Public Version
FTC Docket No. 9298

UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of

POLYGRAM HOLDING, INC.,
a corporation,

DECCA MUSIC GROUP LIMITED,
a corporation,

UMG RECORDINGS, INC.,
a corporation,

and

UNIVERSAL MUSIC & VIDEO DISTRIBUTION CORP.,
a corporation.

Docket No. 9298

PUBLIC VERSION

To: The Honorable James P. Timony
Administrative Law Judge

COMPLAINT COUNSEL'S POST-TRIAL REPLY MEMORANDUM OF LAW IN RESPONSE TO RESPONDENTS' POST-TRIAL BRIEF

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INTRODUCTION

Initially, Respondents argued that the Three Tenors moratorium agreement never existed.[1] Now the moratorium has been admitted: Respondents agreed with Warner, a horizontal competitor, to fix prices and to forgo advertising for certain audio and video products.[2] Initially, Respondents averred that the moratorium was necessary for the formation of the PolyGram/Warner collaboration.[3] Now Respondents have, by stipulation, abandoned this defense.[4] Initially, Respondents claimed that the moratorium was necessary for the efficient operation of the joint venture.[5] Yet, Respondents have effectively forfeited this contention by offering no supporting evidence.[6]

All that remains is Respondents' argument that the moratorium was adopted in the context of a joint venture, and that there is a plausible (albeit not valid) efficiency justification.[7] The principal issue to be decided by this Court is whether Respondents' efficiency justifications are plausible, and if so, whether the presumption of illegality is then overcome (requiring a plenary market review under the rule of reason). We note in this regard that this Court has

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[1] Answer of Respondents to the Commission's Complaint, Fifth Additional Defense; Respondents' Status Report at 3 (Nov. 27, 2001); PHC Tr. 30:13-20 (Respondents' counsel tells the Court that moratorium was "not ultimately agreed to").

[2] RPF ¶¶ 62-63.

[3] Answer of Respondents to the Commission's Complaint, Third Additional Defense.

[4] PHC Tr. 83:4-84:1.

[5] Answer of Respondents to the Commission's Complaint, Third Additional Defense.

[6] CPF ¶¶ 327-334; 347-350; 361-364.

[7] Respondents, in a display of bravado, characterize their efficiency arguments as being "at least plausible." Respondents' Post-Trial Brief at 41, 45.

already ruled that "plausibility" alone is not a sufficient defense, and that the Court's conclusion is founded on extensive Supreme Court and lower court precedent. Order Denying Motion For Summary Decision at 8-11 and cases cited therein (Feb. 26, 2002) ("Summary Decision Order").

The moratorium agreement should be presumed to be anticompetitive – on the basis of legal precedent, economic analysis, and record evidence. The burden of proof therefore shifts to Respondents to prove a plausible and valid efficiency justification.

Despite Respondents' disbelief, the concept that certain categories of agreements are presumed to be anticompetitive is not new, and ought not to be controversial. For decades, price and output restraints have been conclusively presumed to be anticompetitive – without proof of market power and without direct evidence of adverse competitive effects. In *NCAA*[8] and *BMI*,[9] the Supreme Court refined the law regarding *per se* liability for restraints ancillary to an integrated joint venture. Restrictions on price competition and similar restraints are no longer automatically (or conclusively) judged unreasonable; instead, the presumption of likely anticompetitive effects may be rebutted.

If the presumption of anticompetitive effects is to remain meaningful – and clearly this was the Supreme Court's intention – then in order to defeat liability a defendant must do more than Respondents have done here. A defendant must do more than point to the commonplace marketing challenges that confront every seller. And given that 3T2 was efficiently and successfully marketed in 1994 without restraining competition from 3T1, Respondents should explain what was different in 1998. There has been no serious attempt to do so.

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[8] *NCAA v. Board of Regents*, 468 U.S. 85 (1984) ("*NCAA*").

[9] *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979) ("*BMI*").

Respondents' first efficiency argument is that for 3T3 to compete against 3T1 (PolyGram) and 3T2 (Warner) would be confusing for customers and retailers, and for the companies themselves. No doubt, shopping would be less confusing (and selling more stream-lined) if stores offered a single brand of detergent, a single flavor of ice cream, and a single compact disc of recorded music. One cost of competitive markets is that sellers must teach, and consumers must learn, how to distinguish among similar products. In this very limited sense, Respondents' claim that the moratorium agreement eliminates the costs associated with consumer confusion is "plausible" – or conceivably true. But our entire antitrust regime is built upon the premise that the inherent costs of competition – including a modicum of confusion – are worth their price in the great majority of circumstances. Eliminating the costs of the competitive market system is not a plausible or legitimate defense to a horizontal restraint.[10]

There may be extraordinary market circumstances in which consumer confusion is so pervasive, and the danger of mistaken decisions so great, that consumers should not be permitted to choose; competitors could in this hypothetical context arrange for their dangerous products to be high-priced and hidden from view. But there is no evidence that these unusual conditions were present in the marketplace for Three Tenors albums during 1998. The assertion by PolyGram employees that they truly believed that confusion was a problem does not come near

[10] *F.T.C. v. Indiana Federation of Dentists,* 476 U.S. 447, 463 (1986) ("*IFD*"); *National Society of Professional Engineers v. United States*, 435 U.S. 679, 695 (1978) ("*NSPE*") ("The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services . . . . Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad."). *See also* H. HOVENKAMP, XI ANTITRUST LAW ¶1907c at 223 (1998).

to proving that the moratorium was necessary for the effective marketing of 3T3. Yet this is the sum total of Respondents' supporting evidence.

Respondents' second efficiency argument is that the moratorium remedies a free-riding problem: perhaps, absent the moratorium, consumers brought to the store by advertising for 3T3 would instead purchase 3T1 or 3T2. It is a "fact of life" that a consumer is not obligated to purchase the product whose advertising brought him to the store – and many consumers exercise this prerogative in many different markets. CPF ¶¶ 312-317. As a result, free riding is so pervasive that the free-riding defense also has the potential to sweep aside all abbreviated review of horizontal restraints.

The courts and the Commission have determined however that routine instances of free riding will not justify suspect restraints. Respondents are required to show that absent the moratorium agreement, advertising for 3T3 would have been eliminated or substantially curtailed. Yet, the evidence shows that advertising for 3T3 was not threatened. Respondents have also failed to demonstrate that PolyGram and Warner were unable to share the costs of advertising 3T3. In fact, PolyGram and Warner agreed to share the costs of advertising 3T3 on terms satisfactory to them. CPF ¶ 336. "When payment is possible, free-riding is not a problem because the 'ride' is not free." *Chicago Prof'l Sports Ltd. Partnership v. National Basketball Ass'n*, 961 F.2d 667, 675 (7th Cir.), *cert. denied*, 506 U.S. 954 (1992).

Respondents' Post-Trial Brief repeatedly asserts that the moratorium was an "integral part" of the marketing plan for 3T3, as if suppressing the promotion of competing products were just one more tool in the creative marketer's bag of tricks. The Court should reject this argument, and insist that price restraints and advertising bans are permissible only in unusual

market circumstances, where there is a demonstrable need, and where less restrictive alternatives are not available. A decision to require full rule of reason review on the basis of the superficial and unsupported arguments asserted by the Respondents would be tantamount to abandoning abbreviated antitrust analysis altogether. Efficient enforcement of the antitrust laws would be needlessly undermined.

