UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS: Timothy J. Muris, Chairman
Sheila F. Anthony
Mozelle W. Thompson
Orson Swindle
Thomas B. Leary

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

RESPONDENTS' *CORRECTED* REPLY BRIEF ON APPEAL FROM INITIAL DECISION AND ORDER

I. INTRODUCTION

Complaint Counsel portray PolyGram as the party that is asking the Commission to adopt sweeping new principles of antitrust law in this case. Thus, Complaint Counsel contend that PolyGram is seeking to "jettison the core principles of abbreviated rule of reason analysis," and to "return antitrust analysis to the days of the strict *per se*/rule of reason dichotomy, with abbreviated analysis surviving in name only, " and that a decision in PolyGram's favor "would effectively abolish abbreviated rule of reason analysis." CCAB at 2, 28, 32. A reversal of the Initial Decision clearly would not cause any portion of this parade of horribles to come to pass. After all, Complaint Counsel chose not to present *any* evidence that the moratorium – a ten-week restriction on the discounting and promotion of two older Three Tenors products that PolyGram and Warner adopted as part of their joint venture for the creation of new Three Tenors products – had any anticompetitive effect in any relevant market, and their expert economist admitted that he was unaware of any such effect. Complaint Counsel's expert economist also admitted that it was plausible that this alleged restraint, which all of the relevant witnesses testified was an important part of their efforts to compete in a crowded market place and to act in the long-term best interests of the Three Tenors brand, was procompetitive in the context of the joint venture. And Complaint Counsel failed to present any evidence that there is any real threat that PolyGram will enter into any similar agreement in the future absent the sweeping "cease and desist" order adopted by the Initial Decision. Any of these evidentiary failures in Complaint Counsel's case should result in a decision in PolyGram's favor without any need to test the boundaries of abbreviated analysis under the antitrust laws and without jeopardizing the Commission's ability to pursue cases involving conduct that actually harms competition.

Rather, it is an affirmance of the Initial Decision, not a decision in PolyGram's favor, that would require the Commission to rewrite the antitrust laws. More than two decades of controlling case law make clear that the Initial Decision was wrong and should be reversed. Controlling law establishes that any antitrust challenge to an alleged restraint that was reasonably

related to a joint venture is governed by the rule of reason, *see NCAA v. Board of Regents*, 468 U.S. 85 (1984); *Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n*, 961 F.2d 667 (7th Cir. 1992)**;** the Initial Decision nonetheless holds that the moratorium is illegal *per se.* Controlling law establishes that, under the rule of reason, there can be no violation absent at least some evidence that the challenged practice had some anticompetitive effect, *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 771-81 (1999); the Initial Decision nonetheless permitted Complaint Counsel to prevail under a "presumption" that the moratorium was anticompetitive that was based purely on the theoretical observations of an economist who admitted that he was unaware of any actual effect on competition in the United States, that the moratorium may well have been procompetitive or competitively neutral, and that he had done nothing to analyze the effects of the moratorium in the context of the Three Tenors joint venture and the United States music industry. Controlling law establishes that the presence of any plausible procompetitive justification for a challenged practice triggers a need for a more detailed analysis of its actual effects under the rule of reason, *id.*; the Initial Decision nonetheless concluded that PolyGram's inability to show that the moratorium was "necessary" to its overall joint venture established a violation notwithstanding Complaint Counsel's decision not to offer any evidence of anticompetitive effect. And controlling law establishes that a "cease and desist" order may issue only upon an evidentiary showing that there is some "real threat" that similar conduct will recur absent entry of the order, *United States v. Oregon State Med. Soc'y*, 343 U.S. 326, 333 (1952); the Initial Decision nonetheless entered a sweeping "cease and desist" order the absence of any evidentiary basis for concluding the order was needed to prevent PolyGram from entering into similar agreements in the future. In short, at every step in its analysis, the Initial Decision ignored the controlling case law to permit Complaint Counsel to prevail despite their complete failure to make the evidentiary showings required to satisfy the governing legal standards.

PolyGram respectfully requests that the Commission exercise its *de novo* review to reaffirm the application of these well-established principles of antitrust law to the facts of this

case. There is no authority to support the positions urged by Complaint Counsel and adopted by the Initial Decision in this case. The Initial Decision should be reversed in its entirety.

II. ARGUMENT

A. Complaint Counsel Mischaracterize Both The Three Tenors Joint Venture And The Limited Moratorium On The Discounting And Promotion Of The Older Three Tenors Products.

Complaint Counsel's description of the Three Tenors joint venture and the moratorium agreement that PolyGram and Warner adopted as part of that joint venture shows little fidelity to the evidentiary record. As the Commission will find during its *de novo* review of the record, the witness testimony and the contemporaneous documents provide no support for the version of the facts that was urged by Complaint Counsel and adopted by the Initial Decision. The evidentiary record instead makes clear that the moratorium was closely related to the procompetitive purposes of the Three Tenors joint venture and was adopted for the procompetitive reasons identified by PolyGram.

1. The Three Tenors Joint Venture Was Not Limited To The "Distribution" Of The New Album.

The joint venture was not, as Complaint Counsel contend, simply a joint venture for the "distribution" of 3T3. CCAB at 1 ("PolyGram and Warner formed a joint venture to distribute [3T3]"), 6 (both parties "were interested in acquiring the right to distribute the 3T3 products"), 54 (claiming that moratorium had "no tangible nexus" to the "agreement to share distribution rights"). As part of their joint venture – which included the Paris concert, the creation, marketing and distribution of 3T3; the creation, marketing and distribution of the greatest hits and/or box set albums; and the substantial joint investments required for those activities to occur – PolyGram and Warner agreed to "consult and coordinate" with one another regarding "*all* marketing and promotion activities" relating to their joint venture. RPF 41 (JX10 ¶ 4). From the outset, PolyGram and Warner planned to work together closely in developing the marketing plans for 3T3 and recognized that each would have access to the other's confidential

marketing plans for 3T3. RPF 43. PolyGram and Warner were, as Mr. O'Brien testified, "full partners" in their Three Tenors joint venture and consequently had a legitimate and common interest in maximizing the long-term success of the Three Tenors brand and the long-term output of Three Tenors products. RPF 50.[1]

2. The Joint Venture Agreement Did Not Establish The Scope Of Any "Covenant Not To Compete" And Did Not Identify And Define All Of The Important Aspects Of The Joint Venture.

Complaint Counsel's contention that the joint venture agreement was intended to establish "the scope of any covenant not to compete," CCAB at 6-7; IDF 61, also is unsupported by the record. No witness confirmed Complaint Counsel's hypothesis that the agreement was intended to set forth the full extent of any agreement not to compete, and no contemporaneous document supports Complaint Counsel's view that the "holdback" provision in the contract constitutes a "covenant not to compete" or that the exception to that provision under which the parties remained free to "exploit" 3T1 and 3T2 reflected a view that no restrictions whatsoever on the marketing of the prior albums would be required during the launch period. RPF 46-47. The exception to the holdback provision was not the subject of any separate negotiation, as Complaint Counsel suggest. *Id.* Rather, it was drafted and revised as the parties exchanged their proposed revisions to the entire agreement. CX 357-59, 361-62. Neither the "holdback" provision nor the exception had anything to do with the way in which the pre-existing albums would be marketed during the period surrounding the release of the new album; those provisions merely clarified that, while the parties could not "re-package" or "re-release" those albums or

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[1] The fact that the "market functioned well," CCAB at 5, without a moratorium in 1994 and thereafter is irrelevant. Prior to 1998, the parties were not partners in any joint venture and had no legitimate interest in coordinating their marketing activities. Conversely, in 1998, PolyGram and Warner were contractually obligated to coordinate their marketing activities relating to 3T3, and were participants in an efficiency-enhancing collaboration. RPF 41. It is the existence of the joint venture that provided PolyGram and Warner with a legitimate and procompetitive reason – and, indeed, a contractual and fiduciary obligation – to cooperate with respect to the marketing of Three Tenors products. This was precisely the point Professor Ordover was making in opining that, while naked agreements to restrict prices have "clearly pernicious effects on competition and consumers," restraints adopted by joint venture partners require further analysis, even if they would be illegal *per se* outside a joint venture, so long as they are reasonably related to the procompetitive purposes of the joint venture. RX 715 (Ordover Report).

any other Three Tenors album during the term of the joint venture, they could continue to sell the prior albums while the venture was in existence. *Id.*

Nor is it appropriate to infer anything regarding the importance of the moratorium to the joint venture from the fact that it was not set forth in the joint venture agreement itself.[2] The proper marketing of catalog Three Tenors products in conjunction with the release of the new album was one of the many important elements of the joint venture – including, *inter alia*, the repertoire, the marketing plans, the advertising budget, and the release date – that the parties understood would be resolved in a commercially reasonable manner. PolyGram and Warner elected to defer the resolution of *all* of these important issues until after the venture was formed and they began developing their marketing plans. RPF 48, 50.

