking whether imposing a SSNIP would increase or decrease profits for the hypothetical monopolist. This involves a “break-even” profit calculation. The Guidelines (§1.11) ask a facially similar, but ultimately different question: whether the profit-maximizing price increase is at least a SSNIP, not whether a SSNIP would raise or lower profits for the hypothetical monopolist. Clarification of this distinction could be useful. Another problem with critical loss analysis is that it typically only considers a small price increase; in some cases, a large price increase may be profitable even if a small one is not.¹² Regardless of the size of the price increase, the role of pre-merger price/cost margins in the

¹¹ To the best of my knowledge, critical loss analysis dates back to a 1989 article by Barry Harris and Joseph Simons, “Focusing Market Definition: How Much Substitution is Necessary,” *Research in Law and Economics*, Richard O. Zerbe, Jr., ed.

¹² On this point, see Gregory Werden, (2005), “Beyond Critical Loss: Tailored Application of the Hypothetical Monopolist Test,” *Competition Law Journal*, 4, 69.

analysis could be explained.¹³ The higher the pre-merger margin, the smaller is the critical loss, simply as a matter of arithmetic. But higher margins also constitute strong evidence that the “actual loss” is smaller. The Guidelines could discuss how the Agencies assess the “actual loss,” including the role of pre-merger margins in making this assessment. Alternatively, the Guidelines could refrain from explicating these issues related to critical loss.

C. Technical Adjustments

Questions 4 and 5 address several “technical adjustments” that could be made to the hypothetical monopolist test employed by the Guidelines. We welcome further input on the pros and cons of making such changes.

The Guidelines (§1.11) instruct that products be added to the candidate market in the order of “next-best substitutes.” In some cases, adding products in this order requires more information about substitution patterns than is available to the Agencies. Plus, when the order in which products should be added using this procedure is unclear, the analysis can get bogged down in details that may be of little relevance for the ultimate assessment of competitive effects. Are the benefits of using the “next best substitutes” ordering worth these costs?

The Guidelines (§1.11) state: “The Agency generally will consider the relevant product market to be the smallest group of products that satisfies this test.” This “smallest market” principle, strictly followed, can lead to certain well-known problems when the products sold by the merging firms are not next-best substitutes. Consider a merger between rival Products A and B. Suppose that Product C is the closest substitute to each of these two products. Suppose further that, using the normal SSNIP, and starting with Product A, Products A and C form a relevant market. Suppose as well that, starting with Product B, Products B and C form a relevant market. The Guidelines could thus fail to identify this merger as horizontal, even though

¹³ Some of my academic work has been critical of approaches that lead to broader markets in the presence of higher pre-merger price/cost margins, all else equal. Michael Katz and Carl Shapiro, “Critical Loss: Let’s Tell the Whole Story,” *Antitrust*, (Spring 2003). Michael Katz and Carl Shapiro, “Further Thoughts on Critical Loss,” *Antitrust Source*, (March 2004). Joseph Farrell and Carl Shapiro, “Improving Critical Loss Analysis,” *Antitrust Source*, (February 2008). See also Daniel O’Brien and Abraham Wickelgren, “A Critical Analysis of Critical Loss Analysis,” *Antitrust Law Journal*, (2003). For a recent application, see Kevin Murphy and Robert Topel, “Critical Loss Analysis in the Whole Foods Case,” *Global Competition Policy*, (March 2008).

Products A and B are substitutes, even if the merger substantially raises concentration in a relevant market consisting of Products A, B, and C, and even in situations where the merger could lead to significant unilateral or coordinated effects. This problem could be skirted through the device of using a larger-than-normal SSNIP. Employing this solution is problematic, however, because it is unclear what guidance could be given to indicate what larger-than-normal SSNIP size will be used in any given case. This problem could be avoided by dropping or easing up on the “smallest market” principle, as suggested in Question 4. Is this change worthwhile? Are there other principled ways to avoid this problem?

Question 5 raises some additional technical issues regarding the size of the SSNIP. The Guidelines (§1.11) state that “the Agency, in most contexts, will use a price increase of five percent lasting for the foreseeable future.” Should the Agencies provide further guidance on when different SSNIP sizes will be used, or generally provide for the use of larger SSNIP sizes? Should the SSNIP size used in most contexts be increased to 10%, which would lead to broader markets? Should the Guidelines provide further explanation of the base price from which the SSNIP is calculated?

6. Market Shares and Market Concentration

The Guidelines (§1.41) state: “Market shares will be calculated using the best indicator of firms’ future competitive significance.” This principle does not appear to be controversial, but in practice a great deal of effort can revolve around the “correct” way to measure market shares. For example, merging parties sometimes argue that all firms should be counted equally in markets where suppliers engage in negotiations and bidding for business. Debate can also ensue over whether market shares should be measured in units vs. revenues, or sales vs. capacities. Measuring shares can be especially tricky in dynamic markets, where assessing “future competitive significance” can be controversial. Questions 7 and 8 address these issues.

Once the market shares are measured and the level and change in the HHI is computed, the Guidelines (§1.51) specify various thresholds that can either establish safe harbors or be used to create presumptions that a merger will create or enhance market power or facilitate its exercise. Question 9 asks whether these thresholds accurately reflect current Agency practice, whether they should be adjusted, and if so, to what values.

7. Unilateral Effects with Differentiated Products

The 1992 Guidelines introduced unilateral effects explicitly into the analysis. This was a major advance. In a significant proportion of merger investigations, the Agencies pursue a unilateral effects theory of harm. This proportion is especially high in cases involving highly differentiated products. Unilateral effects theories are also very common in markets for intermediate products where the customers are themselves businesses and prices are set through negotiations. In many of these cases, intellectual property rights are important sources of product differentiation, and suppliers must anticipate that prices will significantly exceed marginal costs in order to have the incentive to incur the fixed costs necessary to conduct the R&D leading to these intellectual property rights. Further complicating the analysis, the relationship between market definition under the hypothetical monopolist test and unilateral competitive effects can be confusing. Question 10 provides some details on the issues related to unilateral effects that we hope will be addressed in the upcoming workshops.

The basic economic theory underlying unilateral effects with differentiated products goes back to 19th century work by Bertrand. This theory is a standard part of any undergraduate course on industrial organization economics, but applying these ideas in practice to assess the likely effects of horizontal mergers is far from straightforward. A great deal of learning has taken place since unilateral effects were introduced into the Guidelines in 1992. The Agencies and private parties have accumulated considerable experience with a range of techniques, including simple illustrative calculations of unilateral effects, sophisticated merger simulation, and analysis of product repositioning. One of the most important contributors to this learning is a long-standing member of the Antitrust Division's Economic Analysis Group, Greg Werden.¹⁴

Economists have long recognized that the exercise of defining relevant markets and measuring market concentration is more closely aligned with theories of coordinated effects than with theories of unilateral effects. In coordinated effects cases, the hypothetical monopolist

¹⁴ See, for example, Gregory Werden and Luke Froeb, (1994), "The Effects of Mergers in Differentiated Product Industries," *Journal of Law, Economics and Organization*, 10(2), 407-426, and Luke Froeb, Steven Tschantz, and Gregory Werden, (2005), "Pass-Through Rates and the Price Effects of Mergers," *International Journal of Industrial Organization*, 23, 703-715.

exercise, which identifies a set of products that could profitably be cartelized, is directly relevant. Market definition and market concentration can thus frame and inform the analysis of whether the proposed merger will significantly increase the danger that such coordination will succeed.

Market definition and market concentration are less relevant to the theory of competitive harm in cases involving unilateral effects. This point is not made explicit in the Guidelines, but it is clearly noted in the Commentary:

“Indeed, market concentration may be unimportant under a unilateral effects theory of competitive harm. As discussed in more detail in Chapter 2’s discussion of Unilateral Effects, the question in a unilateral effects analysis is whether the merged firm likely would exercise market power absent any coordinated response from rival market incumbents. The concentration of the remainder of the market often has little impact on the answer to that question.” Commentary, p. 16.