ARGUMENT

I. The Moratorium Agreement Should Be Condemned on the Basis of an Abbreviated Rule of Reason Analysis

A. Suspect Restraints May Be Condemned Without a Finding of Actual Adverse Effects or Market Power

In order to prevail under traditional rule of reason analysis, a plaintiff is required to prove – on the basis of detailed market analysis – that the challenged restraint was likely to have an adverse effect on competition. The burden of proof then shifts to the defendant to prove offsetting competitive benefits. *See, e.g., Capital Imaging Assoc. v. Mohawk Valley Med. Assoc., Inc.*, 996 F.2d 537, 543 (2d Cir. 1993); *Bhan v. NME Hosp., Inc.*, 929 F.2d 1404, 1413 (9th Cir. 1991). With certain categories of horizontal restraints (including price restraints and advertising bans), the analysis may be truncated. An inference of likely adverse effects is triggered by proof of the suspect agreement alone. Here too, the burden then shifts to the defendant to prove offsetting competitive benefits. This analytical framework is referred to as "abbreviated or 'quick-look' analysis under the rule of reason." *California Dental Ass'n v. F.T.C.*, 526 U.S. 756, 770 (1999) ("*CDA*").[11]

[11] Respondents' insistence that Complaint Counsel offer direct evidence of actual net anticompetitive effects is inconsistent with how competitive analysis of horizontal restraints is actually conducted by courts: guided by precedent, and relying upon a series of inferences and

Respondents state that they "are aware of no rule of reason case in which a restraint was held unlawful, or the burden of proof was shifted to the defendant . . . without any evidence either of an actual anticompetitive effect or of market power." Respondents' Post-Trial Brief at 37. Here then are some prominent cases that have employed an abbreviated rule of reason, shifting the burden of proof to the defendant without evidence of actual anticompetitive effects or market power:

> In *BMI*, 441 U.S. at 6, 24-25, a restriction on price competition among composers was judged presumptively anticompetitive, shifting to the defendants the burden of showing a legitimate efficiency rationale.
>
> In *United States v. Brown University*, 5 F.3d 658, 674 (3d Cir. 1993), a restriction on price competition among nine universities was judged presumptively anticompetitive, shifting to the defendants the burden of showing a legitimate efficiency rationale.
>
> In *Chicago Prof'l Sports*, 961 F.2d at 674, an agreement among professional basketball teams to restrict the telecast of basketball games was judged presumptively anticompetitive, shifting to the defendants the burden of showing a legitimate efficiency rationale.
>
> In *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 597 (7th Cir. 1984) an agreement among trucking companies not to enter one another's territories was judged presumptively anticompetitive, shifting to the defendants the burden of showing a legitimate efficiency rationale.

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presumptions. ABA Section of Antitrust Law, Antitrust Law Developments at 67-78 (5th ed. 2002). "Efforts to prove substantial actual anticompetitive effects have seldom been successful, in part because of the 'difficulty of isolating the market effects of challenged conduct.'" *Id.* at 66 (*citing United States v. Brown University*, 5 F.3d 658, 668 (3d Cir. 1993)). *See also* H. Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice §5.1 at 192 (2d ed. 1999) ("In a world of perfect and costless information, we could learn everything there is to know about a restraint before deciding whether to condemn it. But the actual world is characterized by ignorance and ambiguity, and obtaining reliable information is costly. Antitrust has had to devise shortcuts for evaluating business practices. Because of their complexity, their great potential for harm, but the offsetting potential for considerable good, horizontal restraints is an area where the use of these shortcuts is particularly prominent.").

See also In re Detroit Auto Dealers Ass'n, 111 F.T.C. 417, 494 (1987); *In re Massachusetts Bd. of Registration in Optometry*, 110 F.T.C. 549, 604 (1988) ("*Mass. Board*").

Respondents have chosen to ignore these cases. Respondents' effort to find in other decisions a repudiation of abbreviated analysis is not persuasive. In *CDA*, the Supreme Court explicitly endorsed the use of the abbreviated rule of reason in cases where "an observer with even a rudimentary understanding of economics could conclude that the arrangement in question would have an anticompetitive effect on customers and markets." 526 U.S. at 70. *CDA* indicates that a full ban on product advertising is properly presumed to be anticompetitive (although the limited restrictions on professional advertising adopted by the dental association required a more detailed analysis). *See* Complaint Counsel's Memorandum of Law in Support of Complaint Counsel's Proposed Findings of Fact, Conclusions of Law and Order ("Complaint Counsel's Post-Trial Memorandum") at 24-25.

In *NCAA*, the district court did find market power and anticompetitive effects. But the Supreme Court emphasized that these findings were not necessary to affirm liability: "As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output . . . . This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." *NCAA*, 468 U.S. at 109-110.

Respondents' misread *IFD*, asserting that it stands for the proposition that "proof of actual anticompetitive effect (or of market power as a surrogate for such effect) is required in any rule of reason case." Respondents' Post-Trial Brief at 38. Because of an agreement among certain Indiana dentists, insurance companies were unable to obtain compliance with their requests for the submission of x-rays. *IFD*, 476 U.S. at 461. The Court was willing to infer a

link between the unavailability of x-rays and an increase in the price of dental treatment:

> A concerted and effective effort to withhold (or make more costly) information desired by consumers for the purpose of determining whether a particular purchase is cost justified is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned even absent proof that it resulted in higher prices or, as here, the purchase of higher priced services, than would occur in its absence.

Id. The Court then went on to explain that, even if the there were in fact no actual effect upon prices or output, the challenged agreement would still be unlawful:

> Moreover, even if the desired information were in fact completely useless to the insurers and their patients . . . [the dental association] is not entitled to pre-empt the working of the market by deciding for itself that its customers do not need that which they demand.

Id. at 462.

Thus, in *IFD* the dentists' agreement to withhold x-rays was judged unreasonable without proof that the restraint had any actual effect upon the price of dental treatment, and without a finding of market power. Likely anticompetitive effects were inferred from the nature of the agreement, shifting to respondents the burden of establishing a legitimate efficiency justification:

> A refusal to compete with respect to the package of services offered to customers, no less than a refusal to compete with respect to the price term of an agreement, impairs the ability of the market to advance social welfare by ensuring the provision of desired goods and services to consumers at a price approximating the marginal cost of providing them. Absent some countervailing procompetitive virtue . . . such an agreement limiting consumer choice by impeding "the ordinary give and take of the market place," cannot be sustained under the Rule of Reason.

Id. at 459. *See* Antitrust Law Developments at 65 (5th ed. 2002) ("proof of actual anticompetitive effect was not essential in *Indiana Federation* because the agreement could . . . be condemned as a naked restraint").