3. The Moratorium Was Designed To Prevent Free Riding And Maximize The Long-Term Output Of Three Tenors Products And Was Unrelated To Any Subsequent Concern Regarding The Repertoire For 3T3.

As they developed their marketing plans for the new album, PolyGram and Warner recognized a substantial risk that their operating companies would use the expenditures of the joint venture to promote the prior Three Tenors albums rather than the new Three Tenors album that those expenditures were intended to promote. RPF 52-55. PolyGram and Warner believed that aggressive discounting and promotion of 3T1 or 3T2 during the release period would harm 3T3 and the Three Tenors brand, leading to fewer sales of all Three Tenors products in the long term. RPF 54-55. Mr. O'Brien's uncontradicted testimony was that he "would not have continued with the deal" if PolyGram had suggested it intended to discount and promote 3T1 during the period surrounding the release of the new album. RPF 56.

Thus, as set forth in PolyGram's opening brief, the parties adopted the moratorium to prevent their respective operating companies from "free riding" on their joint

[2] Complaint Counsel carefully note that the Concert/License Agreement was "*dated* December 19, 1997," CCAB at 7 (emphasis added), but they do not dispute that the agreement actually was not executed until February 5, 1998, RPF 57; JX 10, and that the Initial Decisions finding that the venture was formed "months before" the moratorium was adopted, ID F. 263, is simply incorrect.

venture and to ensure that 3T3 was marketed in a manner that served the long-term best interests of the Three Tenors brand. RPF 51-104. Absent the moratorium, aggressive discounting and promotion of the prior albums in certain territories could have had the anticompetitive effect of reducing the long-term output of Three Tenors product. *Id.* The contemporaneous documents and witness testimony make it perfectly clear that the moratorium was adopted for precisely these reasons. For instance, an April 29, 1998 PolyGram memorandum explained that the moratorium reflected the parties' decision "that the 'original' album should not interfere with the launch of the new album . . . . This will help ensure that when purchasers walk into retail on the day of release they face a simple, uncluttered selling proposition . . . . [T]his new policy strikes a balance between maximizing an opportunity on the 'original album' and yet protecting our considerable investment in the new album." RPF 76. Mr. Cloeckaert, PolyGram's Vice President for Continental Europe, testified that the marketing strategy reflected in the moratorium paralleled PolyGram's general practices in situations where it owns both the catalog products and the new release. RPF 81.

Despite the uncontradicted evidence regarding the parties' reasons for adopting the moratorium, Complaint Counsel assert that the moratorium was adopted "as a result" of concerns that the repertoire for the new album "would be neither as original nor as commercially appealing" as the prior albums. CCAB at 7. However, it is undisputed that the moratorium was adopted in March 1998 at the first joint marketing meeting after the joint venture agreement was executed, F. 92, and that the repertoire for 3T3 was determined months later. F. 1. There is no evidence that the repertoire for 3T3 was a motivating factor in the decision to adopt the moratorium. Rather, the evidence is that the moratorium was viewed by all parties as an important part of the joint venture from the outset because of the importance of ensuring a successful launch of the new album and the legitimate interest in preventing their respective operating companies from free riding on the Paris concert and the release of the new album. RPF 51-56.

4. The Moratorium Was Limited To "Special" Discounting And Advertising Campaigns.

Complaint Counsel consistently fail to acknowledge the limited nature of the moratorium, characterizing it as a naked "price fixing" agreement, "broad advertising restriction," and a "complete ban on advertising," CCAB at 3, 14 n. 6, 23. However, the moratorium was neither naked nor broad; it was adopted in the context of a joint venture, and it applied to two older classical cd's for a ten-week period. Moreover, as the Initial Decision found, the moratorium did not embody a complete ban on discounting and advertising of the prior albums but instead reflected an agreement that "prices should be 'normal' and not subject to any special discounts or promotions" during the period surrounding the launch of the new album RPF 64; F. 45. Thus, the moratorium was not, as Complaint Counsel contend, designed to "prohibit[ ] the parties from offering *any* discounts that may be passed on to consumers." CCAB at 7 n. 2. The moratorium placed no limitation on the parties' ability to offer their normal range of discounts and promotions for 3T1 and 3T2, and it placed no limitation on the ability of retailers to discount any prior albums that they were able to purchase prior months (after the concert and new album had already been announced) at extraordinarily low prices. RPF 72-73. Rather, the moratorium simply prohibited the parties' operating companies from free riding on the promotional opportunity the parties had created through the Paris concert and the release of the new album by creating aggressive *new* campaigns that were designed to capitalize on that opportunity. RPF 92, 102-104.

5. Complaint Counsel Disclaimed Any Effort To Prove – And, In Fact, Presented No Evidence – That The Moratorium Had Any Effect On Competition In The United States.

Complaint Counsel's mischaracterization of the factual record culminates in their assertion that they have "not 'stipulated' that there is no evidence that the moratorium agreement had an anticompetitive effect." CCAB at 10 n.3, 26. Complaint Counsel long ago repudiated any effort to establish any anticompetitive effect in this case. In their Status Report and Statement of the Case, filed on November 27, 2001, Complaint Counsel made no reference to any actual anticompetitive effect, but instead asserted that the moratorium was "presumptively

anticompetitive," and that the required effect on interstate commerce existed because "respondents' general business activities affect interstate commerce, and also [because] the 1990 Three Tenors recordings are marketed by Respondents in interstate commerce." CCSR at 4, 9. Similarly, in opposing PolyGram's motion for summary judgment, Complaint Counsel did not point to any evidence of actual anticompetitive effect. Instead, they argued that they were not required to present any such evidence because the moratorium was "presumptively anticompetitive" and because PolyGram had not proven that the moratorium was "necessary." CCOSJ at 12, 18-19. At the last pre-trial hearing, Complaint Counsel stated that "we don't see it as a relevant issue in this case whether the agreement was in fact implemented or what its actual effect was," Tr. of 5/4/02 Proceedings at 33:10-13, and that "it's complaint counsel's position that we are not obligated to show that the moratorium was implemented or what its effects may be," *id.* at 55:9-12.

Any lingering ambiguity on the issue whether Complaint Counsel were stipulating to the absence of any evidence of actual anticompetitive effect was resolved at trial. During Dr. Stockum's examination, Complaint Counsel specifically "*disclaimed any intention to do this full [rule of] reason analysis and offer conclusions as to what the actual anticompetitive effects of the moratorium was*." Trial Tr. at 626:20-23 (emphasis added). On the heels of this long series of representations, Complaint Counsel's belated efforts to argue that the moratorium actually had an anticompetitive effect in the United States, CCAB at 19, 26 n. 26, demonstrate incredible chutzpah. Complaint Counsel plainly are now estopped from arguing that the moratorium had any actual anticompetitive effect.

In view of Complaint Counsel's long-stated position that actual effects are irrelevant in this case, it should not be surprising that the "evidence" they now point to is incapable of supporting any inference of actual anticompetitive effect. Thus, while Complaint Counsel now suggest that the existence of the moratorium provides "a strong indication that PolyGram and Warner exercised market power," CCAB at 19, they failed to define or present any evidence of the relevant market or to provide any explanation of how the parties' efforts to

position their three products in the crowded marketplace for thousands of recorded music products could conceivably support any inference of market power. Moreover, any inference of any anticompetitive effect in the United States from the fact that PolyGram and Warner operating companies *outside* the United States considered discounting the prior albums, CCAB at 26 n. 26, is squarely foreclosed by Dr. Stockum's admission that the relevant market conditions may be different outside the United States. RPF 120, 122; RRCPF 275-76, 288-91.[3] Likewise, although Complaint Counsel now assert that PolyGram's provision of co-op advertising funds to U.S. retailers for 3T1 in 1994 suggests that the moratorium likely prevented PolyGram from advertising 3T1 in the United States, CCAB at 26 n. 26, Complaint Counsel cannot point to any document or witness testimony that would support any such inference. Nor does the mere existence of the moratorium, CCAB at 26 n. 26, support any inference of some actual anticompetitive effect in the United States. The moratorium was a single worldwide agreement that was adopted in the context of a worldwide joint venture, not a stand-alone agreement applicable only to the United States. There is no evidence that the parties gave any consideration to the issue whether the rationale for the moratorium applied equally in every relevant territory; rather, the moratorium plainly was motivated by specific concerns regarding the European operating companies' plans to discount the prior albums in Europe. RPF 51-56.