While unilateral effects are not naturally diagnosed by looking at market shares and changes in market concentration, except in special cases, there are some simple and informative diagnostics regarding such effects: the profitability of the competing products sold by the merging firms, as measured by their price/cost margins, and the extent to which they compete directly against each other, as measured by the diversion ratios between them.

These ideas are not novel. They can be found in a variety of published papers going back more than a decade.¹⁵ I published an article in 1996, during my previous tour of duty as Economics Deputy AAG, sketching out these ideas.¹⁶ But the logic and operation of unilateral effects is not fully articulated in the Guidelines, and it continues to generate some confusion, raising the question of whether it could be more clearly explained and more extensively developed. Again, the Commentary goes beyond the Guidelines and provides a roadmap for at least part of what updated Guidelines might say:

“Merging two sellers of competing differentiated products may create an incentive for the merged firm to increase the price of either or both products because some of the sales lost as a result of the increase in the price of either of the two products would be ‘recaptured’ by the other.” Commentary, p. 27.

¹⁵ For an overview of this literature, see Gregory Werden and Luke Froeb (2008), “Unilateral Competitive Effects of Horizontal Mergers,” in P. Buccirossi, ed., *Advances in the Economics of Competition Law*, MIT Press. See also Jonathan Baker and David Reitman, “Research Topics in Unilateral Effects Analysis,” October 2009, prepared for inclusion in the *Research Handbook on the Economics of Antitrust*, Einer Elhauge, ed.

¹⁶ Carl Shapiro, “Mergers with Differentiated Products,” *Antitrust*, Spring 1996, 23-30.

“In all merger cases, the Agencies focus on the particular competitive relationship between the merging firms, and for mergers involving differentiated products, the ‘diversion ratios’ between products combined by the merger are of particular importance. An increase in the price of a differentiated product causes a decrease in the quantity sold for that product and an increase in the quantities sold of products to which consumers switch. The diversion ratio from one product to another is the proportion of the decrease in the quantity of the first product purchased resulting from a small increase in its price that is accounted for by the increase in quantity purchased for the other product. In general, for any two products brought under common control by a transaction, the higher the diversion ratios, the more likely is significant harm to competition.” Commentary p. 27.

We look forward to learning more about these issues at the upcoming workshops. The role of price/cost margins can be discussed, along with the role of diversion ratios. The use of more sophisticated techniques, including merger simulation, can also be addressed.

Unilateral effects also differ from coordinated effects in that the merger certainly will eliminate independent competition between the two merging firms, which is the source of unilateral effects, whereas a merger may or may not have any effect on coordination with non-merging parties. Because some unilateral effects are “inevitable,” it is important for the Agencies to have safe harbors within their unilateral effects analysis so that we can close investigations promptly when no significant unilateral effects are likely to be found.

Just about one year ago, before joining the Antitrust Division, I wrote a paper with Joseph Farrell that discussed the treatment of unilateral effects in markets with differentiated products.¹⁷ We emphasized the role of pre-merger price/cost margins and diversion ratios in diagnosing unilateral effects for such mergers. For this class of mergers, we argued that margins and diversion ratios could be more informative than changes in the HHI. Our analysis relied heavily on work by Greg Werden and by Dan O’Brien and Steve Salop.¹⁸ We constructed a measure of “upward pricing pressure” by multiplying together the margin and the diversion ratio. We suggested that a merger generating substantial upward pricing pressure would tend to lead to higher prices, unless this pressure was offset by other factors such as repositioning, entry, or

¹⁷ Joseph Farrell and Carl Shapiro, “Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition,” available at <http://faculty.haas.berkeley.edu/shapiro/alternative.pdf>.

¹⁸ See Gregory Werden (1996), “A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products,” *Journal of Industrial Economics*, 44, 409-413 and Daniel O’Brien and Steven Salop (2000) “Competitive Effects of Partial Ownership: Financial Interest and Corporate Control,” *Antitrust Law Journal*, 67:559.

efficiencies.¹⁹ The economic logic underlying our analysis is the same as that underlying the quote from the Commentary given above. The Agencies look closely at diversion ratios and margins when diagnosing unilateral effects in markets with differentiated products, and have done so for some time. We hope to learn at the workshops whether a more detailed explanation in the Guidelines of how this is done would be helpful.

8. Large Buyers

The Guidelines do not explicitly address the implications of large buyers. In many markets, large buyers are able to negotiate more favorable terms than smaller buyers. Question 12 asks whether the Guidelines should be revised to discuss the implications of large buyers.

In practice, merging parties commonly argue that the merged entity would not be able profitably to raise price because it will be selling to large, powerful buyers. The Commentary expresses skepticism about this argument:

“In assessing a merger between rival sellers, the Agencies consider whether buyers are likely able to defeat any attempts by sellers after the merger to exercise market power. Large buyers rarely can negate the likelihood that an otherwise anticompetitive merger between sellers would harm at least some buyers. Most markets with large buyers also have other buyers against which market power can be exercised even if some large buyers could protect themselves. Moreover, even very large buyers may be unable to thwart the exercise of market power.” Commentary, p. 17-8.

Even if large buyers are able to negotiate more favorable terms than smaller buyers, what further evidence is required to establish that they are immune from harm due to the loss of competition resulting from the merger? Is the role of large buyers different in cases involving coordinated effects, where they might be able to disrupt coordination, than in cases involving unilateral effects? And, even if large buyers are protected, under what circumstances should antitrust analysis attend to the interests of smaller buyers?

Section V of the European Commission’s merger guidelines is entitled “Countervailing Buyer Power.” Should our Guidelines be revised to incorporate some of the ideas in that Section of the EC’s merger guidelines?

¹⁹ We suggested that a merger generating substantial upward pricing pressure could be presumed to raise prices. This presumption could then be rebutted based on a more complete analysis of competitive effects, encompassing evidence of repositioning, entry, and efficiencies. This is not dissimilar to how the Agencies currently evaluate unilateral effects in markets with differentiated products.

9. Entry

Section 3 of the Guidelines describes the entry analysis used by the Agencies, stating: “A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels.” The Guidelines continue: “Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.” We do not envision changing this basic approach to entry analysis.

Within this framework, however, meaningful changes could be made. For example, how well does the “minimum viable scale” approach to the likelihood of entry in Section 3.3 work in practice? Question 13 asks specifically about the distinction made in the Guidelines between “uncommitted” entry, which is discussed in Section 1.32, and “committed” entry, which is discussed in Section 3. During the workshops we would like to learn more about how useful this distinction is in practice and whether it should be retained.

10. Conclusion

The Agencies, and the joint DOJ/FTC Working Group engaged in reviewing the Guidelines, are looking forward to the workshops that will be held during December and January. I encourage you to attend the workshops and continue to provide the Agencies with your views on whether, and how, we should update the Horizontal Merger Guidelines.

111TH CONGRESS
2D SESSION

H. R. 4626

AN ACT

To restore the application of the Federal antitrust laws to the business of health insurance to protect competition and consumers.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as the “Health Insurance In-
3 dustry Fair Competition Act”.

4 **SEC. 2. RESTORING THE APPLICATION OF ANTITRUST**
5 **LAWS TO HEALTH SECTOR INSURERS.**

6 (a) AMENDMENT TO MCCARRAN-FERGUSON ACT.—
7 Section 3 of the Act of March 9, 1945 (15 U.S.C. 1013),
8 commonly known as the McCarran-Ferguson Act, is
9 amended by adding at the end the following:

10 “(e) Nothing contained in this Act shall modify, im-
11 pair, or supersede the operation of any of the antitrust
12 laws with respect to the business of health insurance. For
13 purposes of the preceding sentence, the term ‘antitrust
14 laws’ has the meaning given it in subsection (a) of the
15 first section of the Clayton Act, except that such term in-
16 cludes section 5 of the Federal Trade Commission Act to
17 the extent that such section 5 applies to unfair methods
18 of competition.”.