Of course, there are antitrust cases in which courts have required proof of market power or evidence of actual anticompetitive effects: these are cases decided under the full rule of reason. *E.g., United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001). To require a similar showing where a restraint is anticompetitive on its face would be equivalent to abandoning abbreviated rule of reason analysis. *See Brown University*, 5 F.3d at 673 ("[I]f an abbreviated rule of reason analysis always required a clear evidentiary showing of a detrimental effect on price, output, or quality, it would no longer be abbreviated . . . . This is because proof of actual adverse effects generally will require the elaborate, threshold industry analysis than an abbreviated inquiry is designed to obviate.").

B. <u>The Three Tenors Moratorium Is Presumptively Anticompetitive</u>

Complaint Counsel's Post-Trial Memorandum (at pp. 24-35) explains that antitrust case law, economic theory, empirical research, and the trial record all support findings that: (i) the agreement between PolyGram and Warner not to discount Three Tenors products is presumptively anticompetitive; and (ii) the agreement between PolyGram and Warner not to advertise Three Tenors products is also presumptively anticompetitive.

Respondents' response is short on evidence or analysis. Respondents start by acknowledging that price and output restraints arising in other corners of the entertainment industry have been judged presumptively anticompetitive. *See NCAA*, 468 U.S. at 99 (price and output restraints applicable to college football telecasts have obvious anticompetitive effects); *Chicago Prof'l Sports* 961 F.2d at 672 (output restraint applicable to Chicago Bulls telecasts has obvious anticompetitive effects). Respondents' Post-Trial Brief at 36. Then comes the following assertion: To consider the anticompetitive effects of a price-fixing agreement affecting

"two among thousands of compact discs" as "comparably obvious" is "absurd." *Id.* This is hardly a sufficient rebuttal argument. First, there is nothing fanciful about the conclusion that an agreement not to discount Three Tenors products is likely to harm consumers, including those consumers who purchase 3T1 and 3T2 at the artificially high price.[12]

In addition, as a matter of law, market power is not a necessary element for establishing liability in an abbreviated rule of reason case. *Law v. National Collegiate Athletic Ass'n*, 134 F.3d 1010, 1020 (10th Cir. 1998) ("[W]here a practice has obvious anticompetitive effects – as does price-fixing – there is no need to prove that the defendant possesses market power.").[13] The

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[12] It is entirely plausible that PolyGram and Warner have market power. Respondents' contentions that PolyGram and Warner charge very different prices in different territories (*i.e.*, engage in price discrimination) (RPF ¶¶ 78-80), and that 3T1 and 3T2 are uniquely capable of diverting sales from 3T3 (RPF ¶ 69), would support a finding (if such were necessary) that PolyGram and Warner have market power. *Cf. NCAA*, 468 U.S. 85, 116-17 n. 60 (NCAA's contention that restrictions on college football telecasts are necessary to protect live attendance rests on the assumption that football telecasts are a unique product, and belies NCAA's denial of market power); H. HOVENKAMP, XII ANTITRUST LAW ¶ 2032b at 185 (1999) ("[T]he minimum coverage for effective free rider protection is often the minimum coverage necessary to cartelize the entire market."); *In re Brand Name Prescription Drugs Antitrust Litig.*, 186 F.3d 781, 783 (7th Cir. 1999) ("The reason price discrimination implies market power is that assuming the lower of the discriminatory prices covers cost, the higher must exceed cost.").

[13] *Accord CDA*, 526 U.S. at 769-770; *NCAA*, 468 U.S. at 109; *Chicago Prof'l Sports*, 961 F.2d at 674; Summary Decision Order at 8-9. *See also* S. Calkins, California Dental Association: *Not a Quick Look But Not the Full Monty*, 67 ANTITRUST L.J. 495, 496 (2000) ("The most important lesson of *CDA* is that the defendant's principal argument throughout the proceeding – that the Commission could prohibit its restraints only through elaborate, formal proof of market power – was rejected."); T. Muris, California Dental Association v. Federal Trade Commission: *The Revenge of Footnote 17*, 8 S. CT. ECON. REV. 265, 306-07 (2000) (citations omitted):

> [In *CDA*, the] Court did not conclude that the lower court failed because it did not properly find market power. Although CDA vigorously raised the market power issue at all levels, the Court instead focused on the too hasty condemnation of restraints that in fact may well have been justified. The Court's description of 'quick look' analysis belies any claim that market power is necessary . . . . Thus,

relevant question is whether the restraints employed by PolyGram and Warner – an agreement not to discount and an agreement not to advertise – fall within a category of restraints that is likely to be anticompetitive absent an efficiency justification. Plainly, the answer to this question is yes; these are considered to be among the most serious and pernicious restraints that competitors may adopt. *See* Complaint Counsel's Post-Trial Memorandum at 24-35.

Respondents' contention that courts lack experience with restraints similar to those challenged in this case is baseless. This Court should be guided by *NCAA*, *BMI*, *Law*, and *Brown University* – all teaching that a horizontal agreement restricting price competition is presumptively anticompetitive. This Court should likewise be guided by *CDA*, *Mass. Board*, and *Blackburn v. Sweeney*, 53 F.3d 825 (7th Cir. 1995) all teaching that a broad ban on advertising is presumptively anticompetitive.[14]

The present case is fundamentally different from *Continental Airlines v. United Airlines*,

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> the application of abbreviated analysis focuses on the restraint itself rather than the market in which the restraint occurred.
>
> The Court is correct in not requiring a finding of market power . . . . [B]oth economic theory and economic evidence reveal the anti-consumer, price-increasing effect of restraints on advertising . . . . Under these circumstances, requiring market power is an unnecessary diversion that serves only to increase litigation costs and the probability that a restraint without consumer benefits escapes condemnation.

[14] In addition, the Court should give weight to the substantial body of economic literature establishing that advertising bans result in consumers paying higher prices. *See* Appendix A: Empirical Literature Concerning Advertising Restrictions, submitted with Complaint Counsel's Findings of Fact, Conclusions of Law, Memorandum of Law in Support Thereof and Order (April 26, 2002).

Even in the context of criminal antitrust enforcement, courts have held that the fact that a "scheme did not fit precisely the characterization of a prototypical per se practice does not remove it from per se treatment." *United States v. Andreas*, 216 F.3d 645, 667 (7th Cir. 2000).

277 F.3d 499 (4th Cir. 2002), upon which Respondents rely. The Court of Appeals determined that an agreement among airlines defining the size of the template placed adjacent to x-ray machines at airport luggage checkpoints did not have obviously anticompetitive effects. Courts have no prior antitrust experience with such agreements; there is no economic literature that addresses such agreements; the relationship between the templates and the price of air transportation is not obvious; and it was essential that the airlines collectively reach some agreement defining the size of the template. Given all of these distinguishing factors, the conclusion that the x-ray template agreement is not presumptively anticompetitive has no bearing on the present case.[15]

C. A Plausible Efficiency Benefit Is Not a Sufficient Defense

As detailed in Complaint Counsel's Post-Trial Memorandum (at 24), a finding that the Three Tenors moratorium is presumptively anticompetitive shifts to Respondents the burden of establishing a plausible and valid efficiency justification for these restraints. This is the rule of law stated by this Court in its Summary Decision Order.[16]

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[15] Respondents mistakenly assert that price and advertising competition among Three Tenors products was made possible by the PolyGram/Warner joint venture.