It is telling that Complaint Counsel chose to assert the existence of actual effects in a footnote in their appeal brief rather than to present any such evidence at trial. Instead of asking their expert to render any opinion on the actual effect of the moratorium, Complaint Counsel were very careful to ask Dr. Stockum to opine only about the "*possible* likely effects of an agreement not to discount," Tr. at 583:16-17 (emphasis added), and the "*likely* effect of an

[3] Indeed, the Initial Decision's findings that the moratorium "likely" prevented discounting or advertising in the United States are based *exclusively* on evidence of the marketing plans for territories *outside* the United States. RPF 80, 97-100, 111; RRCPF 288-91. However, the relevant witnesses (including Dr. Stockum) all testified that there was no evidence that the moratorium prevented any discounting or promotional activities in the United States, and that the economics of the music industry may be different outside the United States. RPF 80, 120, 122; RRCPF 271-272.

agreement between competitors not to advertise," *Id.* at 591:11-13 (emphasis added), without any reference to the existence of the joint venture. Complaint Counsel never asked Dr. Stockum to offer any opinion about the actual "likely" or even "potential" effects of this moratorium in the context of this Three Tenors joint venture. Rather, Complaint Counsel asked Dr. Stockum to opine whether the moratorium was "*necessary* to the formation of the joint venture," *Id.* at 617:21-621:17, or "*necessary* to the efficient operation of the joint venture," *Id.* at 621:18-638:24 (emphasis added). On cross-examination, Dr. Stockum admitted that the very academic literature on which he relied indicated that there are circumstances in which an agreement like the moratorium "would have no effect whatsoever." *Id.* at 652:19-655:6, 834:9-835:1. Dr. Stockum further conceded that it was "plausible" that the moratorium was procompetitive, Tr. at 643:7-644:9.

B. The Moratorium Is Not Illegal *Per Se*.

Complaint Counsel have practically abandoned any argument that the Initial Decision erred in concluding that the moratorium was illegal *per se*. And rightly so. As Judge Posner has explained, if the restraint at issue involves "a joint venture, then the Rule of Reason supplies the framework for antitrust analysis . . . . *NCAA* leaves no room for debate." *Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n*, 961 F.2d 667, 673 (7th Cir. 1992). Consistent with the lack of any "room for debate" on this subject, Complaint Counsel's discussion of the potential application of the *per se* rule is confined to a two and one-half page section of their brief that begins on page 52. If Complaint Counsel seriously believed the moratorium was illegal *per se*, they surely would have featured that argument more prominently; after all, a conclusion that the moratorium was illegal *per se* would logically precede any discussion of the rule of reason.

Complaint Counsel's apparent lack of confidence in the application of the *per se* rule is matched by their argument's lack of merit. In half-heartedly urging the application of the *per se* rule, Complaint Counsel rely principally on *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46

(1990), a *per curiam* opinion that spans seven full paragraphs. The notion that *BRG* "controls this case," CCAB at 53, is ridiculous. There was no joint venture or other procompetitive collaboration to create any new product or service involved in *BRG*; instead, there was simply a division of markets between two competitors accomplished through a license agreement. Although Complaint Counsel refer to the parties having "combined their assets in Georgia" and to "the formation of the venture," those are merely fictions created by counsel: neither the Eleventh Circuit's nor the Supreme Court's decision in *BRG* supports the notion that there was any "combination of assets" or "formation of a venture" involved in the case. Moreover, Complaint Counsel wrongly suggest that the agreement not to compete *outside* Georgia was judged *per se* illegal "because it restricted competition outside the scope of the venture [which, according to Complaint Counsel, was limited to Georgia]." CCPTB at 47. In fact, the Supreme Court held the *entire* agreement, including the restraint on competition *in Georgia* (i.e., "inside" Complaint Counsel's supposed joint venture), *per se* illegal because it was a naked allocation of markets (there in fact being no joint venture or other combination of assets). 498 U.S. at 49-50. In short, *BRG* is irrelevant to this case.[4] Similarly, in *New York ex rel. Spitzer v. Saint Francis Hosp.*, 94 F. Supp. 2d 399, 415 (S.D.N.Y. 2000), the court held that a series of agreements whereby hospitals jointly negotiated rates, divided markets, and allocated patients were illegal *per se*, not because they affected products or services that were beyond the scope of any legitimate collaboration but because *there was no lawful collaboration* between the defendant hospitals. *Id.*

[4] Complaint Counsel attempt to analogize HBJ's Georgia license to BRG and the accompanying agreement by BRG not to compete with HBJ outside Georgia to Warner's license to PolyGram to distribute 3T3 outside the United States and PolyGram's agreement not to discount or advertise 3T1 in the United States for a 10-week period. CCAB at 53-54. What Complaint Counsel ignore, of course, are the distinguishing facts, among others, that the moratorium arose in connection with marketing of a new, jointly-owned product that could not have been produced without the joint venture, that PolyGram was paying 50% of the costs of marketing 3T3 in the United States and Warner paying 50% of the cost outside the U.S., that PolyGram and Warner were sharing the risks and rewards of the joint venture, that the moratorium applied throughout the world, that 3T1 and 3T2 were not "outside" the joint venture because PolyGram and Warner planned to include recordings from those products in the greatest hits and/or box set albums, and that the moratorium was limited to a 10-week period surrounding the launch of the joint venture product. None of these crucial circumstances existed in *BRG*.

Complaint Counsel also point to *In re General Motors Corp. and Toyota Motors Corp.*, 103 F.T.C. 374 (1984, *vacated* 5 Trade Reg. Rep. (CCH) ¶ 23,491 1993 WL 767061 (F.T.C.) (Oct. 29, 1993), another case that provides no support for the position that a joint venture restraint will be subject to *per se* condemnation whenever it affects products that are "outside" the joint venture. The consent decree in that case – which precluded GM and Toyota from exchanging information regarding products that were not part of the joint venture – was not, as Complaint Counsel misleadingly suggest, "vacated on other grounds." It was vacated because the Commission concluded a provision of the consent decree was not necessary to prevent any anticompetitive conduct and might have prevented procompetitive benefits of the joint venture by "increas[ing] the costs of the joint venture and hinder[ing] the ability of respondents and the joint venture to respond to competitive conditions." 1993 WL 767061, at 6. Rather than establishing a rule that restrictions on products "outside" a joint venture are *per se* impermissible, *GM/Toyota* instead stands for the proposition that such restrictions may be procompetitive and must be analyzed under the rule of reason.

Complaint Counsel fare even worse in their effort to analogize the moratorium to a "criminal bid-rigging conspiracy." CCAB at 52 n. 59 (citing *United States v. MMR Corp.*, 907 F.2d 489 (5th Cir. 1990); *New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065 (2d Cir. 1988); *United States v. Metropolitan Enters.*, 728 F.2d 444 (10th Cir. 1984)). Of course, a bid-rigging conspiracy is not illegal *per se* because the agreement extends beyond the legitimate scope of any joint venture; such agreements are illegal *per se* because courts and economists have consistently found that naked agreements to rig bids result in the anticompetitive effect of destroying the market for the bid.

Complaint Counsel also repeatedly cite *Blue Cross & Blue Shield of Wisc. v. Marshfield Clinic*, 65 F.3d 1406, 1414-16 (7th Cir. 1995), in support of their position that they were not required to offer any evidence of actual anticompetitive effects in this case. CCAB at 3, 4, 14, 17, 37, 42. Complaint Counsel's newfound fascination with *Marshfield* – a case that was neither cited in the Initial Decision nor discussed in any of Complaint Counsel's briefing to

the ALJ – is inexplicable. In *Marshfield*, the Seventh Circuit affirmed a jury verdict holding the Marshfield Clinic liable for entering into a horizontal agreement with its competitor, NCHPP, whereby each agreed not to compete in the other's territory because – a *per se* violation. 65 F.3d at 1415-16. Marshfield never argued that the agreement at issue was reasonably related to a legitimate joint venture or that the agreement was procompetitive; instead, Marshfield's defense was based on evidence that it did not enter into the alleged agreement. *Id.* In discussing his decision to affirm the jury verdict against Marshfield, Judge Posner noted that *he* could "imagine" a free-riding defense based on the facts surrounding the agreement, and suggested this was "not a bad argument" on the facts of the case. *Id.* However, because Marshfield had not asserted that defense and there was thus no evidence in the record to support it, the jury verdict was affirmed. *Id.* *Marshfield* is simply irrelevant to the issues in this case. Here, the evidence shows that the moratorium was reasonably related to a legitimate joint venture, complaint counsel's own economist admitted that the moratorium was plausibly procompetitive in the context of that joint venture, and all of the relevant witnesses testified that the moratorium was adopted for the procompetitive purposes of preventing free-riding and increasing the long-term output of all Three Tenors products.