19 (b) RELATED PROVISION.—For purposes of section
20 5 of the Federal Trade Commission Act (15 U.S.C. 45)
21 to the extent such section applies to unfair methods of
22 competition, section 3(e) of the McCarran-Ferguson Act
23 shall apply with respect to the business of health insurance
24 without regard to whether such business is carried on for
25 profit, notwithstanding the definition of “Corporation”

1 contained in section 4 of the Federal Trade Commission
2 Act.

Passed the House of Representatives February 24,
2010.

Attest:

Clerk.

111TH CONGRESS
2D SESSION

H. R. 4626

AN ACT

To restore the application of the Federal antitrust laws to the business of health insurance to protect competition and consumers.

111TH CONGRESS
1ST SESSION

S. 148

To restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act.

IN THE SENATE OF THE UNITED STATES

JANUARY 6, 2009

Mr. KOHL introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To restore the rule that agreements between manufacturers and retailers, distributors, or wholesalers to set the minimum price below which the manufacturer's product or service cannot be sold violates the Sherman Act.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Discount Pricing Con-
5 sumer Protection Act".

6 **SEC. 2. STATEMENT OF FINDINGS AND DECLARATION OF**
7 **PURPOSES.**

8 (a) FINDINGS.—Congress finds the following:

1 (1) From 1911 in the Dr. Miles decision until
2 June 2007 in the Leegin decision, the Supreme
3 Court had ruled that the Sherman Act forbid in all
4 circumstances the practice of a manufacturer setting
5 a minimum price below which any retailer, whole-
6 saler or distributor could not sell the manufacturer’s
7 product (the practice of “resale price maintenance”
8 or “vertical price fixing”).

9 (2) The rule of per se illegality forbidding re-
10 sale price maintenance promoted price competition
11 and the practice of discounting all to the substantial
12 benefit of consumers and the health of the economy.

13 (3) Many economic studies showed that the rule
14 against resale price maintenance led to lower prices
15 and promoted consumer welfare.

16 (4) Abandoning the rule against resale price
17 maintenance will likely lead to higher prices paid by
18 consumers and substantially harms the ability of dis-
19 count retail stores to compete. For 40 years prior to
20 1975, Federal law permitted States to enact so-
21 called “fair trade” laws allowing vertical price fixing.
22 Studies conducted by the Department of Justice in
23 the late 1960s indicated that retail prices were be-
24 tween 18 and 27 percent higher in States that al-
25 lowed vertical price fixing than those that did not.

1 Likewise, a 1983 study by the Bureau of Economics
2 of the Federal Trade Commission found that, in
3 most cases, resale price maintenance increased the
4 prices of products sold.

5 (5) The 5–4 decision of the Supreme Court ma-
6 jority in *Leegin* incorrectly interpreted the Sherman
7 Act and improperly disregarded 96 years of antitrust
8 law precedent in overturning the per se rule against
9 resale price maintenance.

10 (b) PURPOSES.—The purposes of this Act are—

11 (1) to correct the Supreme Court’s mistaken in-
12 terpretation of the Sherman Act in the *Leegin* deci-
13 sion; and

14 (2) to restore the rule that agreements between
15 manufacturers and retailers, distributors or whole-
16 salers to set the minimum price below which the
17 manufacturer’s product or service cannot be sold vio-
18 lates the Sherman Act.

19 **SEC. 3. PROHIBITION ON VERTICAL PRICE FIXING.**

20 (a) AMENDMENT TO THE SHERMAN ACT.—Section 1
21 of the Sherman Act (15 U.S.C. 1) is amended by adding
22 after the first sentence the following: “Any contract, com-
23 bination, conspiracy or agreement setting a minimum
24 price below which a product or service cannot be sold by

1 a retailer, wholesaler, or distributor shall violate this
2 Act.”.

3 (b) EFFECTIVE DATE.—The amendment made by
4 subsection (a) shall take effect 90 days after the date of
5 enactment of this Act.

○



DEPARTMENT OF JUSTICE

VIGOROUS ANTITRUST ENFORCEMENT IN THIS CHALLENGING ERA

CHRISTINE A. VARNEY
Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Remarks as Prepared for the
United States Chamber of Commerce

May 12, 2009

I. Introduction

Good afternoon and on behalf of the Antitrust Division, I want to thank you for the opportunity to speak today about the importance of antitrust enforcement in a distressed economy. I am especially pleased to give remarks here at the Chamber of Commerce, which represents businesses of all sizes, sectors, and regions, and has focused the attention of its Antitrust Council and International Competition Working Group on domestic and international competition policy. I look forward to working with the business community and the Chamber throughout my tenure as AAG.

I have had a wonderful first month on the job. As I begin each day with the Division, I pass the photographs of all of the former AAGs for Antitrust. Among those photographs are former AAGs who faced the challenges posed by tumultuous economic conditions. Thurman Arnold is one. He served as the AAG for Antitrust just after the Great Depression, and the Antitrust Division played a very active role in bringing competition back to the market during his tenure. I keep such luminaries in mind as I consider the great challenges that lie ahead of us.

I want to talk with you today about three issues. First, I want to address the role of antitrust enforcement in a distressed economy. Second, I want to discuss the Antitrust Division's approach to enforcement regarding single-firm conduct under Section 2 of the Sherman Act. Finally, I want to share my thoughts on the challenges we face going forward.

II. Lessons Learned From Prior Economic Crises: National Industrial Recovery Act and Industrial Codes

The question on every American's mind is: "*What can the Government do to help ease consumers' burden in these troubled economic times?*" This question is particularly pressing for the Antitrust Division, which in the past has come forward to play a significant role in response to economic crises. It is time for the Antitrust Division to step forward again. I believe this country's prior experience in responding to economic crises must be considered in evaluating our response to current market conditions. As Shakespeare once put it – "what's past is prologue." In particular, I have considered the Government's response to the market conditions that followed the Great Depression, and I believe there are important lessons we can learn from that era.

At the turn of the century, after the passage of the Sherman Act, our country faced catastrophic events: the Panic of 1907 and World War I. The latter event brought a close to the Government's previous commitments to trust-busting. This lack of interest in antitrust enforcement continued through the 1920s. Significantly, the onset of the Great Depression did not cause the nation to reconsider the damaging effects of cartelization on economic performance. Instead of reinvigorating antitrust enforcement, the Government took the opposite tack. Legislation was passed in the 1930s that effectively foreclosed competition. The National Industrial Recovery Act ("NIRA"), which created the National Recovery Administration ("NRA"), allowed industries to create a set of industrial

codes. These “codes of fair competition” set industries’ prices and wages, established production quotas, and imposed restrictions on entry.

At the core of the NIRA was the idea that low profits in the industrial sectors contributed to the economic instability of those times. The purpose of the industrial codes was to create “stability” – *i.e.*, higher profits – by fostering coordinated action in the markets. The codes developed following the passage of the NIRA governed many of America’s major industrial sectors: lumber, steel, oil, mining, and automobiles. Under this legislation, the Government assisted in the enforcement of the codes if firms contributed to a coordinated effort by permitting unionization and engaging in collective bargaining.

What was the result of these industrial codes? Competition was relegated to the sidelines, as the welfare of firms took priority over the welfare of consumers. It is not surprising that the industrial codes resulted in restricted output, higher prices, and reduced consumer purchasing power.