In *BMI*, the challenged restraint affected only competition made possible by the joint venture. 441 U.S. at 23-24 (price restraint applied to blanket license only; each individual collaborator remained free to sell its own music without restraint). Here, in contrast, the moratorium agreement constrains PolyGram and Warner from making unilateral decisions regarding their pre-existing, separately produced products. This is an additional reason for viewing the moratorium agreement as presumptively anticompetitive. *See* H. HOVENKAMP, XIII ANTITRUST LAW ¶ 2131c at 136-37 (1999) (courts should "require specific proof" justifying any efficiency defense for joint venture rules that limit members' output outside the venture).

[16] *See* Summary Decision Order at 10 ("If the Three Tenors moratorium price restrictions and advertising bans are *prima facie* anticompetitive, the burden shifts to the Respondents to advance a plausible and valid efficiency justification."); *id.* at 13 ("Respondents must show how

Respondents on the other hand contend that they are required to show only that it is conceivably true that the moratorium might have been efficiency-enhancing (with no obligation to produce evidence that the moratorium did in fact promote efficiency).[17] Respondents' contention that plausibility alone is sufficient, if accepted, would eviscerate abbreviated rule of reason analysis. The argument also is plainly contrary to the case law.

Respondents' argument would return antitrust analysis to the days of the strict *per se*/rule of reason dichotomy, with abbreviated analysis surviving in name only. Abbreviated rule of reason analysis would apply only where a defendant's attorneys and experts are too hapless to utter the words "free riding," or otherwise fail to assert any efficiency rationale (albeit knowing that no supporting evidence is required). Under Respondents' view of the law, naked cartel agreements would have to be analyzed under the fullest rule of reason where there is a plausible efficiency claim. And there is nearly always a plausible efficiency claim that can be asserted.

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the moratorium was necessary and how it benefitted consumers and competition.").

[17] According to Respondents, if the proffered efficiency rationale "is at least plausible," then the restraints must be analyzed under the fullest rule of reason, to determine whether the actual net effect of the restraints is anticompetitive. *E.g.*, Respondents' Post-Trial Brief at 4.

Respondents cite the *Antitrust Guidelines for Collaborations Among Competitors Issued by the Federal Trade Commission and the U.S. Department of Justice* § 2.3 (April 2000) ("Collaboration Guidelines") for the proposition that the competitive effects of the PolyGram/Warner venture and the moratorium agreement should be analyzed together. This fundamentally misconstrues the Guidelines. In general, the Guidelines instruct, antitrust analysis should address the competitive effects of the precise agreement that is alleged to harm competition. There are exceptional circumstances in which two agreements "are so intertwined" that they must be assessed together. Collaboration Guidelines § 2.3. Such exceptional circumstances are not present here. *See* W. Cohen & G. Zinfagna, *Inside the Competitor Collaboration Guidelines: The Forest Among the Trees*, 2000 U. CHI. L. FORUM 191 at 192 (2000) ("the cornerstone of [the Collaboration Guidelines is] a focus on the 'relevant agreement,' potentially as narrow as a single component of a complex collaboration, provided that the individual restraint's competitive effects can be meaningfully evaluated in isolation").

See In re SKF Indus., Inc., 94 F.T.C. 6, 103 ("Some efficiencies may, of course, result from almost any market allocation scheme . . ."). This is not what the Supreme Court intended when it relaxed the rule of *per se* liability in *NCAA* and *BMI*.

Not surprisingly, then, there are numerous cases imposing liability on the basis of an abbreviated rule of reason analysis where the defendant's efficiency argument, though plausibly true, was deemed an insufficient defense. *See* Complaint Counsel's Post-Trial Memorandum at 36 nn.46-49 and cases cited therein (plausible efficiency defenses have been rejected as invalid where the defense was speculative or unproven, where the argument swept too broadly, where there was a less restrictive alternative, and where the challenged restraint was not an effective remedy for the competitive problem that it purported to address). Free-riding defenses, on their face no less plausible than that advanced by Respondents here, were summarily rejected in *Chicago Prof'l Sports*[18] and *General Leaseways*.[19] A "marketing strategy" argument, on its face no less plausible than that advanced by Respondents, was summarily rejected in *NCAA*,[20] *Chicago Prof'l Sports*,[21] and *SKF*.[22] The contention that plausibility alone is sufficient to require

[18] 961 F.2d at 675 (free-riding defense rejected where co-venturers were able to share costs of advertising).

[19] 744 F.2d at 592 (free-riding defense rejected where co-venturers compensated one another for services provided).

[20] 468 U.S. at 114 (marketing strategy defense rejected where product of venture could be marketed just as effectively without challenged restraints).

[21] 961 F.2d at 674 (rejecting argument that joint venture should be permitted to market output on an exclusive basis, similar to a single firm).

[22] 94 F.T.C. at 103 (rejecting argument that market division agreement is necessary to enable firms to achieve economies from specialization).

full rule of reason review of presumptively anticompetitive restraints cannot be reconciled with these cases.[23]

Contrary to Respondents' argument, *CDA* does not support the proposition that a plausible efficiency benefit is a sufficient defense. The *CDA* Court instructed that where likely anticompetitive effects are obvious, the burden then shifts to the defendants "to show empirical evidence of procompetitive effects." *CDA*, 526 U.S. at 775 n.12. A plausible efficiency justification is, in such cases, not sufficient to require a plenary market analysis under the rule of reason.[24]

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[23] Respondents quibble with the proposition that, to be judged reasonable, a suspect ancillary restraint must be necessary for the formation or efficient operation of the underlying collaboration. Respondents' Post-Trial Brief at 24-29. The cases cited by Respondents support Complaint Counsel's position. The restraints evaluated in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221 (D.C. Cir. 1986), made the van line network more efficient, and no alternative was proposed. In each case cited by Respondents where the Court found that the challenged restraint was not necessary (*i.e.*, where there was a less restrictive alternative), the restraint was judged illegal. *NCAA*, 468 U.S. at 114; *Chicago Prof'l Sports*, 961 F.2d at 676. *Accord* Collaboration Guidelines at § 3.36(b) ("The Agencies consider only those efficiencies for which the relevant agreement is reasonably necessary . . . [i]f the participants could have achieved . . . similar efficiencies by practical, significantly less restrictive means, then the Agencies conclude that the relevant agreement is not reasonably necessary to their achievement.").

If a suspect restraint is judged necessary to the efficient operation of the joint venture, then it generally will be reviewed under the full rule of reason. In other words, a finding of necessity does not end the inquiry. *E.g.*, *BMI*, 441 U.S. at 24-25. Thus, Respondents' contention (Respondents Post-Trial Brief at 25) that ancillary restraints judged necessary to the efficient operation of a venture are *per se* lawful is mistaken. *Id.* (*BMI* case remanded for full rule of reason review of blanket license).