Complaint Counsel confine to a footnote their discussion of *In re Brunswick Corp.*, 94 F.T.C. 1174, 1275-77 (1979), *aff'd as modified sub. nom.*, *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 984 (8th Cir. 1981), even though the Initial Decision relied almost exclusively on that case in concluding that the *per se* rule applies here. While Complaint Counsel cling to the notion that *Brunswick* was decided under a *per se* rule, CCAB at 53 n. 60, the Eighth Circuit made it clear that the restraints at issue in that case were held unlawful under the rule of reason. The Eighth Circuit affirmed the Commission's decision that the restraints were "unreasonable" (*i.e.*, unlawful under the rule of reason) on the ground that the agreements were not "reasonably necessary to the purpose of the joint venture," "serve[d] only to insulate Brunswick from Yamaha in the United States market," and constituted an "unreasonable extension of the joint venture agreement." *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 981 (8th Cir. 1981). The Eighth

Circuit decision in *Brunswick* contains no suggestion that the restraints at issue there were illegal *per se*.

Finally, Complaint Counsel's contention that there is no support for the "reasonably related to" standard for ancillary restraints set forth in PolyGram's opening brief is ludicrous. In *NCAA*, the Court held that "it would be inappropriate to apply a *per se* rule in this case," because the case "*involve[d] an industry* in which horizontal restraints on competition are essential if the product is to be available at all." *NCAA v. Board of Regents*, 468 U.S. 85, 100-01 (1984) (emphasis added). Similarly, in *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979), the Court held that the blanket license was subject to the rule of reason because it "*accompanied* the integration" and was "*potentially beneficial* to both sellers and buyers." *Id.* at 20-21 (emphasis added). And, in *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 595 (7th Cir. 1984), Judge Posner explained that a "plausible connection" between the challenged practice and "the essential character of the [joint venture] product" will result in rule of reason analysis under the ancillary restraints doctrine.

Moreover, the courts in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) and *Polk Bros., Inc. v. Forest City Enters., Inc.* 776 F.2d 185(7th Cir. 1985) squarely endorsed the proposition that a restraint is ancillary to a joint venture, and thus subject to the rule of reason, if it is "*related to* the efficiency sought to be achieved." *Rothery Storage,* 792 F.2d at 224 (emphasis added); *Polk Bros*, 776 F.2d at 188-9 (holding that "ancillary restraints" are "those that are part of a larger endeavor whose success they promote"). Complaint Counsel do not cite or discuss *Rothery Storage* or *Polk Bros.* anywhere in their appeal brief, despite the fact that those cases were discussed extensively in PolyGram's opening brief. Complaint Counsel's failure to address these cases is inexplicable in light of the fact that they plainly are among the leading authorities on the standards for analyzing joint ventures under the antitrust laws and were authored by Judge Bork and Judge Easterbrook, two of the leading judicial authorities on antitrust issues.

PolyGram submits that there is no basis for distinguishing this case from *Polk Bros.* and *Rothery Storage* other than disagreement with Judge Bork and Judge Easterbrook regarding the proper analytical framework for analyzing restraints adopted by joint venture partners. Complaint Counsel offer no other basis for distinguishing the cases, and it is beyond dispute that the Initial Decision's only grounds for distinguishing those cases from this case was based on a misreading of those decisions. Thus, while the Initial Decision reads *Polk Bros.* to require that a restraint be an "integral part" of a joint venture before it may be considered ancillary and subject to the rule of reason, ID at 52, the fact is that the words "integral part" appear in that decision only in explaining why the district court had erred in concluding that the restraint was illegal *per se*. 776 F.2d at 190. The unambiguous holding of *Polk Bros.* is that any agreement that even "arguably" "promoted enterprise and productivity at the time it was adopted" requires a "more discriminating assessment" under the rule of reason. 776 F.2d at 189.[5] Similarly, while the Initial Decision reads *Rothery Storage* as a case involving restraints on the "venturers use of joint venture assets," ID at 52 n. 9 (citing *Rothery Storage*, 792 F.2d at 214), *this case* also involves a restraint on the use by the members of the joint venture of the joint venture assets (*i.e.,* the Paris concert and the release of the new album) to compete against the joint venture.

Indeed, the Commission itself has advocated the very ancillary restraints standard that PolyGram urges it to apply here. In *NCAA*, the Commission observed that for an agreement to be considered ancillary it need only be "reasonably related to" a procompetitive collaboration, *not* "absolutely necessary." Brief of the United States as Amicus Curiae in *NCAA*, Attachment A to CCPTB at 13 (criticizing the petitioner for "tak[ing] the word 'necessary' out of the legal context in which it was used by the lower courts, *i.e.*, to mean 'reasonably related to,' and

[5] Notably, as in this case, the restraint at issue (*i.e.,* the decision to renew a covenant not to compete as a 50-year covenant) in *Polk Bros.* was not adopted until after the joint venture was formed, *id.* at 187-91, and thus clearly was not "necessary" to the formation of the joint venture. Nonetheless, the court held that the restraint was "ancillary" to the joint venture because it eliminated the potential for "free riding" by one venturer on the promotional efforts of the other. *Id.*

ascrib[ing] to it a meaning – 'absolutely necessary,' *i.e.*, there being no less restrictive alternative – not fairly attributable to those courts"). In the same brief, the Commission proceeded to emphasize "that plaintiffs and courts can [not] merely second-guess those participating in an otherwise legitimate enterprise, and invalidate any restraint that is not the 'least restrictive' imaginable or practicable." *Id.* at 6.[6]

Here, it is undisputed that the moratorium was adopted in the context of the joint venture and the evidence makes clear that it is at least plausibly connected to the procompetitive purposes of the joint venture. Accordingly, the moratorium is subject to the rule of reason, not any *per se* rule.

C. The Moratorium Cannot Be Found Unlawful Under The Rule Of Reason Because Complaint Counsel Failed To Provide Any Evidence Of Anticompetitive Effect.

As noted above, Complaint Counsel chose not to develop any evidence of anticompetitive effect – and, indeed, expressly "disclaimed" any obligation to do so under the highly abbreviated version of the rule of reason they advocate here. Trial Tr. at 626:20-23. Because there is no evidence of any anticompetitive effect, Complaint Counsel can prevail under the rule of reason only if the moratorium is subject to some "presumption" of anticompetitive effect. However, the governing case law makes clear that no such presumption is available under the rule of reason and, in any event, any such presumption could not be triggered by the purely theoretical projections of "likely" competitive effects offered by Complaint Counsel's expert, Dr. Stockum. Moreover, PolyGram's procompetitive justifications for the moratorium are sufficient to trigger a need for a more detailed analysis of actual effects under the rule of reason regardless of whether any presumption applies. Under any version of the rule of reason –

[6] Complaint Counsel make no effort to defend the extremely narrow version of the ancillary restraints doctrine adopted by the Initial Decision, under which restraints would be condemned as illegal *per se* unless they "inevitably arose" from a joint venture or were absolutely "necessary" to make a joint venture work. ID at 51-52. That standard plainly is inconsistent with the cases discussed above and the Commission's position in *NCAA*.

from a "quick look" to plenary review – the absence of any evidence of any actual anticompetitive effect thus requires a decision in PolyGram's favor.

1. The Absence Of Any Evidence Of Anticompetitive Effect Mandates A Decision In PolyGram's Favor Because There Are No Presumptions Of Anticompetitive Effects Under The Rule Of Reason.