It was not until 1937, during the second Roosevelt Administration, that the country saw a revival of antitrust enforcement. From 1937-1939, the number of antitrust cases initiated by the Antitrust Division jumped to 48 cases, a significant up-tick from the 15 cases filed in the preceding three years. Under the leadership of Thurman Arnold, who served as the AAG for Antitrust from 1938 until 1943, the Department continued its enforcement efforts. As Thurman Arnold later commented, the Roosevelt Administration “was responsible for the first sustained program of antitrust enforcement on a nationwide scale” that the country had ever

had. The cases brought by the Antitrust Division during this era represented the beginning of a strengthened competition policy. Thurman Arnold's legacy of vigorous antitrust enforcement was thus a cornerstone of the New Deal's economic agenda and a part of that era's legacy for modern economic policy.

The lessons learned from this historical example are twofold. First, there is no adequate substitute for a competitive market, particularly during times of economic distress. Second, vigorous antitrust enforcement must play a significant role in the Government's response to economic crises to ensure that markets remain competitive.

This country's prior experience raises the question of whether current economic challenges reflect a "failure of antitrust." In other words, could United States antitrust authorities have done more? As many observers agree, in past years, with the exception of cartel enforcement, the pendulum swung too far from Thurman Arnold's legacy of vigorous enforcement.

Americans have seen firms given room to run with the idea that markets "self-police," and that enforcement authorities should wait for the markets to "self-correct." It is clear to anyone who picks up a newspaper or watches the evening news that the country has been waiting for this "self-correction," spurred innovation, and enhanced consumer welfare. But these developments have not occurred. Instead, we now see numerous markets distorted. We are also seeing some firms fail and take American consumers with them. It appears that a combination of factors, including ineffective government regulation, ill-considered

deregulatory measures, and inadequate antitrust oversight contributed to the current conditions. I believe that these extreme conditions require a recalibration of economic and legal analysis and theories, and a clearer plan for action. As antitrust enforcers, we cannot sit on the sidelines any longer – both in terms of enforcing the antitrust laws and contributing to sound competition policy as part of our nation’s economic strategy.

III. Actions Ahead: Enforcement Priorities

Section 2 Enforcement

The Antitrust Division must step forward and take a leading role in the development of the Government’s multi-faceted response to the current market conditions. Vigorous antitrust enforcement action under Section 2 of the Sherman Act will be part of the Division’s critical contribution to this response.

Just as I do, my predecessors in the Antitrust Division saw the need for a clear Department policy regarding enforcement under Section 2 of the Sherman Act. Starting in June 2006, the Department of Justice, with the aid of the Federal Trade Commission, embarked on a year-long series of joint hearings to study issues relating to enforcement of Section 2 against single-firm conduct. The goal of these efforts was to clarify the analytical framework for assessing the legality of single-firm conduct and to provide guidance to the courts, antitrust counselors, and the business community. In September 2008, after review and analysis of the extensive hearing record, the Department of Justice issued its report, entitled “*Competition and Monopoly: Single-Firm Conduct Under Section 2 of the*

Sherman Act.”¹ The Section 2 Report reflected a significant effort by my predecessors and the FTC in collecting and evaluating the opinions and expertise of antitrust enforcement officials from the United States and abroad, leading economists and legal scholars, antitrust practitioners, and representatives of the business community. To its credit, the Report provided a comprehensive evaluation of the history of single-firm enforcement and careful consideration of the risks and benefits of particular enforcement strategies. The Report’s ultimate conclusions, however, missed the mark. In my view, the greatest weakness of the Section 2 Report is that it raised many hurdles to Government antitrust enforcement.

At the core of the Section 2 Report were several critiques of 1960s antitrust enforcement policy, which, taken to their extremes, counseled in favor of a significant limitation of Section 2 enforcement. The Report sounded a call of great skepticism regarding the ability of antitrust enforcers – as well as antitrust courts – to distinguish between anticompetitive acts and lawful conduct, and raised the related concern that the failure to make proper distinctions may lead to “over-deterrence” with regard to potentially procompetitive conduct.² I do not share these concerns. I strongly believe that antitrust enforcers are able to separate the wheat from the chaff in identifying exclusionary and predatory acts. As Judge

¹ *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, UNITED STATES DEPARTMENT OF JUSTICE (2008) (“Section 2 Report” or the “Report”).

² This sentiment was expressed by a majority of FTC Commissioners upon the publication of the Section 2 Report in September 2008. Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice, FEDERAL TRADE COMMISSION, at 3-4 (Sept. 8, 2008).

Posner explained, “antitrust doctrine is supple enough...to take in stride the competitive issues presented by the new economy.”³

The Section 2 Report also characterized a dominant firm’s ability to act efficiently as a core concern in evaluating any possible anticompetitive impact of its conduct.⁴ There is no dispute that the evaluation of potential economic efficiencies is an important aspect of the analysis of firm conduct. The Report, however, went too far in evaluating the importance of preserving possible efficiencies and understated the importance of redressing exclusionary and predatory acts that result in harm to competition, distort markets, and increase barriers to entry. The ultimate result is that consumers are harmed through higher prices, reduced product variety, and slower innovation.⁵ Accordingly, I believe the Section 2 Report lost sight of an ultimate goal of antitrust laws – the protection of consumer welfare.

With its twin bases for skepticism, the Report counseled in favor of the exercise of extreme caution in enforcing Section 2 and called for the adoption of a number of safe harbors for certain conduct within its reach. While there is no question that Section 2 cases present unique challenges (for example, in the fashioning of injunctive remedies), the Report advocated extreme hesitancy in the

³ Richard A. Posner, *Antitrust in the New Economy*, 69 ANTITRUST L.J. 925, 925 (2001).

⁴ For a thoughtful development of the basis for this concern, see William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1, 35-38.

⁵ Harvey J. Goldschmidt, *Comment on Herbert Hovenkamp and the Dominant Firm: The Chicago School Has Made Us Too Cautious About False Positives and the Use of Section 2 of the Sherman Act*, in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK 123 (Robert Pitofsky ed., 2008).

face of potential abuses by monopoly firms.⁶ We must change course and take a new tack.

For these reasons, I have withdrawn the Section 2 Report by the Department of Justice. Effective May 11, 2009, the Section 2 Report no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act. The Report and its conclusions should not be used as guidance by courts, antitrust practitioners, and the business community.

In withdrawing the Section 2 Report, I made specific reference to the Report's conclusions. In particular, Chapter 3 of the Section 2 Report concluded that where conduct-specific tests are not applicable, "the disproportionality test is likely to be the most appropriate test[.]"⁷ With this baseline, conduct is only considered anticompetitive where it results in harm to competition that is disproportionate to consumer benefits and to the economic benefits to the defendant. In other words, the anticompetitive harm must substantially outweigh procompetitive benefits to be actionable. The Report's adoption of the disproportionality test reflected an excessive concern with the risks of over-deterrence and a resulting preference for an overly lenient approach to enforcement. The failing of this approach is that it effectively straightjacketed antitrust enforcers and courts from redressing monopolistic abuses, thereby

⁶ See note 2 *supra*.

⁷ Section 2 Report at 45-46.

allowing all but the most bold and predatory conduct to go unpunished and undeterred.

While the Department is not proposing any one specific test to govern all Section 2 matters at this time, I believe the balanced analyses reflected in the leading cases interpreting the reaches of the Sherman Act provide important guidance in this regard. In particular, leading Section 2 cases – from *Lorain Journal v. United States*⁸ to *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*⁹ to *United States v. Microsoft*¹⁰ – highlight a common concern regarding the harmful effects of a monopolist’s exclusionary or predatory conduct on competition and, ultimately, consumers. Reinvigorated Section 2 enforcement will thus require the Division to go “back to the basics” and evaluate single-firm conduct against these tried and true standards that set forth clear limitations on how monopoly firms are permitted to behave. There can be no better charter for our return to fundamental principles of antitrust enforcement.