[24] Respondents' brief cites to every use of the term "plausible" in the *CDA* opinion. Some sensitivity to context is necessary. As Professor Hovenkamp points out, plausible can mean many things, from "barely possible" to "likely." "The Supreme Court did not mean that any time competitors could offer a plausible explanation that their price- or output-affecting agreement was procompetitive they were entitled to full rule of reason treatment." P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 2023.1c8 at 519 (2001 Supp.). *See also* S. Calkins, *supra* note

As described below, Respondents have not advanced sufficient evidence to validate their efficiency arguments; these contentions should therefore be summarily rejected.

II. The Moratorium Was Not Necessary for the Effective Marketing of 3T3

Respondents assert in conclusory fashion that the Three Tenors moratorium was necessary for the effective marketing of 3T3. The analysis is unpersuasive, and the requisite evidence is lacking. In addition, the underlying premise of Respondents' argument, that marketing activity for similar products sold by competing companies must be coordinated, is incompatible with the antitrust laws. For all of these reasons, this defense is not valid.

The analysis starts with the following uncontested background facts: It is common for recording artists, over the course of a career, to release albums with more than one record label. CPF ¶ 371. This means that the company releasing the new recording is forced to compete with the company that distributes the artist's older, catalogue recordings. It is the experience of the recorded music industry that every time an artist switched labels, the new album was released and marketed without an agreement constraining competitive activity in support of the catalogue albums – except 3T3. *See, e.g.*, RPF ¶ 149 (the "relevant witnesses were . . . unaware of any other situation in which any similar agreement has been considered or implemented"). For example, in 1994, Warner released 3T2 without a restraint on PolyGram's promotion of 3T1. CPF ¶ 233. In 2000, Sony released the Three Tenors Christmas album without restricting promotion of older Three Tenors albums. CPF ¶¶ 229-232. Why then was it necessary to

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13 at 549 ("In *CDA*, the Supreme Court was invited to hold that whenever a defendant can point to 'facially plausible' efficiencies, scrutiny of its actions must proceed under the full-blown rule of reason – the Full Monty. The Court refrained from doing so.").

suppress discounting and advertising of older Three Tenors albums in order to effectively market a new recording during 1998, but not in 1994 or 2000?

The proffered explanation, in its entirety, is limited to a single sentence: According to Respondents, discounting and advertising of older Three Tenors albums "could have jeopardized the potential success of the new album by sending a confusing message to consumers and the trade and diverting the operating companies' focus away from the new album." Respondents' Post-Trial Brief at 42. Which is to say, competition is messy: sometimes confusing for buyers, sometimes distracting for sellers. Certainly, more is needed before courts can abandon inter-firm rivalry for a world of moratoriums, price fixing, and advertising bans. *See NSPE*, 435 U.S. at 696 ("[T]he Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.").[25]

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[25]*See also* H. HOVENKAMP, XI ANTITRUST LAW ¶1907c at 221-23 (1998):

> [O]ne class of cost reductions is commonly ignored – namely, the costs of operating the competitive market system . . . . A simple agreement among breakfast cereal manufacturers to not advertise their products could thus reduce costs significantly, but we would not expect a court to apply a rule of reason inquiry to such an agreement, determining if possible the gains from reduced advertising expenses, and balancing these against threats to competition. The reason is that communicating information to consumers about a market's competitive offerings is essential to our conception of competition. Indeed, a sine qua non of a well-functioning market is well-informed participants, and an agreement to not advertise threatens the right of consumers to become well-informed . . . .
>
> Our entire market system is built on the premise that [the costs of operating the competitive system] are worth their price in the great majority of circumstances. Further, a rule that permitted judicial consideration of claimed cost reductions would be often asserted, be extremely expensive to administer, be prone to the production of many errors, and free only a small number of defendants from liability.

As detailed in Complaint Counsel's Post-Trial Memorandum, there is no evidence of actual or likely consumer confusion in selecting among the various Three Tenors recordings. Complaint Counsel's Post-Trial Memorandum at 60-64; *see also* CPF ¶¶ 347-350.[26] And in any event, the appropriate strategy for addressing consumer confusion is to provide potential consumers with additional and clearer information (*e.g.*, through distinctive packaging and effective advertising). CPF ¶¶ 351-355. Price fixing and restrictions on truthful, non-deceptive advertising are not a necessary or legitimate remedy, especially when selling ordinary commercial products. *CDA*, 526 U.S. at 773 & n.10.

Similarly, there is no evidence that music retailers (what Respondents refer to as "the trade") were confused by the availability of multiple Three Tenors products, or were incapable of simultaneously marketing 3T1, 3T2, and 3T3 in a non-confusing manner. If it were important to PolyGram and Warner that 3T3 be presented to consumers in a display area that did not also contain older Three Tenors albums, then this could have been negotiated with the retailers. CPF ¶¶ 356-359. Respondents' expert witness agreed that suppliers often compensate retailers in return for favorable store placement and special services. Wind Dep. (JX 91) 81:20-86:9; CPRF

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[26] Even if PolyGram and Warner employees (together with Respondents' litigation experts) believe that the moratorium was necessary, these opinions are insufficient to validate the "sound marketing strategy" defense. *See* Complaint Counsel's Post-Trial Memorandum at 64-68. Courts have recognized a variety of methods for demonstrating consumer confusion. *See ConAgra Inc. v. Hormel & Co.*, 784 F.Supp. 700, 722 (D. Neb. 1992) ("[C]onsumer surveys, designed to determine the existence of likelihood of confusion, are frequently conducted and received into evidence."); *PPX Enters. v. Audiofidelity Enters.*, 818 F.2d 266, 271 (2d Cir. 1987) ("Actual consumer confusion often is demonstrated through the use of direct evidence, e.g., testimony from members of the buying public, as well as through circumstantial evidence, e.g., consumer surveys or consumer reaction tests."); *Gillette Co. v. Wilkinson Sword, Inc.*, 1992 U.S. Dist. LEXIS 1265, *2 (S.D.N.Y 1992).

¶ 144.[27] Given this less restrictive alternative, PolyGram and Warner are not permitted to act in concert to impose their preferred marketing plan upon the trade. *Fashion Originators' Guild of America v. F.T.C*, 312 U.S. 668 (1941).

Most implausible of all is the claim that concerted action was required in order to ensure that Warner's operating company in the United States would "focus" appropriate resources upon 3T3. First, PolyGram's U.S. operating company was not involved in marketing or distributing 3T3 in the United States. (This was solely Warner's responsibility.) CPF ¶ 299. Hence, leaving PolyGram free to market 3T1 in the United States would not have diverted any resources from the marketing of 3T3. Second, the suggestion that Warner's U.S. operating company lacked sufficient resources simultaneously to market 3T2 and 3T3 is far-fetched. CPF ¶¶ 190-194. At any given time, Warner is marketing hundreds of different albums.[28] Finally, Warner was free – without an agreement – to instruct its U.S. operating company to focus all of its attention and resources on 3T3. As concerted action was not necessary to enable Warner to "focus" upon 3T3, this efficiency defense must be rejected. *See Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 352-353 (1982); *In re Detroit Auto Dealers Ass'n.*, 111 F.T.C. 417, 500; *SKF*, 94 F.T.C. at 103.

