Truncated Rule of Reason Analysis in Antitrust Representations
Strategies for Applying the Test Following the FTC’s Realcomp II Decision

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:
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Truncated Rule of Reason Analysis

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Section 1 & Restraints of Trade

• Section 1, Sherman Act
  • “Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”

• Prohibits Only Agreements That Unreasonably Restrains Trade
  • “Every agreement concerning trade . . . restraints.” Chicago Bd. Of Trade v. US (1918)
  • The Sherman Act prohibits only those agreements that are “unreasonably restrictive of competitive conditions.” Standard Oil Co. v. US (1911)

• Issue – How to determine whether a particular agreement unreasonably restrains trade?
Traditional Analysis

• Per Se v. Rule of Reason
• Permits courts to balance
  • Desire to condemn practices without redeeming value with minimal expenditure of time and resources
  • Benefit of more careful consideration of practices for which the net effect is less apparent or well-understood
Per Se Rule

• Practices that have been identified as having a “pernicious effect on competition and lack any redeeming virtue”
  • *N. Pac. Ry. V. United States*, 356 U.S. 1, 5 (1958)

• Conclusively presumed to be unreasonable

• Per Se Conduct – Horizontal Competitors’
  • Fixing of Prices or Terms of Sale
  • Agreements Not To Compete
  • Division of Markets or Customers
  • Certain Boycotts
  • Bid rigging
Rule of Reason Analysis

- Traditionally, all practices not subject to the per se rule
- Requires a plaintiff to establish that
  - the agreement in question caused, or is likely to cause, harm to competition
  - The harm to competition outweighs any procompetitive justifications advanced by the defendant
Erosion of the Traditional Dichotomy

- Continental T.V. v. GTE Sylvania (1977)
- Nat. Soc. of Prof. Engineers v. U.S. (1978)
- Broadcast Music Inc. v. CBS (1979)
- FTC v. Indiana Fed. of Dentists (1986)
- California Dental Ass’n v. FTC (1999)
Continental T.V. v. GTE Sylvania (1977)

• Factual Background
  • Sylvania established a franchise system for sale of TVs
  • Each retailer could sell only in its designated region
  • Following a dispute, Sylvania terminated Continental’s franchise
  • Continental sued, challenging the territorial allocations
  • Jury instructions – per se market allocation (Schwinn)

• Any “departure from the [usual] rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing”

• There has been no showing that vertical restrictions “are likely to have a ‘pernicious effect on competition’ or that they “lack . . . any redeeming virtue’.”

• Court applied rule of reason
Nat. Soc. of Prof. Engineers v. U.S. (1978)

Factual Background

- NSPE Code of Ethics stated that an engineer “will not compete unfairly with another engineer by . . . [engaging in] competitive bidding”
- Dept. of Justice challenged as a per se violation
- NSPE defended on grounds that the provision was reasonable because competition among engineers is contrary to the public interest

Whether per se or rule or reason analysis is applied, “the purpose of the analysis is to form a judgment about the competitive significance of the restraint”

“no elaborate industry analysis is required to demonstrate the anticompetitive character” of the restraint, but nevertheless considered NSPE’s proffered justifications
Broadcast Music Inc. v. CBS (1979)

- Factual Background
  - BMI and ASCAP acted as “clearing houses” for individual copyright owners
  - Together, they included 4 million copyrighted compositions
  - They granted “blanket” licenses to radio and TV broadcasters
  - CBS challenged the blanket licenses as unlawful price fixing
- “easy labels do not always supply ready answers”
- The blanket license in question “cannot be wholly equated with a simple horizontal arrangement among competitors”
- Should be analyzed under the rule of reason
Factual Background

- NCAA adopted a television plan
  - NCAA granted ABC and CBS the right to broadcast 14 football games each
  - Limited the number of times any NCAA member’s games could be televised
  - Prohibited NCAA members from negotiating television broadcasts outside the NCAA plan
- Universities of Oklahoma and Georgia challenged the plan

“these practices share characteristics of restraints we have previously held unreasonable.”

“whether the ultimate finding is the product of a presumption or actual market analysis, the essential inquiry remains the same – whether or not the challenged restraint enhances competition.”