The claim that the moratorium is "presumptively anticompetitive" hinges on the proposition that the Supreme Court did not mean what it said in *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 771-81 (1999). As Complaint Counsel acknowledge, CCAB at 13-14, the Supreme Court in *CDA* stated that a "theoretical claim of anticompetitive effects" in a quick-look rule of reason case may justify a presumption whereby the burden shifts to the defendant to prove procompetitive effects *only* if the evidence shows "some indication that the court making the decision has properly identified the theoretical basis for the anticompetitive effects and considered whether the effects *actually are anticompetitive*." *Id.* at 775 n. 12 (emphasis added). While Complaint Counsel apparently believe that this language represents the Court's stray musings on the subject of the rule of reason rather than its actual views of the law, this was not an isolated "snippet" in the opinion.

Earlier in the opinion, the Court summarized its "quick-look" cases as holding that abbreviated review is appropriate when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question *have* an anticompetitive effect on customers and markets." *Id.* at 770-71. The "great likelihood of anticompetitive effects can easily be ascertained," for instance, when there is evidence that the particularly agreement "expressly limit[ed] output," "fix[ed] a minimum price," or imposed a "complete ban on competitive bidding" in the relevant industry. *Id.* (collecting cases). Thus, *at a minimum*, the application of any abbreviated version of the rule of reason must be predicated on empirical evidence regarding the effects of the particular restraint at issue in the industry in which it was adopted. On page 771, one of the pages which Complaint Counsel reference as supposedly recognizing their proposed "presumption," the Court held that a more detailed analysis of the advertising restraints was required under the rule of reason because the restraints "might

plausibly be thought to have a net procompetitive effect, or possibly no effect at all on competition." *Id.* at 771; *see also id.* at 776 ("The question is . . . whether the limitation on advertisements obviously tends to limit the total delivery of dental services."), 779 ("factual underpinnings" for "obvious" anticompetitive effect needed to justify abbreviated analysis).

Indeed, even the dissenting Justices in *CDA* viewed it as necessary for the Commission to show "that the Association's restraints would likely have made a real difference in the particular marketplace." *CDA*, 526 U.S. at 788 (Breyer, J., dissenting). On Justice Breyer's view, this requirement was met in *CDA* by the evidence that CDA had "enough market power to make a difference." *Id.* (noting that *CDA* possessed market share as high as 90% in some geographic areas). Additionally, Justice Breyer emphasized that it was the "record evidence affirmatively establishing that quality-based competition is important to dental consumers in California" – including, *inter alia*, testimony regarding the actual effect of the restrictions on dentists and patients – that, on his view, justified the Commission's decision in that case. *Id.* at 786. And that was *the dissent*. The majority opinion in *CDA* – which, obviously, is controlling law – clearly imposes a higher evidentiary burden on Complaint Counsel.

On remand, the Ninth Circuit in *CDA* held that the Commission's case failed under a "quick look" version of the rule of reason because it had not offered "substantial evidence of a net anticompetitive effect." *Cal. Dental Ass'n v. FTC*, 224 F.3d 942, 957-58 (9th Cir. 2000. In particular, the court concluded that the academic articles relied upon by the Commission in support of its position that anticompetitive effects were "obvious" did not "show some relevant data from the precise market at issue in the litigation." *Id.* at 957. Moreover, "[t]he FTC proved neither that dentists who advertise lower prices (through methods prohibited by the regulations) in fact offer below average prices, nor that dentists who advertise the high quality of their services are qualitatively superior to those dentists who do not advertise the quality of their services." *Id.* The decision makes clear that it was the Commission's burden, *even under a "quick look" version of the rule of reason*, to show that the challenged practice

would have actual anticompetitive effects in the relevant industry before the defendant was required to show procompetitive effects. *Id.* at 947-48. The Ninth Circuit declined the Commission's request that the case be remanded so that it could develop further evidence of actual effects, noting that the absence of such evidence was the result of a "tactical decision" under which complaint counsel "evidently assum[ed] that the economic literature would suffice to win . . . if the Ninth Circuit or Supreme Court required a more onerous level of analysis." *Id.* at 959.

Complaint Counsel's tactical decision not to put on any evidence of actual anticompetitive here should likewise result in a decision in PolyGram's favor. The proceedings in *CDA* make it perfectly clear that a rule of reason case cannot proceed based solely on theoretical observations and abstract comments regarding the "likely effects" of generalized categories of agreements that are untethered to the specific conduct at issue or its actual effects in the relevant industry.

Other Supreme Court cases that Complaint Counsel cite for the "presumption" of anticompetitive effects adopted by the Initial Decision also illustrate that there is no such presumption under the rule of reason, but rather that the application of abbreviated analysis turns on the actual evidence regarding the effects of the particular restraint at issue in the particular industry in which it was adopte. Thus, in *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1 (1979), the Supreme Court reversed a Court of Appeals decision that had employed precisely the approach urged by Complaint Counsel here – *i.e.,* an analytical framework under which the "blanket license" agreement was condemned except in circumstances where the defendants were able to show that it was "necessary or sufficiently desirable." 441 U.S. at 17 n. 27. The Supreme Court squarely rejected this approach, describing it as "a rather bobtailed application of the rule of reason, bobtailed in the sense that it is *unaccompanied by the necessary analysis demonstrating why the particular licensing system is an undue competitive restraint." Id.* (emphasis added).

The Court explained that the blanket license was subject to the rule of reason, rather than the *per se* rule, and remanded the case to the Court of Appeals. *Id.* at 19-25. On remand, the Court of Appeals affirmed the trial court's finding that "CBS has failed to prove that the existence of the blanket license has restrained competition." *Columbia Broadcasting System, Inc v. American Soc. of Composers Authors & Publishers, et al.*, 620 F.2d 930, 939 (2d Cir. 1980). Thus, *BMI* confirms PolyGram's position that, under *any* version of the rule of reason – quick look or otherwise – the absence of any empirical evidence of the anticompetitive effect of the particular restraint at issue precludes any finding of liability.

Similarly, in *NCAA*, the Supreme Court emphasized that "[b]oth lower courts found not only that NCAA has power over the market for intercollegiate sports, but also that in the market for television programming – no matter how broadly or narrowly the market is defined – the NCAA television restrictions have reduced output, subverted viewer choice, and distorted pricing." 468 U.S. at 110 n.42. Only after concluding that "*the findings of the District Court* establish that [the NCAA television plan] has operated to raise prices and reduce output" did the Court hold that, under the rule of reason, the defendant had the burden of establishing an efficiency defense. *Id.* at 113 (emphasis added). Complaint Counsel would like to pretend that the emphasized language does not exist – they claim it was "unnecessary" verbiage on the part of Justice Stevens, CCAB at 11 – but it does.[7] Moreover, the Court's statement that it did not require "proof of market power" before the defendant was required to offer "some competitive justification," CCAB at 11 & n. 5, hardly shows that the *NCAA* Court believed an antitrust case could proceed in the absence of any evidence that the challenged practice had, or even was likely to have, any anticompetitive effect in the relevant industry. Rather, the Court merely stated that

[7] Complaint Counsel correctly note that, in *NCAA*, actual restrictions on price and output were "'apparent' from the terms of the television plan." That's exactly right. No further analysis is required to determine that a rule under which some set number of games can be shown restricts output when the plaintiffs are the entities who were seeking to televise more games. Here, by contrast, there is no evidence whatsoever that PolyGram or Warner would have engaged in additional discounting or advertising of 3T1 or 3T2 in the United States absent the moratorium, and no actual restriction is apparent from the terms of the agreement. Rather, the agreement simply reflects the marketing strategy that both parties agreed was appropriate under the circumstances.

a "detailed market analysis" is not required before the defendant is required to offer a procompetitive justification in a "quick look" case. *NCAA*, 468 U.S. at 110.

Finally, while Complaint Counsel correctly note that the Court in *IFD* did not require proof of the "contours of the relevant market," "market power," or "higher costs to insurers and patients," CCAB at 12, they lose sight of the fact that the nature of the express restriction on output of the x-ray services at issue in that case amply supported a finding of actual effects and obviated the need for inquiry into those other issues. Thus, the Court held that "the Commission's failure to engage in detailed market analysis [was] not fatal [under an abbreviated rule of reason]" because "the [District Court's] finding of *actual, sustained adverse effects on competition* . . . [was] legally sufficient . . . ." 476 U.S. at 460-61 (emphasis added).[8]

The lower court cases cited by Complaint Counsel likewise provide no support for the proposition that a presumption of anticompetitive effect might apply in the absence of *any* evidence that the challenged conduct had any effect whatsoever on price or output in the United States. In *Chicago Prof'l Sports*, for instance, the restraint expressly imposed a limitation on the number of Chicago Bulls telecasts in the Chicago area, and there was no dispute that the restraint actually resulted in a reduction in the number of telecasts – i.e., an actual reduction of output. *Chicago Prof'l Sports Ltd. P'Ship v. National Basketball Ass'n*, 961 F.2d 667, 674-76 (7th Cir. 1992). Similarly, in *Law*, the agreement actually fixed assistant coaches' salaries throughout the nation, *Law v. NCAA*, 134 F.3d 1010, 1020 (10th Cir. 1998); with a class of plaintiff coaches whose salaries actually had been restricted by the challenged agreement, the NCAA was hardly in any position to argue that its conduct had no effect on price or output. And in *Brown University*, the challenged agreements actually fixed the amount of student aid available to prospective applicants. *United States v. Brown University*, 5 F.3d 658, 677-78 (3d Cir. 1993).