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[27] *See also Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.*, 94 F. Supp. 2d 804, 816 (E.D. Ky 1999) (describing practice in the soft drink industry whereby a manufacturer compensates retailers in exchange for the retailers' commitment to advertise, discount, promote, and/or display that manufacturer's products on an exclusive basis); *In re Coca Cola Bottling Co. of the Southwest*, 118 F.T.C. 452, 551-52 (1994) (same).

[28] O'Brien 394:19-395:5.

A similar efficiency argument was considered and rejected by the Commission in *SKF*. Competition was eliminated when one firm agreed to limit its activity to manufacturing bearings, and a second firm agreed to limit its activity to the distribution of bearings. The Commission explained that this market division agreement would not be justified by the claim that each firm is now able "to concentrate on the specialized production at which it is most efficient." *SKF*, 94 F.T.C. at 103. The Commission recognized that such an argument could be advanced in defense of any market division agreement. *Id.* In addition, if specialization is required, then a firm could unilaterally adopt this strategy (indeed, "these are efficiencies that a competitive market is likely to force upon a firm in the long run in any event"). *Id.*[29]

In sum, the Three Tenors moratorium agreement was not necessary to assure the efficient marketing of 3T3, and therefore the proffered efficiency defense must be rejected. *NCAA*, 468 U.S. at 114.[30]

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[29] Respondents charge that Complaint Counsel would "require [PolyGram and Warner] to engage in conduct they viewed as completely antithetical to the purposes of their venture." *See* Respondents' Post-Trial Brief at 41. This is incorrect. Complaint Counsel's view of the law is that the parties are not required to discount, and are not required to advertise 3T1/3T2. PolyGram and Warner are obligated only to make unilateral decisions with regard to their separate products.

[30] In addition to the other deficiencies noted, Respondents' "sound marketing strategy" argument is premised upon a faulty reading of the evidence. PolyGram Vice President Bert Cloeckaert testified that it was <u>not necessary</u> to suppress promotion of 3T1 and 3T2 in order to achieve an effective launch of 3T3. Cloeckaert Dep. (JX97) 97:23-98:7 ("It's an open debate of how do you promote your back catalog related to new release, and there are as many views as there are labels and people as there are labels."). Respondents' marketing expert, Dr. Wind, favored coordinating the marketing of 3T1, 3T2, and 3T3, but did not opine that it was necessary for the parties to forgo discounting and advertising for the catalogue products. Wind Dep (JX 91) 10:12-11:20. Finally, the observation of Complaint Counsel's expert, Professor Catherine Moore, that when marketing a new release, it makes sense to "take into account" the existence of catalogue recordings by the same artist (Moore 153:12-17), is not an endorsement of the moratorium. As Professor Moore explained, 3T3 could be distinguished from earlier Three

III. The Moratorium Agreement Was Not Necessary to Avoid Free Riding

Respondents have established none of the required elements of a valid free-riding defense, as identified by the Commission in In re *Toys "R" Us, Inc.*, 126 F.T.C. 415, 600-07 (1998), *aff'd*, 221 F.3d 928 (7th Cir. 2000).[31]

For antitrust purposes, a significant free-riding problem exists only if there were a danger that, absent a restraint, Warner would find it unprofitable to advertise 3T3 upon its release because of sales lost to 3T1 and 3T2. Measured by this standard, the free-riding problem here was not significant. Warner executive Anthony O'Brien testified that, with or without the moratorium, Warner would have aggressively and appropriately promoted 3T3 in the United States during its initial release period (August to October 1998). O'Brien 490:19-22. For Warner to cut-back on advertising would have been, in O'Brien's view, to shoot itself in the foot. O'Brien 448:12-21.

O'Brien's acknowledgment that the moratorium was not necessary to remedy a free-riding problem is consistent with Warner's experience marketing 3T2 during 1994. No moratorium agreement was in place when 3T2 was released, and still 3T2 was aggressively promoted by Warner. CPF ¶¶ 233-242, 255-256. Any free-riding problem confronting Warner in 1998 should have been less pronounced than in 1994 – given that approximately half of the

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Tenors albums, and effectively launched, without suppressing competition between PolyGram and Warner. Moore 119:19-124:7

[31] Respondents must show that: (i) absent the moratorium agreement, free riding was likely to have the effect of eliminating advertising in support of 3T3 from the marketplace; (ii) there were no reasonable means by which PolyGram and Warner could share the costs of advertising 3T3; and (iii) there were no other less restrictive alternatives.

diverted sales would go to Warner (3T2) and only half to competitor PolyGram (3T1), and given that in 1998 PolyGram was compensating Warner for the advertising expenditures. CPRF ¶ 91.[32]

Respondents answer by citing the following testimony: The volume of 3T3 sales during the moratorium period will influence the venturers' judgment as to how much advertising should be funded following the moratorium period; if 3T3 is very successful during August, September, October 1998, then the album will continue to be promoted aggressively. This testimony has absolutely nothing to do with free riding, consumer welfare, or the moratorium agreement. To the extent that there is a free-riding problem that may diminish 3T3 sales, the moratorium addresses that problem (and boosts 3T3 sales) only when it is in effect. There has been no rational explanation for why the moratorium should impel Warner to invest more money in advertising 3T3 during the post-moratorium period. Not only is Respondents' analysis faulty, the necessary supporting evidence is absent. Respondents have offered no evidence that Warner's decision regarding advertising expenditures for the post-moratorium period was in fact influenced by the existence of the (then-expired) price and advertising restraints. CPRF ¶ 108. If

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[32] Respondents state that PolyGram and Warner were principally concerned about the danger of free riding "outside the United States." Respondents' Post-Trial Brief at 49 n.15. Accordingly, the moratorium should have been implemented outside the United States, if at all.

Respondents rely upon *Polk Brothers v. Forest City Enterprises, Inc.*, 776 F.2d 185, (7th Cir. 1985), involving a joint venture between two chain stores (one selling appliances and one selling hardware) to build a new store from which both firms could operate. The venturers agreed that, at the new facility, they would sell complementary but not competing lines of merchandise. *Polk Brothers* is distinguishable in two significant respects. First, according to the Court of Appeals, the ancillary agreement not to compete was necessary in order to induce the parties to enter into the venture in the first place. 776 F.2d at 190. Second, the restraint limited only sales from the joint venture facility. 776 F.2d at 187.

there were an effect, was it minuscule or substantial? Respondents offer no information, and hence have not met their burden to demonstrate that the free-riding problem was significant.[33]

Assuming, contrary to the evidence, that there was a significant free-riding problem here, the Court would then need to consider whether there were remedies less restrictive than the moratorium agreement. Respondents do not deny that PolyGram and Warner could have (and did) share the cost of advertising 3T3. As a matter of law, this defeats the asserted free-riding defense. *High Technology Careers v. San Jose Mercury News*, 996 F.2d 987, 992 (9th Cir. 1993) (free-riding defense fails because the alleged free-rider "paid what it was asked to pay"); *Chicago Prof'l Sports*, 961 F.2d at 675 ("Free-riding is the diversion of value from a business rival's efforts without payment . . . . When payment is possible, free-riding is not a problem because the 'ride' is not free."); *General Leaseways*, 744 F.2d at 592; *United States v. Microsoft Corp.*, 1998-2 Trade Cas. (CCH) ¶ 72, 261 at 82,682 (D.D.C. 1998); *Toys "R" Us, Inc.*, 126 F.T.C. at 601 ("[Free-riding] concerns evaporate because TRU is compensated for the services, and there is no threat that the services will be driven from the market."), *aff'd*, 221 F.3d 928, 938 (7th Cir. 2000) ("[The toy] manufacturers were paying for the services TRU furnished, such as advertising, full-