In 1951, the Supreme Court laid down a marker for Section 2 enforcement in its decision in *Lorain Journal*.¹¹ In that case, the Court made a clear step forward in identifying single firm conduct that crossed the line separating lawful, fair competition from exclusionary, anticompetitive acts.¹²

⁸ 342 U.S. 143 (1951).

⁹ 472 U.S. 585 (1985).

¹⁰ 253 F.3d 34 (D.C. Cir. 2001) (en banc).

¹¹ 342 U.S. at 155.

¹² Indeed, in his seminal work, *Antitrust Paradox*, Judge Bork points to *Lorain Journal* as a touchstone for Section 2 enforcement. See Robert H. Bork, ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 344-46 (1978); see also Robert H. Bork, Letter to the Editor, WALL STREET JOURNAL (May 15, 1998).

The Court addressed the conduct of a newspaper publisher, which was the only business disseminating news and advertising in an Ohio town until a small radio station began broadcasting in a neighboring community.¹³ The publisher, perceiving a threat posed by the radio station, took action to destroy this competitor.¹⁴ The publisher refused to sell advertising space to any parties that also used the radio station for local advertising.¹⁵ This practice forced numerous advertisers to refrain from using the radio station for advertising.¹⁶ The publisher's actions also threatened to deprive surrounding communities of their only nearby radio station.¹⁷ The Court found that the publisher's conduct violated Section 2 because its acts were plainly exclusionary in their ultimate effect, were not justified by any legitimate reason, and were aimed at the "complete destruction and elimination" of the radio station.¹⁸

In light of the publisher's purpose to create or maintain a monopoly and the plainly anticompetitive impact of its conduct, the *Lorain Journal* decision expressly rejected the claim that the publisher had a "right as a private business concern to select its customers and to refuse to accept advertisements from whomever it pleases."¹⁹ As the Court explained its critical point: "*We do not dispute the general right. But the word 'right' is one of the most deceptive of*

¹³ *Lorain Journal*, at 146-47.

¹⁴ *Id.* at 148-50.

¹⁵ *Id.* at 149-50.

¹⁶ *Id.*

¹⁷ *Id.* at 150.

¹⁸ *Id.*

¹⁹ *Id.* at 153, 155 (internal citations omitted).

pitfalls...Most rights are qualified.”²⁰ Consequently, the Court called for an injunction restraining the publisher from refusing to accept advertising from entities that also advertised in other media.²¹

The decisions that followed *Lorain Journal* echoed the Supreme Court’s admonition to dominant firms regarding exclusionary and predatory conduct, and filled out the roadmap for Section 2 enforcement. In *Aspen Skiing Co.*,²² the Court again considered whether a monopolist can refuse to deal with its competitors, and reaffirmed that any such right is not unqualified.²³ In that case, the Court considered the conduct of Ski Co., the owner of three of the four major downhill skiing facilities in Aspen, Colorado.²⁴ After several years of cooperating with Highlands, the owner of the fourth Aspen skiing facility, to issue interchangeable ski passes that could be used at all four facilities, Ski Co. discontinued the practice. Ski Co. offered to reinstate the 4-area pass only if Highlands would accept a fixed percentage of the revenue, which was considerably below Highlands’s historical average revenue.²⁵ After Highlands refused to accept Ski Co.’s offer to reinstate the 4-area pass, Ski Co. embarked upon a national advertising campaign that strongly implied to visitors that there were only three

²⁰ *Id.* (internal citations omitted).

²¹ *Id.* at 156-58.

²² 472 U.S. 585 (1985). While commentators have debated the implications of the Supreme Court’s decisions in *Pacific Bell Telephone Co. v. Linkline Communications, Inc.*, – U.S. –, 129 S. Ct. 1109 (2009), and *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, 540 U.S. 398 (2004), on the scope of the Section 2 analysis set forth in *Aspen Skiing*, particularly as it applies in limited, specific sectors subject to significant and specialized regulatory overlay, there is no question that these decisions reaffirmed *Aspen Skiing*’s limits on a monopolist’s ability to engage in exclusionary or predatory conduct.

²³ 472 U.S. at 609-10.

²⁴ *Id.* at 587-90.

²⁵ *Id.* at 592-93.

ski mountains in the area.²⁶ Ski Co. also made efforts to frustrate Highlands’s ability to market its own multi-area package by refusing to accept Highlands’s vouchers, each equal to the price of a daily lift ticket at a Ski Co. mountain, which were guaranteed by an Aspen bank and could be redeemed for face value.²⁷

Echoing its previous decision in *Lorain Journal*, the Supreme Court noted that “[t]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified.”²⁸ The critical question before the Court was therefore whether Ski Co.’s decision to make “an important change in the pattern of distribution that had originated in a competitive market” was unlawfully exclusionary.²⁹ In finding that Ski Co. had violated Section 2, the Court considered not only Highlands’s steady decline in market share, but significantly, considered the impact of Ski Co.’s conduct on consumers.³⁰ Expert testimony and anecdotal evidence indicated that the elimination of the 4-area pass deprived skiers of a desired choice; many wanted to ski all four mountains, but would not because their ticket would not permit it.³¹ Finally, the Court identified indicia of Ski Co.’s anticompetitive motivation to discourage skiers from doing business with Highlands. In particular, Ski Co. was unwilling to accept Highlands’s vouchers, even though it entailed no cost to itself and would have satisfied potential customers. In other words, Ski Co. appeared willing to sacrifice

²⁶ *Id.* at 593.

²⁷ *Id.* at 593-94.

²⁸ *Id.* at 601.

²⁹ *Id.* at 603-05.

³⁰ *Id.* at 605-10.

³¹ *Id.* at 605-06.

short-run benefits and consumer goodwill in exchange for a perceived long-run impact on Highlands’s business.³² Moreover, Ski Co. acted markedly different in Aspen than it did in another Colorado ski area, where it owned only one mountain and continued to cooperate in providing access to a four mountain pass.³³ Thus, as Judge Posner put it, *Aspen Skiing* stands for the proposition that dominant firms can be expected to deal with their rivals where “cooperation is indispensable to effective competition.”³⁴

Following these Supreme Court cases, the Government and private parties have successfully challenged unlawful exclusionary conduct that harms consumers and competitors. *United States v. Dentsply International, Inc.*,³⁵ *United States v. Microsoft*,³⁶ and *Conwood Co. v. United States Tobacco Co.*³⁷ are strong examples of successful challenges to exclusionary conduct and the Department will look to them in establishing its Section 2 enforcement priorities. In particular, following the D.C. Circuit’s decision in *United States v. Microsoft*, we will need to look closely at both the perceived procompetitive and anticompetitive aspects of a dominant firm’s conduct, weigh these factors, and determine whether on balance the net effect of this conduct harms competition and consumers. Going forward,

³² *Id.* at 610-11.

³³ *Id.* at 603 n.30.

³⁴ *Olympia Equip. Leasing Co. v. W. Union Tel. Co.*, 797 F.2d 370, 377–78 (7th Cir. 1986). Carl Shapiro, Deputy Assistant Attorney General for Economics, elaborated on this principle as to network industries, explaining that the strategic denial of access to a network facility controlled by a dominant firm can deny “consumers the full benefits of technological progress that a dynamically competitive market would offer.” Carl Shapiro, *Exclusivity in Network Industries*, 7 GEO. MASON L. REV. 673, 674 (1999).

³⁵ 399 F.3d 181 (3d Cir. 2005).

³⁶ 253 F.3d 34 (D.C. Cir. 2001) (en banc).

³⁷ 290 F.3d 768 (6th Cir. 2002).

the Department is committed to aggressively pursuing enforcement of Section 2 of the Sherman Act in furtherance of the principles embodied in these cases.