[8] The Commission made precisely this point in its Supreme Court brief in *CDA*. Brief for the Respondent, *CDA*, at 19 (arguing that, in *IFD*, "[the Court] ruled that "[a]pplication of the Rule of Reason to these facts is not a manner of any great difficulty,' in light of the nature of the restraint *and the Commission's finding of actual effects on competition*") (emphasis added). A copy of the brief is attached hereto as Attachment A.

Here, by contrast, Complaint Counsel's expert economist admitted both that he was unaware of any actual deleterious effect the moratorium may have had on price or output in the United States and that the moratorium had a significant potential for procompetitive effects. RPF 51-104.

In arguing that a presumption of anticompetitive effects applies to the extremely limited moratorium at issue in this case – which, again, applied only to two older Three Tenors cd's for a ten-week period surrounding the launch of a new Three Tenors cd as part of the joint venture – Complaint Counsel fail, as noted above, even to mention *Polk Bros*, or *Rothery Storage*. In each of those cases, the parties entered into wholesale agreements not to compete that almost certainly would have been illegal *per se* if they had not been related to a procompetitive joint venture. *Polk Bros.,* 776 F.2d at 187-91; *Rothery Storage*, 792 F.2d at 224. However, the *Polk Bros.* and *Rothery Storage* decisions did not hold that those agreements were illegal *per se* or suggest that they were subject to any "presumption" that required the defendants to show that they were procompetitive before the plaintiff was obligated to offer any evidence of anticompetitive effect. Rather, the courts held that the agreements were subject to the rule of reason, and *lawful*, because they were reasonably related to the procompetitive purposes of the underlying joint ventures.

In short, the "presumption" of anticompetitive effects urged by Complaint Counsel and adopted the Initial Decision is not a component of the rule of reason that is applied by the federal courts in antitrust cases. Rather, it is a relic of the Commission's decisions in *Mass. Board of Registration in Optometry*, 110 F.T.C. 603-604 (1988), and *Detroit Auto. Dealers Ass'n*, 111 F.T.C. 417, 493 (1987). In *Detroit Auto. Dealers*, the Sixth Circuit rejected the Commission's "inherently suspect" methodology, concluding that it reflected improper use of a "per se approach" without any "demonstrated effect" on competition. *In re Detroit Auto Dealers Ass'n*, 955 F.2d 457, 470-71 (6th Cir. 1992). Indeed, the Commission itself subsequently recognized that the *Mass. Board* approach that its Complaint Counsel seek to use here was rejected by the Sixth Circuit and is not appropriate under the rule of reason. *In re Cal. Dental Ass'n*, 121 F.T.C. 190, 1996 FTC LEXIS 81, at *93 (1996) (acknowledging that "the

Sixth Circuit indeed rejected the Commission's use of the 'inherently suspect' approach"). In doing so, the Commission interpreted the relevant case law in precisely the same manner as PolyGram: "The Supreme Court has indicated that *when a court finds actual anticompetitive effects,* no detailed examination of market power is necessary to judge the practice unlawful." *Id.* at *71 n.19 (citing *NCAA* and *IFD*) (emphasis added). Only after having found actual anticompetitive effect (and market power) did the Commission examine CDA's efficiency justifications. *Id.* at * 80. Under that approach – which the Supreme Court in *CDA* essentially endorsed, while disagreeing with the quickness with which the Commission was willing to condemn the challenged restraints – the evidence presented by Complaint Counsel plainly was insufficient to require PolyGram to identify any procompetitive justification for the moratorium.

2. Any Presumption Of Anticompetitive Effect Would Not Apply On This Record.

Even if there were some place for the "inherently suspect" *Mass. Board* presumption in some rule of reason cases – as now-Chairman Muris has argued, *see, e.g.,* Timothy J. Muris, *The Federal Trade Commission and the Rule of Reason: In Defense of Mass. Board*, 66 Antitrust L.J. 773, 798 (1998) – the evidentiary record in this case provides an exceptionally poor basis for launching any effort to resurrect that presumption. In advocating the use of the *Mass. Board* presumption in certain rule of reason cases, now-Chairman Muris cautioned against the overuse of presumptions in rule of reason cases, noting that "most horizontal agreements will not fall into the inherently suspect class." *Id.* Moreover, any presumption would not be triggered by an abstract, theoretical assertion of "likely" anticompetitive effects; rather, it would be limited to those situations in which economists and courts have "developed *empirical evidence*" regarding the effect of the challenged practice to support the theoretical claim of competitive harm. *Id.* (emphasis added). The presumption would not apply – and a more detailed analysis would be required under the rule of reason – in any case "involv[ing] an integration of productive facilities." *Id.*

The recent track record shows that, rather than adhering to now-Chairman Muris' cautious description of the "presumptively anticompetitive" standard complaint counsel at the Commission have been far too willing to rely on presumptions and burden-shifting rather than actual evidence of anticompetitive effects. Although the Initial Decision here endorsed Complaint Counsel's reliance on a presumption of anticompetitive effect, similar efforts to rely on presumptions of anticompetitive effects were rejected in *CDA* and, more recently, by the Initial Decision in *In re Schering-Plough Corp*, FTC Docket No. 9297 (filed June 26, 2002). In each of those cases, moreover, complaint counsel actually sought to develop evidence regarding the likely effect of the challenged practice in the specific industry at issue. Thus, in *CDA*, the Commission relied on the extensive history of litigated cases involving advertising restrictions adopted by professional associations, specific evidence regarding the effect of restrictions on dental advertising in California, and evidence that the CDA possessed market power in California, in support of its conclusion that the advertising restrictions at issue there could be condemned based on abbreviated antitrust analysis. *In re Cal. Dental Ass'n*, 121 F.T.C. 190, 310-116. The Supreme Court nonetheless held that no presumption of anticompetitive effects applied, and that a more detailed analysis of actual effects was required under the rule of reason, because it was improper "without further analysis to shift the burden to the CDA to adduce hard evidence of the procompetitive nature of its policy" absent additional "empirical evidence . . . of the restrictions' anticompetitive effects." *CDA*, 526 U.S. at 776.

In *Schering-Plough*, the Initial Decision refused to apply any presumption of anticompetitive effect after a three-month trial during which complaint counsel sought to show that the challenged settlement agreements actually delayed generic competition to Schering's K-Dur 20 product. Initial Decision at 4, 104-105, *Schering-Plough*. On appeal, complaint counsel in that case contend that the ALJ erroneously failed to adopt a presumption of anticompetitive effects – but not because the anticompetitive effects of patent settlements in general are sufficiently likely to warrant the imposition of a presumption. Rather, complaint counsel in that case argue that their proposed presumption should be adopted because (they claim) the shows

that the specific settlements at issue "directly limited price and output competition," "delayed expected generic entry," and "enabl[ed] Schering to maintain high prices without losing sales." Appeal Brief of Counsel Supporting the Complaint at 40, *Schering-Plough*, FTC Docket No. 9297 (filed Aug. 9, 2002). Based on the supposed *record evidence of actual anticompetitive effects* in that case – and not the abstract observations of an economist who did not even study the circumstances in which those settlements were agreed to – complaint counsel thus contend that the settlements are "presumptively anticompetitive." *Id.*

The evidence presented by Complaint Counsel here in support of their proposed presumption pales in comparison to even the insufficient evidence offered in *CDA* or the challenged evidence offered in *Schering-Plough* regarding the specific practices challenged in those cases and the likely effects of those practices in the relevant industries. In this case, Complaint Counsel asked their expert economist, Dr. Stockum, to completely ignore the fact that the moratorium was adopted in the context of a procompetitive joint venture and to instead render opinions on the issues of whether, in the abstract, "agreements not to discount" and "agreements not to advertise" are "likely" to have anticompetitive effects. Trial Tr. at 583, 591. This tactical decision not to attempt to develop any evidence that the moratorium had any actual anticompetitive effect – undoubtedly motivated by the absence of any such evidence – was made in the face of extensive evidence that the moratorium was adopted in the context of, and was designed to contribute to the efficiency and success of, a legitimate joint venture. RPF 51-104.