[33] Respondents' brief misstates the evidence regarding the promotion of 3T2 by WMI. In late 1997, O'Brien expressed concern that, if as part of the negotiations for the 3T3 project, WMI demanded that Tibor Rudas reduce his royalty on 3T2, then this (the royalty demand, not discounting) could "blow the deal" with Rudas. CPRF ¶¶ 94-96

When the collaboration agreement was entered into, there was no agreement between PolyGram and Warner to restrict the marketing of 3T2 by WMI. Christopher Roberts, President of PolyGram Classics, testified that he would have endorsed the 3T3 project even if there were reason to expect discounting of 3T2 by Warner upon the release of 3T3. Roberts (JX 93) 143:20-144:1.

line product stocking, and extensive inventories . . . . [T]hus these services were not susceptible to free riding.").

These cases reject a free-riding defense when compensation is possible, and Respondents' attempts to distinguish these precedents are not persuasive. Respondents point out that PolyGram and Warner may both benefit from advertising for 3T3. But in *Chicago Prof'l Sports*, every team in the National Basketball Association was in a position to benefit from the league's promotional expenditures. Similarly, in *General Leaseways*, all members of the venture benefitted from the repair services guaranteed by the association. In this regard, there is nothing unique about the structure of the PolyGram/Warner venture.

Respondents charge that PolyGram and Warner would continue to have an incentive to discount and promote their catalogue Three Tenors products regardless of how financial responsibility for 3T3 advertising is allocated.[34] From the standpoint of consumers, this is a good thing; this is confirmation that sharing advertising expenses is less restrictive of competition than the moratorium agreement. Stated differently, the cost-sharing mechanism assures that the venture has appropriate incentives to advertise 3T3, while preserving the individual venturers' incentives to market 3T1 and 3T2.

Finally, Respondents cannot complain that the allocation of advertising expenses as between PolyGram and Warner does not precisely match the division of benefits. First, there is no evidentiary basis for such claim. Second, the parties themselves decided to share advertising

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[34] Respondents refer to this as a continuing "incentive to free ride," but this is a misnomer. Since no firm is taking free advantage of the 3T3 advertising, there is no free riding as that term is used in the antitrust cases. CPRF ¶¶ 139-142.

costs on a 50:50 basis; they were free to adopt a different cost-sharing mechanism, or change the allocation of costs at any time. CPF ¶¶ 335-340; CPRF ¶ 141-142. Finally, so long as advertising for 3T3 is continued, the allocation of costs is of no antitrust concern. *TRU*, 126 F.T.C. at 602.

IV. The Moratorium Was Not Necessary for the Release of Future Three Tenors Albums

Respondents assert that the moratorium was justified because it assures that, at some time in the future, PolyGram and Warner will produce a Three Tenors Greatest Hits album and a Three Tenors box set. This efficiency argument is not supported by the evidence, and is deficient as a matter of law.

No witness testified that the decision of PolyGram and Warner regarding whether to release future Three Tenors albums will be affected by the moratorium agreement. No logical connection between the moratorium agreement (implemented in 1998), and a future Three Tenors album (released some time after 2002) has been identified.

During cross-examination, Dr. Stockum was asked to assume that discounting and advertising of 3T1 and 3T2 following the release of 3T3 results – over the long term – in lower total sales of all Three Tenors products. Respondents' have re-packaged this colloquy so as to suggest that Dr. Stockum pronounced this assumption about long-term effects to be valid. In fact, Dr. Stockum opined that he was aware of no evidence that the moratorium agreement would

lead to increased total output. CPRF ¶¶ 139-142. On this issue, Dr. Stockum is undoubtedly correct.[35]

Respondents have not offered so much as an explanation as to why the release of Three Tenors albums some years hence should depend upon a moratorium agreement in effect four years ago. To the extent that the moratorium leads to higher market prices and greater profits (without a legitimate efficiency), this may make it more attractive for PolyGram and Warner to introduce new products. But this is simply a by-product of cartelization, and not a valid efficiency defense. *See Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 649 (1980):

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

See also FTC v. Superior Court Trial Lawyers Assoc., 493 U.S. 411, 423 (1990) (contention that price-fixing agreement increased incentives for new entry is not a valid defense).[36]

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[35] Several contemporaneous documents express concern that 3T3 will lose sales to 3T1 and 3T2. No document evidences a concern that total output of Three Tenors products will decline without the moratorium. CPRF ¶¶ 54-55. Moreover, the opinion of any expert witness or PolyGram employee that the moratorium is pro-competitive is of little evidentiary value absent supporting evidence and a convincing rationale.

[36] Respondents' claim that the short-term costs of the moratorium (higher prices, reduced promotion for the older albums) were necessary in order to achieve some future benefit is too speculative to constitute a legitimate antitrust defense. Professor Hovenkamp counsels that, in determining whether a suspect restraint is reasonable, courts should look at the short-run or immediate consequences of the restraint, rather than the hypothesized long-run effects. The analysis is fully applicable here. *See* H. HOVENKAMP, XI ANTITRUST LAW ¶ 1906b at 212-213 (1998):

V. The Moratorium Was Not Necessary to Protect Confidential Information

Respondents claim that the moratorium helped assure that neither PolyGram nor Warner would free ride on the "confidential marketing plans developed by the joint venture partners for the new album." Respondents' Post-Trial Brief at 45-46. This argument is pretextual and entirely without merit.

No witness, and no document, suggests that the moratorium was intended to protect against the misuse of confidential marketing plans. This is the attorneys' post hoc rationalization for the moratorium agreement, and is therefore not a valid defense. *See* Complaint Counsel's Post-Trial Memorandum at 44.

There is no evidence that PolyGram and Warner exchanged confidential marketing information relating to 3T3. CPRF ¶¶ 41-50. Even if, hypothetically, confidential marketing information were exchanged, Respondents have not shown that such information would be susceptible to free riding. *See* Collaboration Guidelines Example 10 ("As a general matter, participants' contributions of marketing assets to the collaboration could more readily be monitored than their contributions of know-how, and neither participant may be capable of

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> The principle reason for rejecting defenses that a restraint is competitive in the long run is that proof is nearly always highly speculative and the defense could be asserted so often that it would effectively undermine a large proportion of instances properly subject to per se disposition . . . .
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> [T]he argument effectively includes an admission that the challenged arrangement does produce short-run consumer losses from higher prices and reduced output. Even if there are offsetting gains, courts are ill-equipped to balance immediate and certain losses against future and uncertain gains, particularly considering that such gains would have to be discounted to take into account both that they will be achieved only in the future and that the likelihood of their occurrence is less than 100 percent.

misappropriating the other's marketing contributions as readily as it could mis-appropriate know-how.").