We did not lightly withdraw the Report. In this instance, however, we concluded that the message sent by the doctrinal implications of this Report was too problematic to let stand. In short, while preserving the right of firms with market power to continue to compete, we cannot allow them a free pass to undertake predatory or unjustified exclusionary acts.

Section 1 Enforcement

Continued criminal and civil enforcement under Section 1 of the Sherman Act will also be an important part of the Antitrust Division's response to the distressed economy.

Criminal Enforcement

The Antitrust Division's criminal enforcement program in recent years has obtained unprecedented success in cracking large domestic and international cartels, resulting in increasingly higher criminal fines and longer jail sentences for offenders. In the first six months of the current fiscal year, nearly \$1 billion in criminal fines were obtained against corporate defendants, and the longest jail sentence for a one-count Sherman Act offense was imposed. In the last three years, over \$2 billion in criminal fines and more than 162 years in jail time have been imposed in cases prosecuted by the Division.

With the higher levels of concentration and economic instability, markets are increasingly vulnerable to collusion and other fraudulent activity. We are

especially concerned that the recent infusion of vast amounts of federal funding to distressed industries and stimulus money to federal, state, and local governments may lead to increased collusion and fraudulent activity. Outreach and cooperation with those involved in the public procurement process are important parts of preventing and identifying such illegal conduct.

I am pleased to report that the Antitrust Division is pioneering new territory in its efforts to reach at-risk public sectors. We have launched the Antitrust Division Recovery Initiative, a program developed in response to the enactment of the American Recovery and Reinvestment Act (“ARRA”), an act that provides for significant appropriations to stimulate the country’s economic recovery. Recognizing the substantial risk that ARRA funded agencies will be vulnerable to collusion and other fraudulent activity, the Antitrust Division has dedicated significant resources to assist agencies receiving ARRA funds in detecting and deterring criminal antitrust offenses. As part of this Initiative, the Division is providing training to the investigative arms of agencies receiving ARRA funds, as well as the procurement officials from those agencies responsible for the expenditure of such funds. By the end of this month, Division attorneys will have provided training to over 8,000 agents, auditors, grant recipients, and other procurement professionals. Through this Initiative, the Antitrust Division hopes to make a significant impact on the overall prevention of fraud, waste, and abuse relating to the use of ARRA funds.

We will work hard to enable the Antitrust Division program to establish direct lines of communication with agency Inspector Generals (“IGs”) and state investigative authorities to assist these officers in preventing – as well as detecting – fraud and abuse. Consequently, in the event that preventive efforts fail, we will be there to investigate and swiftly prosecute individuals and entities responsible for criminal antitrust violations.

Civil Merger and Non-Merger Enforcement

On the civil front, the Antitrust Division will continue its push forward with merger and non-merger investigations. In particular, it is my hope that the Antitrust Division, drawing upon the significant expertise of my new leadership team, will have the opportunity to explore vertical theories and other new areas of civil enforcement, such as those arising in high-tech and Internet-based markets. Increasingly, Americans are relying on high-tech solutions in the home and the workplace and enjoying the fruits of innovation in those markets that have been spurred on by competition between rival firms. We thus plan to devote attention to understanding the unique competition-related issues posed by these markets. In the past, the Antitrust Division was a leader in its enforcement efforts in technology industries, and I believe we will take this mantle again. In so doing, I am cognizant that we must find the right balance to ensure that when intellectual property is at issue, competition is not thwarted through its misuse or illegal extension.

IV. Thinking Ahead: New Ideas

Antitrust authorities must continue to look forward in order to remain at the forefront of the dialogue, economic learning, and the development of legal doctrine. While our most pressing challenges relate to enforcement in the distressed economy, there are other important issues awaiting our attention.

Not only is the Antitrust Division charged with enforcing the antitrust laws, but it also supports the development of competition policy more broadly. In my view, we cannot develop sound antitrust policy merely on a case-by-case basis. Instead, as I have charged the Division's staff, we must consider the overall state of competition in the industries in which we are reviewing potentially anticompetitive conduct or mergers, or providing guidance to regulatory agencies charged with industry oversight. We thus must consider market trends and dynamics, and not lose sight of the broader impacts of antitrust enforcement.

Rigorous economic analysis has been, and will continue to be, at the foundation of the Division's antitrust policy. The focus of this fundamental analysis needs to be on the power of competition in the market to ensure the American consumer's access to the best products at the lowest prices. We need to bring the focus of the economic discourse back to the basic and practical principle: when markets are competitive, the consumer "wins."

Beyond recalibrating our economic analysis, another important and pragmatic aspect of sound antitrust policy is an understanding of the regulatory frameworks governing the industries that are subject to antitrust enforcement. The

Antitrust Division cannot operate in a vacuum, nor can it only focus on the case before it. Antitrust policy and enforcement undoubtedly have a significant impact on affected industries. For this reason, we must bring to our antitrust analysis a comprehensive knowledge of the economic and regulatory environments in which industries operate. This broader understanding of the playing field is particularly critical now, in light of our distressed economy and the new administration's pledge of broad-reaching reforms across numerous industries.

Another challenge we will face is how to pursue effective enforcement in an era of change and reform. The Obama Administration has pledged broad reforms across numerous industries, including banking, healthcare, energy, telecommunications, and transportation. The Antitrust Division will need to contribute our experience and expertise to these reform efforts. Indeed, part of our efforts will be to foster inter-agency discussions regarding the competition-related issues posed by existing and proposed regulations and policies, and to play an active role in competition advocacy. Our review of these industries may reveal that antitrust enforcement is but one of the necessary elements of a broader approach requiring the expertise of other agencies and potential legislative solutions. If that is the case, the Antitrust Division will be at the table with other key decision-makers to make the case for competition policy, underscore the importance of antitrust enforcement, and advocate for America's consumers.

Finally, I want to address the issue of collaboration with other antitrust authorities, which I know is an issue of significant concern with the Chamber and

its members in the business community. I am in search of ways to renew enforcement collaboration between the Antitrust Division and the FTC. Unfortunately, our policies and processes have diverged too frequently in recent years. While we are sister agencies with certain differences in terms of our operations, we have many shared enforcement goals. We will be even closer to reaching those goals if we can collaborate in pursuing our shared concerns regarding threats to competition. We will focus our efforts on working through our previously divergent policies regarding single-firm conduct and pursuing vigorous enforcement on the Section 2 front. We will also look at whether there is common ground between the two agencies in Section 1 enforcement, and in particular, with regard to vertical arrangements and in the review of mergers and acquisitions. In addition, I am focused on merger clearance with the hope of smoothing that process over time.

In the same spirit, I would like the Division to continue its fruitful collaboration with international antitrust enforcement authorities. I want to assure you that the withdrawal of the Section 2 Report does not mean that we are abandoning our efforts to work with our international colleagues. To the contrary, I believe that as targets of antitrust enforcement have expanded their operations worldwide, there is a greater need for U.S. authorities to reach out to other antitrust agencies.

We will therefore need to continue the efforts described in Chapter 10 of the Section 2 Report, and also find new ways to encourage collaboration in the

international antitrust community. The Division is an unparalleled resource for other nations that are developing their own antitrust policies, and we will continue to play a leading role as an international advocate for competition policy.

Although differing international legal frameworks pose certain hurdles to the convergence in substantive laws, we can still explore ways in which antitrust authorities around the world can pursue shared enforcement goals. We will therefore remain active participants in the International Competition Network and the Organization for Economic Cooperation and Development. We will provide continued support to emerging antitrust regimes around the world through technical cooperation with young antitrust agencies. We will also be looking for additional opportunities for bilateral cooperation with our sister antitrust authorities abroad.