• Factual Background
  • IFD was an association of < 100 dentists
    – But concentrated around three cities
  • IFD adopted a work rule prohibiting its members from submitting x-rays to dental insurers
  • The FTC found that the practice violated the FTC Act
    – Direct evidence of anticompetitive harm
    – Rejected IFD’s proffered justification

• “we decline to resolve this case by forcing the Federation’s policy into the ‘boycott’ pigeonhole and invoking the per se rule”

• But “no elaborate industry analysis is required to demonstrate the anticompetitive nature” of the agreement

• The court considered whether there was an offsetting procompetitive justification
California Dental Ass’n v. FTC (1999)

- Factual Background
  - CDA included ¾ of Calif. Dentists as members
  - CDA ethics code prohibited misleading advertising
  - An advisory opinion stated that certain types of fee-related or quality-based advertising was likely to be misleading
  - The FTC found the restraint unlawful under both per se and abbreviated rule of reason analysis
  - “[the] categories of analysis are less fixed than terms like ‘per se,’ ‘quick look’ and ‘rule of reason’ tend to make them appear.”
  - Section 1 analysis requires “an enquiry meet for the case” in order to reach “a confident conclusion about the principal tendency of a restriction”
  - A quick look approach is appropriate if “an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect”
Truncated Analysis in Lower Courts

- **Chicago Prof. Sports v. NBA (7th Cir. 1992)**
  - applying a quick look analysis to an agreement among NBA teams limiting broadcast rights to NBA games

- **Law v. NCAA (10th Cir. 1998)**
  - applying a quick look analysis to a NCAA rule limiting Division I coaches’ salaries to $16,000
  - “under a quick look rule of reason analysis, anticompetitive effect is established, even without a determination of the relevant market, where the plaintiff shows that a horizontal agreement to fix prices exists . . .”

- **California v. Safeway, Inc. (9th Cir., August 17, 2010)**
  - applying a quick look analysis to agreement among four supermarkets to share profits during a union strike
  - “[We] apply a mixed or blended approach, engaging in an analysis ‘meet for the case’.”
  - “we are confident in our conclusion that defendants’ profit-sharing agreement creates ‘a great likelihood of anticompetitive effects’”
Truncated Analysis in Lower Courts

- **Worldwide Basketball Tours v. NCAA (6th Cir. 2004)**
  - “extensive market and cross-elasticity analysis is not necessarily required” under an abbreviated analysis
  - But refusing to apply an abbreviated analysis to NCAA rules restricting the type and number of basketball games member schools could play because of lack of experience with the product market in question

- **Cont’l Airlines v. United Airlines (4th Cir. 2002)**
  - refusing to apply abbreviated analysis to an agreement among airlines regarding size limitation on scanning equipment for carry-on bags

- **Brookins v. Int’l Motor Contest Ass’n (8th Cir. 2000)**
  - refusing to apply abbreviated analysis to an auto racing association’s change of rules regarding permissible transmissions
Truncated Analysis at the DOJ

- United States v. Brown University (3rd Cir. 1993)
  - Agreement among Ivy League schools and MIT
    - to issue financial aid solely on the basis of financial need
    - To determine collectively the amount of financial aid
      commonly admitted students would be awarded
  - “the fact that [the agreement] . . . involve[s] price-fixing in ‘a
    literal sense’ . . . does not mean that it automatically qualifies
    as per se illegal price-fixing.”
  - No finding that the agreement “has caused or is even likely
    to cause any reduction of output” or price effects
  - “Since the . . . Agreement is a price fixing mechanism . . .,
    MIT is obliged to provide justification for the arrangement”
  - “while MIT bears the burden of establishing an affirmative
    justification . . . the absence of any finding of adverse effects
    such as higher price or lower output is relevant, albeit not
    dispositive, when the district court considers whether MIT
    has met this burden.”

- “Step-wise Approach”
Truncated Analysis at the FTC

- Indiana Fed. of Dentists v. FTC (S. Ct. 1986)
- In re Mass. Board of Reg. in Optometry (FTC Decision 1988)
- Detroit Auto Dealers Ass’n v. FTC (6th Cir. 1992)
- California Dental Ass’n v. FTC (S. Ct. 1999)
- Polygram Holding, Inc. v. FTC (D.C. Cir. 2005)
- N. Texas Spec. Physicians v. FTC (5th Cir. 2008)
- In re Dick’s Sporting Goods (FTC Consent 2008)
- In re Realcomp II (FTC Decision 2009)
  - Appeal pending before 6th Cir.