The information relied upon by Complaint Counsel's expert in opining on these abstract questions regarding the "likely" effects of "agreements not to discount" and "agreements not to advertise" was far removed from the facts and circumstances in this case. In arguing that the moratorium was "presumptively anticompetitive" in restricting "special" discounting campaigns for the two older Three Tenors album during the ten-week period surrounding the launch of the new Three tenors album, Complaint Counsel rely principally on a series of cases involving naked agreements to fix prices, rig bids and divide markets. CCAB at 19-22 & nn. 16-19. Most of these cases are *per se* cases, not rule of reason cases, and thus are irrelevant to the

issue of whether a presumption of anticompetitive effects should apply on the facts of this rule of reason case. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (naked price fixing); *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 639 (1992) (same); *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 416-18 (1990) (same); *United States v. Reicher*, 983 F.2d 168 (10th Cir. 1992) (naked bid rigging); *Denny's Marina, Inc. v. Renfro Productions, Inc.*, 8 F.3d 1217 (7th Cir. 1993) (naked agreement not to compete).[9] Dr. Stockum likewise rendered no opinion regarding the actual (or even likely) effects of the moratorium on pricing in the United States but instead offered only the observation that naked agreements to fix prices are, in the abstract, anticompetitive. Trial Tr. at 583:16-17; JX 104-B (Stockum Expert Report). The relevant question, however, is whether the alleged restraint at issue here would have had any effect on competition in the United States music industry, and Complaint Counsel can point to no empirical evidence that could support an inference that PolyGram or Warner likely would have discounted the prior albums in the United States absent the moratorium. RPF 80, 97-100, 120, 122; RRCPF 271-72, 288-91.[10]

Complaint Counsel likewise lack any empirical support for their contention that the restriction on advertising included in the moratorium had any likely anticompetitive effect in the United States. Academic analyses of, *inter alia*, the competitive effects of market-wide

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[9] Most of the cases Complaint Counsel cite on this point do not involve joint ventures, let alone joint ventures in the music industry. Two cases that do involve joint ventures – *United States v. Columbia Pictures Indus., Inc.*, 507 F. Supp. 412 (S.D.N.Y. 1980) and *United States v. National Football League*, 116 F. Supp. 319 (E.D. Pa. 1953) – actually show that there *is* a need for evidence regarding the effects of the particular restraint at issue in the particular market. In *Columbia Pictures*, the court enjoined the creation of the Premiere joint venture, whereby three major movie studios sought to create a pay-television network that would have exclusive access to *each* of their films for a nine month period. This provision of the joint venture was considered illegal *per se* because the court concluded that it did not serve any lawful objective, 116 F. Supp. at 425-35; the case says nothing about whether it is presumptively anticompetitive for joint ventures to agree not to compete against their joint venture product in limited ways and for a specified period. Moreover, the restriction there constituted an express limitation on the output of feature films exhibit on pay-television, and there was thus ample evidence that the restraint actually would have had an effect on competition in the United States. *Id.* Likewise, in *NFL*, an express limitation on telecasts of NFL games was held to be unlawful based on record evidence of its actual effects in the relevant industry, not some presumption based on abstract observations regarding some broad category of agreements.

[10] The evidence cited in F. 239, 240 & 242 may relate to discounting in "many markets," as Complaint Counsel suggest, CCAB at 18, but it critically does not relate to the United States market.

newspaper strikes in upstate New York and market-wide restrictions on liquor advertising in Rhode Island say nothing about the likely (let alone actual) effects in the United States music industry of a ten-week moratorium on "special" discounting and promotion of two older Three Tenors albums during the period surrounding the launch of a new Three Tenors album in a market that includes *thousands* of recorded music products. Dr. Stockum admitted as much on cross-examination, testifying that the actual competitive effects of the moratorium would depend on, *inter alia*, the extent to which the products previously had been advertised, the presence of other advertising for products with the same brand (*i.e.,* 3T3), and the extent to which the relevant consumers' decisions would be influenced by additional advertising. Tr. at 660:4-662:17. Indeed, Dr. Stockum admitted that the very academic literature he relied upon indicated that there are circumstances in which an agreement like the moratorium "would have no effect whatsoever." *Id.* at 652:19-655:6, 834:9-835:1.

In short, the abstract observations of Complaint Counsel's economist that broad categories of restraints are "likely" to have anticompetitive effects would be far from sufficient to trigger even the *Mass. Board* presumption. Complaint Counsel may not have been required to prove exactly what PolyGram's "prices would have been absent" the moratorium, CCAB at 21-26, and PolyGram does not suggest that Complaint Counsel were subject to any such requirement. But the rule of reason plainly required Complaint Counsel to do something more than trot out an economist who was willing to opine that, in the abstract, "agreements not to discount" and "agreements not to advertise" are "likely" to have anticompetitive effects, without any consideration whatsoever of the Three Tenors joint venture or the circumstances surrounding the moratorium.

3. The Procompetitive Justifications For The Moratorium Are Sufficient To Require A Decision In PolyGram's Favor

a. The Presence Of Any Plausible Procompetitive Justification Triggers A Need For More Detailed Analysis Under The Rule Of Reason.

In discussing the standard for evaluating PolyGram's procompetitive justifications, Complaint Counsel now submit that an efficiency justification is sufficient to require an analysis of actual competitive effects if it is "*reasonably* necessary" to a "legitimate objective" of the collaboration. CCAB at 32. This is a dramatic departure from Complaint Counsel's position at trial and is fundamentally inconsistent with the Initial Decision. At Complaint Counsel's urging, the Initial Decision read the word "reasonably" out of the "reasonably necessary" standard now urged by Complaint Counsel and instead concluded that PolyGram's procompetitive justifications were inadequate because they were not absolutely "necessary" for the overall joint venture. Complaint Counsel correctly note that the Initial Decision initially suggested that the moratorium would be considered ancillary if it was "an integral part of the venture or *reasonably* necessary to its promotion," ID at 52 (emphasis added). The Initial Decision proceeded, however, to base its decision that the moratorium was unlawful on the conclusion that it was not an absolutely "necessary" part of the joint venture. ID at 52 (ancillary restraints limited to those "inevitably arising" out of joint venture or "necessary (and of no broader scope than necessary) to make the joint venture work"), *id.* ("The moratorium agreement was not necessary for the creation of 3T3."), *id.* at 52 n. 9 ("The restraint here was not necessary for the creation of the product"), *id.* at 53 n. 10 ("[I]t was not integral to the venture nor necessary to market the product."), *id.* at 55 (PolyGram bore burden of proving procompetitive effects because moratorium "was unnecessary and not integral to the joint venture"), *id.* at 58 n. 10 (criticizing Dr. Wind because he did not analyze whether moratorium was "actually necessary to achieve some efficiency in the United States"), *id.* (concluding that Dr. Ordover's opinion that moratorium required further analysis under the rule of reason because it was "reasonably necessary" "rejects the basic premises of modern antitrust analysis"), *id.* at 60

("The moratorium must be necessary."), *id.* at 60-61 (concluding moratorium was not "necessary" for creation of 3T3, production of Paris concert, or distribution of 3T3 in United States), *id.* at 62 (moratorium was "not necessary to preserve incentives to advertise and promote 3T3 in the United States"), *id.* at 64 (moratorium was "not necessary to the effective marketing of 3T3"), *id.* at 64 ("The moratorium agreement was not a necessary strategy for publicizing 3T3.").[11]

The Initial Decision's unfaltering focus on the unqualified concept of "necessity" – rather than on whether the moratorium was "ancillary," "reasonably necessary" or, most importantly, "plausibly procompetitive" – was a function of the limited evidentiary record Complaint Counsel sought or were able to develop through their expert economist, Dr. Stockum. On direct examination, Complaint Counsel repeatedly asked Dr. Stockum whether the moratorium was "necessary" to the formation or efficient operation of the overall Three Tenors joint venture. Trial Tr. at 617:21-621:17, 621:18-638:24. Complaint Counsel never asked Dr. Stockum whether the moratorium was "reasonably necessary" to achieving any "legitimate objective" in the context of the Three Tenors joint venture. Moreover, on cross-examination, Dr. Stockum *admitted* that it was "plausible" that the moratorium was procompetitive in the context of the Three Tenors joint venture, Trial Tr. at 643:7-644:9, and that he was unaware of any evidence that the moratorium had any actual anticompetitive effect. RPF No. 122-123 (JX 85, Stockum Depo. Tr. at 42:22-43:16); Trial Tr. at 649:25-652:18).