In short, I believe that greater coordination with the FTC and foreign antitrust authorities is in the best interests of America's business community and consumers. Cooperation between antitrust agencies will not only contribute to the development of clearer legal standards around the world, but also may assist in improving cartel, merger, and non-merger enforcement in our respective jurisdictions.

V. Conclusion

The current economic challenges raise unique issues for antitrust authorities and private sectors. We are faced with market conditions that force us to engage in a critical analysis of previous enforcement approaches. That analysis makes

clear that passive monitoring of market participants is not an option. Antitrust must be among the frontline issues in the Government's broader response to the distressed economy. Antitrust authorities – as key members of the Government's economic recovery team – will therefore need to be prepared to take action. The Antitrust Division will be ready to take a lead role in this effort.

Thank you for the opportunity to speak to you this morning. I am happy to answer any questions you may have at this time.



Emerging Antitrust Policy One Year Into the Obama Administration:

What Your Business Needs to Know

Santa Clara, CA
March 19, 2010

Key Principles of Antitrust Law

- ❖ Protect the *competitive process*, not *competitors*
- ❖ Focus more on *inter-brand* competition, as compared to *intra-brand* competition
- ❖ Ultimate objective is to benefit *consumers*:
lower prices, higher quality, more services, more choices, greater innovation

Key Antitrust Laws

❖ Sherman Act

- Section 1 (conspiracies and cartels)
- Section 2 (dominant firm conduct)

❖ Clayton Act

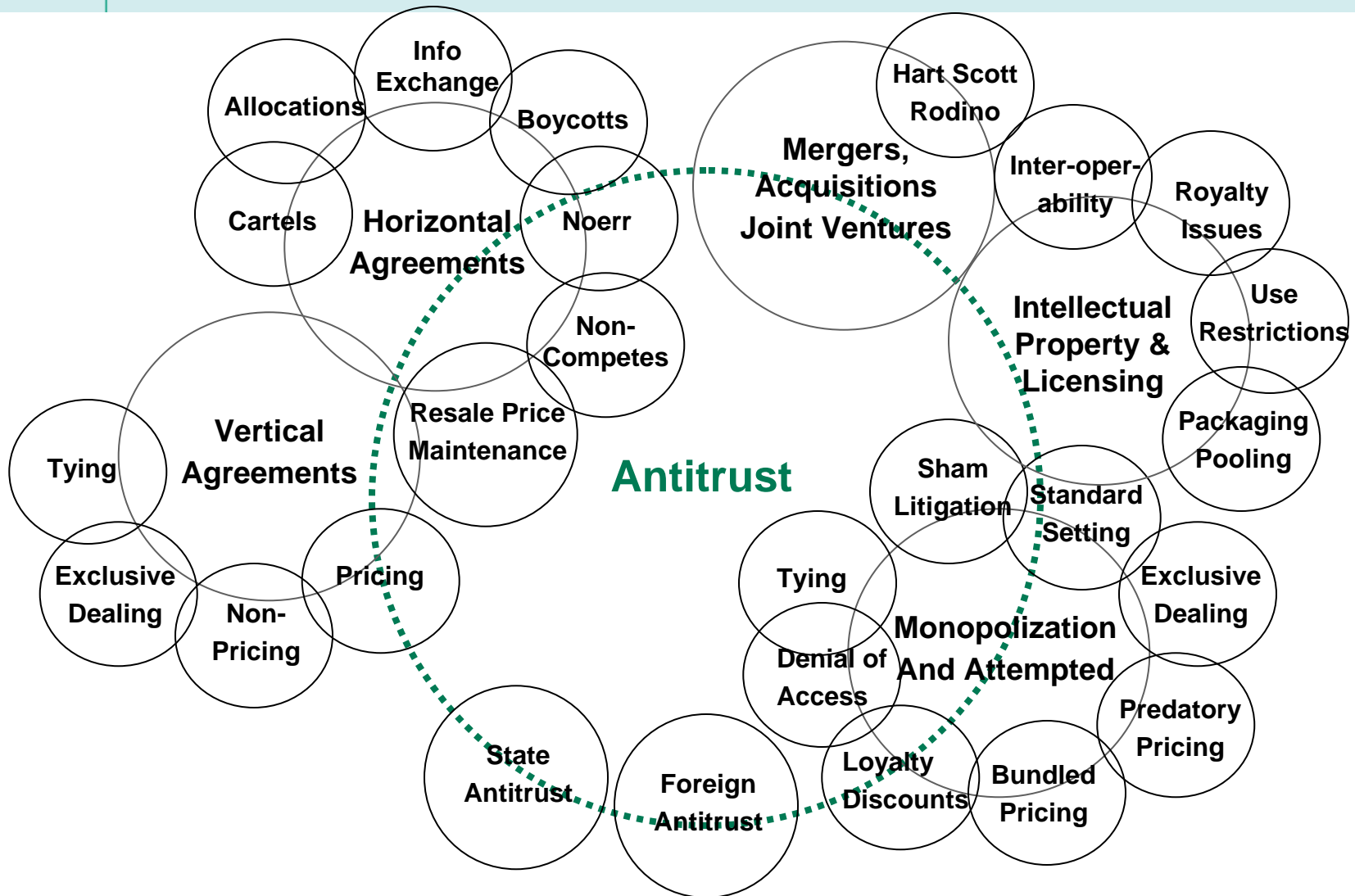
- Section 7 (mergers)
- Section 3 (tying, exclusive dealing – see also Sherman Act § 1)
- Robinson-Patman

❖ Federal Trade Commission Act

- “Unfair methods of competition” and “unfair or deceptive acts or practices”

❖ States and Non-U.S. Jurisdictions

The Scope of Competition Topics



Today's Topics

- ❖ **Obama Administration Antitrust Priorities One Year In**
- ❖ **Mergers/Merger Guidelines: What Was and What Will Be**
- ❖ **IP/Antitrust Interface**
- ❖ **Pricing, New Legislation, International Coordination, and Other Topics**



Carl Shapiro

Deputy Assistant Attorney General for Economics,
Antitrust Division of the U.S. Department of Justice

Transamerica Professor of Business Strategy,
Walter A. Haas School of Business, University of California at Berkeley

Professor of Economics,
Department of Economics, University of California at Berkeley

Carl Shapiro is the Transamerica Professor of Business Strategy at the Haas School of Business, and Professor of Economics in the Economics Department, at the University of California at Berkeley. He earned his Ph.D. in Economics at M.I.T. in 1981, taught at Princeton University during the 1980s, and has been on the Berkeley faculty since 1990. From 1998 to 2008, Shapiro served as Director of the Institute of Business and Economic Research at UC Berkeley. He has been Editor of the *Journal of Economic Perspectives* and a Fellow at the Center for Advanced Study in the Behavioral Sciences, among other honors.

Professor Shapiro is currently on leave, serving as the Deputy Assistant Attorney General for Economics at the Antitrust Division of the U.S. Department of Justice, where he supervises more than fifty Ph.D. economists in the Antitrust Division's Economic Analysis Group (EAG). EAG is widely recognized as one of the most experienced and sophisticated organizations in the world in the application of economics to competition policy. Shapiro had the honor of serving previously as Deputy Assistant Attorney General for Economics in the Antitrust Division, during 1995-1996. Shapiro has consulted extensively for a wide range of private clients as well as for the U.S. Department of Justice and the Federal Trade Commission and the OECD.

Shapiro has published extensively in the areas of industrial organization, competition policy, patents, the economics of innovation, and competitive strategy. His current research interests include antitrust economics, intellectual property and licensing, patent policy, product standards and compatibility, and the economics of networks and interconnection. Shapiro is the co-author, with Hal R. Varian, of *Information Rules: A Strategic Guide to the Network Economy*, published by the Harvard Business School Press. *Information Rules* has received critical acclaim for its application of economic principles to the Information Economy and has been widely read by managers and adopted for classroom use.