- “Rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances”

- “[W]here the likelihood of anticompetitive harm is evident from the nature of the agreement . . . then, absent overriding benefits that could offset the anticompetitive harm, the Agencies challenge such agreements without a detailed market analysis.”
Polygram Holding v. FTC (DC Cir. 2005)

- Agreement between Polygram and Warner Music to co-produce and distribute the Three Tenors 1998 album
- Subsequent agreement -- Polygram and Warner would not discount or promote their respective 1990 and 1994 Three Tenors albums around the same time
- “the Supreme Court has steadily moved away from the dichotomous approach . . . toward one in which the extent of the inquiry is tailored to the suspect conduct in each particular case. . . . [I]t has backed away from any reliance upon fixed categories and toward a continuum.”
- “If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm.”
In re Realcomp II (2009)

- FTC decision issued October 30, 2009
- Currently on appeal before the 6th Circuit
Realcomp and the “Inherently Suspect” Framework

Implications for Competitor Collaborations

September 20, 2010
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The FTC’s Decision in *Realcomp*

- A case about rules adopted by a real estate multiple listing service (MLS) in southeastern Michigan
- Decision focused on FTC’s challenge to MLS’s “Website Policy”
  - Policy distinguished between:
    - traditional “exclusive right to sell” (ERTS) listings -- pursuant to which agent will receive a commission no matter who sells the home, and
    - “exclusive agency” (EA) listings, pursuant to which a commission is earned only if the home if sold with the assistance of an agent
  - Policy allowed members to disseminate traditional ERTS listings directly from the MLS database to “public websites” (e.g., Realtor.com), but did not allow EA listings to be disseminated directly
The FTC’s Decision in *Realcomp*

- FTC sued Realcomp in 2006
- After 8 days of hearings, ALJ ruled in 2007 that Realcomp’s Policies did not violate Section 5
- Complaint Counsel appealed to FTC, but did not urge Commission to analyze Website Policy under the “inherently suspect” framework
- 18 months after hearing oral argument, the Commission reversed, finding a Section 5 violation based on three separate modes of analysis:
  1. under the traditional rule of reason
     - Proof of actual net anticompetitive effects
  2. under the *U.S. v. Realty Multi-List* “facial unreasonableness” test
     - Market power + “facially restrictive rule”
  3. under the “inherently suspect” framework of analysis
     - Inherently suspect conduct + no cognizable justifications
     - Presence or absence of market power not relevant
# Comparison of Three Modes of Analysis

<table>
<thead>
<tr>
<th>Nature of Restraint</th>
<th>Per Se Treatment</th>
<th>Inherently Suspect Framework</th>
<th>Facial Unreasonable -ness</th>
<th>Traditional Rule of Reason</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>✓ “Per se” categories</td>
<td>✓ “Inherently Suspect” conduct</td>
<td>✓ “Significantly Restrictive Rules”</td>
<td>✓ Some Restraint</td>
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<td>Market Power?</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
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<td>Actual Adverse Effects</td>
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<td>✗</td>
<td>✗</td>
<td>✓</td>
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<tr>
<td>Lack of Justification</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓ Effects must outweigh benefits</td>
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The Inherently Suspect Analysis

• Why was Website Policy “inherently suspect”?  
  • Key issue was the “nature of the restraint”  
  • Anticompetitive nature was “intuitively obvious”  
    • Policy “hindered the ability of some competitors to advertise, and disseminate information about, their service offerings”  
  • Two other factors supported “inherently suspect” treatment  
    • The “market context”  
      • Change threatened to upset status quo of traditional brokers charging percentage-based commissions  
    • The “evident aim” of Realcomp  
      • To “retard the emergence of a new business model”  
• Was the tendency of the Policy to regulate the manner in which members offered their services (via EA listings rather than ERTS listings) also relevant?  
  • Perhaps, but was emphatically not the thrust of FTC’s concern, which focused on the disadvantages imposed on nontraditional brokers
The Inherently Suspect Analysis

• Why were Realcomp’s justifications invalid?
  • The “free riding” justification: nontraditional brokers could exploit benefits of MLS while bypassing principal source of compensation for MLS’s members – the percentage-based commission; as Realcomp argued, MLS was not created “to help property owners who wish to procure their own buyers”
    • FTC gave this no weight:
      1 – the ride was not free; alleged free riding was on Realcomp, but Realcomp did charge all members – traditional and nontraditional alike a fee for MLS access
      2 – the asserted free-riding harm was the loss of commission revenues, which allegedly flowed from competition with nontraditional brokers; eliminating competition is never a valid justification
      3 – perhaps also relevant that MLS was up and running long before these new policies imposed, confirming their aim of blunting new forms of competition
  • The “bidding disadvantage” justification: homebuyers represented by a broker would have disadvantage in bidding on a home against unrepresented buyers
    • Again, efforts to remove that disadvantage involved merely the “elimination of competition” aimed at propping up the traditional full-serve compensation scheme
Other Findings