Finally, the hypothetical problem could have been remedied by ensuring that the individuals responsible for marketing 3T1 (for PolyGram) and 3T2 (for Warner) did not have access to competitively-sensitive information regarding 3T3.[37]

VI. The Moratorium Agreement Was Not an Ancillary Restraint

Respondents have identified no case in which joint venture partners were permitted to fix the selling price for their non-venture output: products separately produced, separately distributed, pre-dating the collaboration, and not part of the integration.[38] Instead, Respondents rely upon the vague assertion that the moratorium agreement was adopted "in the context of" a joint venture. This claim has no legal significance. *Engine Specialties, Inc. v. Bombardier, Ltd.*, 605 F.2d 1, 11 (1st Cir. 1979) ("The talisman of 'joint venture'" cannot save otherwise inherently anticompetitive behavior from condemnation under the *per se* rule). Here, as in *General Leaseways*, "the organic connection between the restraint and the cooperative needs of the

[37] Because of the structure of the PolyGram/Warner venture, this remedy would have been simple to implement. Representatives of PolyGram's U.S. marketing operation (responsible for 3T1) had no marketing responsibility for 3T3, and did not attend the marketing meetings for this product. Similarly, representatives of Warner's non-U.S. marketing operation (WMI, responsible for 3T2) had no marketing responsibility for 3T3, and did not attend the marketing meetings for this product. CPF ¶ 123; CPRF ¶¶ 41-50.

[38] The cases cited by Respondents are inapposite. In *Polk Brothers*, 776 F.2d at 185, two chain stores collaborated to build a new facility. The challenged restraints applied only to sales from the jointly constructed facility. In *Rothery*, 792 F.2d at 210, independent moving companies joined a network that provided centralized services, equipment, and national marketing. The challenged restraints applied to the use of joint venture assets only.

enterprise that would allow us to call the restraint a merely ancillary one is missing." 744 F.2d at 595.

The analogy between the present case and *Palmer v. BRG*, 498 U.S. 46 (1990), is compelling. In *Palmer*, one bar review service (HBJ) granted its competitor an exclusive license to market its teaching materials in the state of Georgia; in return, HBJ extracted a promise that the licensee would not compete with HBJ in the other forty-nine states. The Supreme Court judged the arrangement to be *per se* unlawful. *Id.* at 49. Here, Warner has licensed its competitor PolyGram to market 3T3 outside of the United States; in return, Warner has extracted a promise that (for a term) PolyGram would not compete with Warner inside the United States. As in *Palmer*, the restriction on competition is only tenuously related to the parties' collaboration, and should be summarily condemned.[39]

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[39] Respondents' acknowledgment that the parties are not committed to produce future Three Tenors products incorporating selections from 3T1 and 3T2 (Respondents' Post-Trial Brief at 42-43, 46) supports Complaint Counsel's contention that 3T1 and 3T2 should be considered to be "outside" of the PolyGram/Warner collaboration to distribute 3T3.

Another case that highlights the distinction between restraints upon products inside versus outside the venture is *In re General Motors Corp. and Toyota Motors Corp.*, 103 F.T.C. 374 (1984), *vacated*, [FTC Complaints & Orders 1993-1997 Transfer Binder], Trade Reg. Rep. (CCH) ¶ 23,491 (F.T.C. 1993). The Commission approved a manufacturing joint venture between General Motors and Toyota, subject to certain restrictions on the exchange of competitively-sensitive information aimed at reducing the likelihood of collusion between the manufacturers with regard to non-venture products. The Commission later agreed to vacate these fencing-in provisions because they were deemed to interfere with the efficient manufacture of the joint venture automobiles. Contrary to Respondents' representation, in vacating the order, the Commission did not authorize General Motors and Toyota to agree to restrict competitive activity for their non-venture products. *See* H. HOVENKAMP, XIII ANTITRUST LAW ¶ 2131c at 136 (1999) ("[A]lthough General Motors and Toyota cannot operate a joint venture manufacturing plant without settling on production limits, there is no obvious reason why they must also agree to limit their output outside the venture as well. In most cases of productive joint ventures, the benefits of the venture can be fully realized without significantly hampering the venturers' nonventure business.") (citations omitted).

VII. <u>A Cease and Desist Order Should Issue Against Respondents</u>

The Court should issue an order enjoining Respondents from again agreeing with a competitor to fix prices or restrict advertising. Respondents contend that a cease and desist order in this case is inappropriate because the circumstances leading to the Three Tenors moratorium are so "unique and unprecedented" that there is no danger that they might recur. Respondents' Post-Trial Brief at 53-54. This misconstrues the function of a Commission order.

The purpose of a remedial order is not simply to prevent recurrence of the precise illegal conduct that gave to liability. The Court should also enjoin similar conduct arising in comparable market contexts. *See FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952) ("[T]he Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past . . . . [I]t cannot be required to confine its road block to the narrow lane the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity."). *See also FTC v. Morton Salt Co.*, 334 U.S. 37, 51-52 (1948); *FTC v. Beech-Nut Packaging Co.*, 257 U.S. 441, 455-456 (1922) (cease and desist order applied to the practices found illegal and "any other equivalent cooperative means of accomplishing the maintenance of prices fixed by the company"); *In re Wilmington Chemical* Corp., 69 F.T.C. 828, 916 (1966) (cease and desist order entered even though impossible for respondents to resume the same business).

The fact that certain PolyGram corporations have merged with Universal Music Group should not deter the Court from issuing an order against Respondents, the successor corporations. *Cf. B & J School Bus Service, Inc.*, 116 F.T.C. 308 (1993) (consent decree issued against successor corporations). In the course of Respondents' business, situations are likely to arise –

similar to the 3T3 project – in which Respondents have both an incentive and an opportunity to fix prices and restrict advertising for competing products. CPF ¶¶ 371-374. An order will deter Respondents from agreeing in the future to a moratorium on competitive activity.

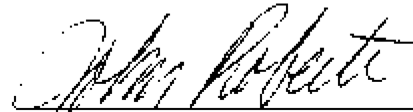
CONCLUSION

PolyGram and its horizontal competitor, Warner, agreed to fix prices and ban advertising for certain audio and video products featuring the Three Tenors. Because the moratorium agreement restricted basic forms of competition, it is presumptively anticompetitive. Respondents have not met their burden of demonstrating a valid efficiency justification for this conduct. Instead, they point to commonplace marketing challenges faced by every seller.

Did the parties anticipate difficulty distinguishing a new product in a crowded marketplace? If so, many tools were available to the marketers, including discounting, advertising, public relations, packaging, and product design. It was not necessary or pro-competitive for PolyGram and Warner to agree that marketing activities for competing products would be withheld. Was there a risk that consumers may choose close substitutes 3T1 and 3T2 in lieu of the advertised product, 3T3? If so, the magnitude of free riding anticipated in the United States was sufficiently small as not to undermine Warner's incentives to advertise 3T3. In any event, any free-riding problem was remedied because PolyGram and Warner were sharing the costs of such advertising.

The Court should issue an order that enjoins Respondents from, in the future, agreeing with competitors to restrict price competition or to forgo advertising.

Respectfully submitted,



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Bureau of Competition
Federal Trade Commission
Washington, D.C.

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