**EDUCATION**

- PhD, Princeton, 1980
- M.A., Princeton, 1978
- B.A., Haverford College, 1975

Timothy F. Bresnahan

Landau Professor in Technology and the Economy,
Stanford University

Research Associate, National Bureau of Economic Research

Director, Center on Employment and Economic Growth, Stanford Institute for Economic
Policy Research

Fellow of the American Academy of Arts and Sciences

Timothy F. Bresnahan conducts research in industrial organization and the economics of technology. His standing research interests cover competition and innovation in high-technology industries, and technical change by users of information technologies. His research draws on specific industry and technology data sets and histories to bring out general analytical points. His current research covers policy-oriented topics—competition in the personal computer business and the Internet and the technological and market sources of growth.

Dr. Bresnahan served as Chief Economist of the Antitrust Division at the U.S. Department of Justice and Chair of the Economics Department at Stanford University. He also held visiting positions at Harvard University, the Hoover Institution, and the Instituto de Análisis Económico.

Dr. Bresnahan earned his bachelor's degree from Haverford College in 1975, and his master's and doctoral degrees in economics from Princeton in 1978 and 1980, respectively.



Robert E. Freitas

Partner, Intellectual Property
Silicon Valley
(650) 614-7364
rfreitas@orrick.com

Bob Freitas, a partner in the Silicon Valley office, focuses his practice on intellectual property litigation, representation of policyholders in insurance coverage claims and litigation, antitrust law, and complex litigation.

The following are some of Mr. Freitas' notable representations:

Related Practice Areas

- Antitrust and Global Competition
- Copyright, Trademark and False Advertising Litigation and Counseling
- Insurance Recovery
- Patent Litigation
- Patent Prosecution and Counseling
- Software Disputes
- Trade Secrets Litigation

Education

- J.D., *Order of the Coif*, University of California, Hastings College of the Law, 1977
- B.S., *Phi Beta Kappa*, University of Oregon, 1974

Clerkship

- Hon. Ralph M. Holman, Supreme Court of Oregon (1977-1978)

Honors

- Note and Comment Editor, *Hastings Law Journal*

- **Nanya Technology Corporation and Nanya Technology Corporation USA, Inc.** Mr. Freitas represents Nanya Technology Corporation and Nanya Technology Corporation USA in *In re DRAM Antitrust* Litigation, a multidistrict proceeding in the Northern District of California, and numerous indirect purchaser cases filed in state courts in California and approximately 25 other states.
- **Vident.** In *Vident v. Dentsply International*, Mr. Freitas represented Vident in a monopolization case in the Central District of California involving exclusive dealing.
- **Seagate Technology LLC.** Mr. Freitas represents Seagate Technology in insurance coverage and bad faith litigation arising out of the patent infringement lawsuit that led to *In re Seagate Technology LLC*, 497 F.3d 1360 (Fed. Cir. 2007).
- **Nanya Technology Corporation and Nanya Technology Corporation USA, Inc.** In *Rambus v. Hynix Semiconductor, Inc., et al.*, Mr. Freitas represents Nanya Technology Corporation and Nanya Technology Corporation USA in a patent infringement case in the Northern District of California in which monopolization and patent misuse issues are also presented .

Mr. Freitas is the author of numerous publications covering intellectual property and antitrust law, most recently "Understanding The Objective Prong In Seagate," *IP Law 360*, July 2009 (co-author). He is a frequent speaker on intellectual property and antitrust topics.



Catherine Sandoval

Assistant Professor of Law,
Santa Clara University

Professor Sandoval's research interests involve business and public interest issues including the effect of securities reform legislation; communications business and regulatory issues, and anti-trust market definition and market-entry issues.

Professor Sandoval also has a high interest in policy research in international telecommunications development law and policy. She has drafted speeches and text for international telecommunications accords. She is also interested in the relationship between communications, transportation and housing infrastructure policies.

EDUCATION

- J.D., Stanford University
- Master of Letters, Oxford University
- B.A., Yale University
- Ms. Sandoval was awarded a Rhodes Scholarship to attend Oxford University.

Professor Sandoval's prior appointments include:

- Undersecretary for the State of California, Business, Transportation and Housing Agency and Senior Policy Advisory for Housing and Economic Development 2003-March 2004.
- Staff Director And Acting Undersecretary, April 2001- October 2003. Vice-President and General Counsel - Z-Spanish Media Corporation, April 1999-April 2001 (merged with Entravision Communications Corporation August 2000).
- Director for the Federal Communications Commission, (FCC), Office of Communications Business Opportunities (OCBO), August 1995-April 1999.
- Deputy Director, OCBO, August 1994-July 1995
- Washington D.C. Associate, Law Offices of Munger, Tolles & Olson, 1991-1993
- Law Clerk to Judge Dorothy W. Nelson, Ninth Circuit Court of Appeals, 1990-1991.

Greg Sivinski

Senior Attorney, LCA Antitrust Group, Microsoft Corporation

Greg Sivinski is a Senior Attorney in the LCA Antitrust Group at Microsoft Corporation, Redmond Washington. Since joining Microsoft in 2003, his practice has included all antitrust and regulatory aspects of software interoperability and mergers and acquisitions for the Company generally, including U.S. and worldwide cases. Most recently he led the Microsoft team in obtaining DOJ, EC and other clearances for the Microsoft/Yahoo! transaction. He has also worked on behalf of the company in connection with numerous third-party transactions under regulatory review. Prior to joining Microsoft, Mr. Sivinski was a Senior Antitrust Attorney at American Airlines, Inc., responsible for antitrust, regulatory, and litigation matters affecting American's international and domestic airline alliances, M&A transactions, and other joint ventures.



Robert A. Rosenfeld

Partner, Litigation
San Francisco
(415) 773-4190
rosenfeld@orrick.com

Robert Rosenfeld, a partner in Orrick's San Francisco office, is the chair of the firm's Antitrust and Competition Group.

Mr. Rosenfeld's practice focuses on antitrust, complex commercial litigation and financial institutions. For the last 10 years, Mr. Rosenfeld has represented Microsoft Corporation in numerous antitrust proceedings in California and elsewhere in the United States and abroad. In addition, he provides advice regarding antitrust issues to companies in Silicon Valley. He also has advised major health insurance companies and has litigated a number of cases involving the application of antitrust principles in the health care marketplace.

Mr. Rosenfeld's practice also includes complex business litigation, principally on behalf of major financial institutions. He has represented and counseled special litigation committees in the conduct of internal investigations and the prosecution and defense of derivative litigation.

From 1986 until 1992, Mr. Rosenfeld traveled to the Soviet Union on a number of occasions to participate with Soviet lawyers and academics in projects involving commercial matters and human rights issues.

Before joining Orrick, Mr. Rosenfeld practiced at Heller Ehrman LLP.

Related Practice Areas

- Antitrust and Global Competition
- Commercial Litigation

Education

- J.D., *cum laude*, *Managing Editor*, *Harvard Law Review*, Harvard Law School, 1976
- B.A., *First Class Honors*, *Rhodes Scholar*, University of Oxford, 1973
- B.A., *Highest Distinction*, Public Affairs, The George Washington University, 1971

Clerkship

- Hon. Warren E. Burger, Chief Justice of the U.S. Supreme Court
- Hon. Marvin E. Frankel of the U.S. District Court for the Southern District of New York

Honors

- Named as one of "America's Leading Lawyers: Antitrust," *Chambers USA*, 2003-2008
- Named one of *The Best Lawyers in America*, Antitrust Law, Bet-the-Company Litigation and Commercial Litigation, 2006-2010
- Included in *Who's Who Legal*, *Commercial Litigation*, 2007