• Realcomp had substantial market power in the provision of MLS services
  • Access indispensable to the efficient dissemination of information about homes for sale in SE Michigan

• The Website Policy made it difficult for nontraditional brokers using EA listings to reach unrepresented buyers via the Internet

• There was evidence of actual anticompetitive effects
  • Statistical evidence showed that EA listings were less prevalent in areas with restrictive MLS website policies
  • This results in reduced pricing pressure on 6% commissions typically charged by traditional brokers
  • Violation does not require proof that EA listings were foreclosed entirely

• In theory, however, none of this is relevant to the application of the inherently suspect framework
What Are the Practical Risks?

- *Realcomp* and other “truncated” approaches pose some serious practical challenges for competitor collaborations:
  - Lack of market power is a far less reliable source of protection
  - Uncertainty over types of conduct that might trigger truncated analysis
  - Potential hostility to the kinds of justifications that can motivate firms lacking in market power
    - Desire to “make money” in launch of venture product unlikely to avoid potential condemnation

- This is not merely a concern about FTC or other government enforcement
  - Case law addresses “inherently suspect” framework and other truncated approaches as reflecting appropriate application of Section 1 of Sherman Act, and not limited to Section 5 of FTC Act
What Can Collaborators Do?

• Stay off the FTC’s radar screen
  • FTC likely to have greater success than private litigants in pushing the envelope of these doctrines
  • Certain settings are particularly likely to attract enforcement attention
    • Efforts by industry incumbents that might be perceived as aimed at impeding new forms of competition, or avoiding potentially destabilizing change
    • Realcomp was such a case – traditional brokers reacting to the rise of Internet-enabled competitors
    • Long history of enforcement in similar contexts:
      • E.g., health care providers resisting rise of HMOs and other managed care networks

• Use common sense
  • Do not act in ways that give rise to an obvious inference that venture-related provisions or rules are intended to reduce competition
What Can Collaborators Do?

• Pay close attention to the “justification” for any restraints on the competitive freedom of venturers or rules governing admission of others
  • Often it will not be sufficient to show that the venture as a whole is net-beneficial
  • Document the rationale for any restriction at the time it is put in place
    • This is even more important for restraints imposed after a venture is up and running (*Three Tenors, Realcomp* both teach this)
  • Be prepared to demonstrate why the benefits of the overall venture could not be achieved effectively without the rule/restraint
    • *E.g.*, participants would not invest on other terms
    • *E.g.*, addresses practical problems with venture’s operation
  • Alternatively, be prepared to offer concrete evidence demonstrating how venture operates at lower cost, or yields better quality, because of the restraint
What Can Collaborators Do?

• Consider alternatives to provisions/rules that might be viewed as bearing a “close family resemblance” to per se unlawful conduct, or other conduct deemed “inherently suspect”
  • Beware of any overt limitation on a venturer’s competitive freedom (as to pricing, output limitations, territories)
    • Consider whether such restrictions are really needed (especially if they are not demonstrably essential to making a procompetitive venture possible)
    • Consider whether objectives might be achieved via other means
      • If concern is that members will act opportunistically to undermine venture, perhaps formulae for allocating venture profit and loss could realign incentives
  • Beware of provisions/rules that single out one group of competitors, or one form of competition, as in Realcomp
    • Neutral rules limiting access likely are safer
    • Complete exclusion may be easier to justify in cognizable way than “regulated” inclusion
Issues Involved in Truncated Analysis

• When is a truncated rule of reason analysis appropriate?
• What is the role of economics in determining when a truncated rule of reason applies?
• What must a plaintiff prove to carry its initial burden in a truncated analysis?
• What defenses are permitted in a truncated analysis?
• Why is a truncated analysis of particular importance to parties to a joint venture?
• What are the practical implications of the FTC's inherently suspect analysis for joint ventures?
• In light of the FTC's approach, what steps can parties to a joint venture take to protect themselves?