PolyGram welcomes Complaint Counsel's apparent recognition that the strict "necessity" standard that the Initial Decision applied in evaluating the procompetitive

[11] Complaint Counsel oddly claim that they are "unable to find" the Initial Decision's conclusion that the fact that the moratorium was adopted after the formation of the joint venture led to the conclusion that it was unlawful. However, the Initial Decision expressly concluded that the moratorium was not an "integral" part of the joint venture and was not "necessary" for the creation of 3T3, even though it may have "*support[ed] the lawful joint venture,*" because "it was created months after the joint venture agreement." ID at 53 & n. 10. The following sentence later appears at page 60: "The later moratorium agreement cannot be deemed necessary for the earlier agreement to collaborate." As noted in PolyGram's opening brief, the fact that the moratorium was adopted after the actual formation of the joint venture is irrelevant to the issue of whether it was plausibly procompetitive. App. at 45.

justifications for the moratorium is not the correct legal standard. Unfortunately, however, after stating that the relevant standard is "reasonable necessity," CCAB at 32-33, Complaint Counsel proceed to argue that PolyGram's procompetitive justifications are insufficient to require some analysis of actual effects based on what is clearly a strict necessity standard. Thus, Complaint Counsel contend that PolyGram "must show that the moratorium was *necessary* in order to promote competition and benefit consumers," *id.* at 28, that the moratorium was not "necessary to assure the production of the Paris concert, the creation of 3T3, or the distribution of 3T3," *id.* at 38, that the moratorium was not "necessary to preserve incentives to advertise and promote 3T3 in the United States," *id.* at 40, that the moratorium was not a "necessary" part of the marketing plans for 3T3, *id.* at 46, and that "the moratorium was not necessary to protect confidential information," *id.* at 51. However, these observations are all irrelevant under the "reasonable necessity" standard discussed by Complaint Counsel at pages 32-33 of their brief, under which PolyGram would be required to show only that the moratorium was "reasonably necessary" to a legitimate objective of the joint venture. *See Brown University*, 5 F.3d at 678-79 (restraint must be "reasonably necessary to achieve the objectives proferred by the defendant"); *Law*, 134 F.3d at 1019 (same); *Collaboration Guidelines* ¶ 3.36(b) (April 2000) ("The Agencies consider only those efficiencies for which the relevant agreement is reasonably necessary.")

Moreover, even Complaint Counsel's "reasonable necessity" standard imposes too strong a burden because there is no basis for considering the necessity of a challenged practice at this stage in the rule of reason analysis. It is the plausibility of a procompetitive justification, not its necessity, that is the touchstone for requiring a more detailed analysis of actual effects under the rule of reason. In *CDA*, the Supreme Court recognized that it is enough at this stage of the rule of reason analysis for the defendant to identify a "plausible" procompetitive justification and that, once such a justification is identified, the net effect of the restraint must be anticompetitive for there to be any violation. 526 U.S. at 771 (holding that actual, net competitive effects must be considered where restraint "might plausibly be thought to have a net competitive effect, or possibly no effect at all").

This is surely why Complaint Counsel attempt to run away from their expert's admission that the moratorium was plausibly procompetitive. According to Complaint Counsel, "Dr. Stockum merely acknowledged that it is 'plausible' in the abstract that advertising for 3T3 may lead some consumers to purchase 3T1 or 3T2." CCAB at 35 n. 36. The transcript does not support Complaint Counsel's characterization. After several hours of questioning regarding the circumstances surrounding the moratorium and PolyGram's procompetitive justifications for the moratorium, the following exchange occurred:

> Q: Okay, but you agree that here you have at least a plausible efficiency justification, and the question then becomes, can you back it up with evidence, correct?
>
> A: Yes.

See also Trial Tr. at 641:13-644:16. Unlike his direct testimony on "likely" anticompetitive effects," Dr. Stockum's admission that the moratorium was plausibly procompetitive was unrelated to any abstract hypothetical but instead was tied to the specific factual circumstances surrounding the moratorium. Dr. Stockum's testimony on this subject was perfectly clear.

b. PolyGram's Procompetitive Justifications For The Moratorium Require Further Analysis Of Actual Effects Under The Rule Of Reason.

Regardless of whether they are assessed under the "plausibility" standard articulated in *CDA* or the "reasonable necessity" standard that Complaint Counsel now advocates, PolyGram's procompetitive justifications plainly are sufficient to require a more detailed analysis of actual effects.

(1) The Moratorium Was A Reasonable And Plausibly Procompetitive Effort To Address A Specific Risk Of Free Riding.

Complaint Counsel do not dispute that the prevention of free riding is a legitimate objective under the antitrust laws. Nor could they. The Commission's own guidelines and the relevant case law consistently have recognized that free riding activities often cause inefficiencies and that controlling such activities is often procompetitive. *See* Collaboration

Guidelines at 24 ("free riding or other opportunistic conduct that could reduce significantly the ability of the collaboration to achieve cognizable efficiencies"); *Polk Bros.*, 776 F.2d at 189-90 ("[C]ontrol of free riding is a legitimate objective" because it "makes it easier for people to cooperate productively in the first place"); *Rothery Storage*, 792 F.2d at 212-13 ("The free ride can become a serious problem for a partnership or joint venture because the party that provides capital or services without receiving compensation has a strong incentive to provide less, thus rendering common enterprise less effective."); *Chicago Prof'l Sports*, 961 F.2d at 673 (free riding is "an accepted justification for cooperation"); RPF 84 (Stockum Dep. 56:13-15) ("free riding can at least potentially create inefficiency in the market").

Absent the moratorium there was a substantial risk that the PolyGram and Warner op-cos' free riding activities would have "driv[en] [valued] services from the market." *In re Toys 'R Us, Inc.*, 126 F.T.C. 415, 600-17 (1998), *aff'd*, 221 F.3d 928 (7th Cir. 2000). The relevant witnesses testified that a successful launch of 3T3 was critical to the long-term success of *all* Three Tenors products, and that the aggressive simultaneous promotion of the prior albums would have jeopardized the prospects for a successful launch of the new album. RPF 53-57. In the long run, promotion of the prior albums during the critical release period for the new album likely would have resulted in less promotional spending and reduced the parties' incentives to create and distribute the greatest hits and/or box set albums. *Id.* Conversely, as PolyGram executive Rand Hoffman testified, a successful launch would increase the value of the catalogue products and lead to increased long-term sales of all Three Tenors products. RPF 53 (Trial Tr. (Hoffman) at 359:12-360:17 ("[T]he catalog is more valuable if the new record is a success, and to make a new record a success, the key is the launch period.) Mr. O'Brien likewise testified that, in the event of an unsuccessful launch, Warner would have spent less money promoting Three Tenors products in the future. RPF 101.

Complaint Counsel provide no support for their assertion that the parties could have compensated one another for any free riding activities in some way that would have adequately addressed their free riding concern. This case is fundamentally distinguishable from

the cases relied upon by Complaint Counsel because the moratorium was *not* designed to internalize whatever benefit the PolyGram and Warner op-co's may have obtained from a short-term spike in the sales of the two older albums associated with any promotion of those albums during the launch period. Rather, the moratorium was motivated by a concern that any such promotional activities during the critical launch period would have harmed the Three Tenors brand and reduced the long-term output of Three Tenors products. Both parties believed that this risk of harm to 3T3 and the Three Tenors brand was asymmetrical to, and greater than, any benefits that could have been obtained from promoting the prior albums. RPF 86-101. Thus, the only "compensation scheme" that would have effectively dealt with that problem would have been one that priced the op-co's ability to use the promotional opportunity created by the Paris concert and the new album to specially promote the two prior albums at a level that was high enough to eliminate *any* incentive to do so – which is effectively what the moratorium itself did. Any other compensation scheme would, as Dr. Stockum admitted (RFP 86, 141), simply have given either PolyGram or Warner more incentive to "free ride" (and the other less), without addressing the harm to the joint venture at all. In other words, a complicated compensation scheme designed to place a value on the op-co's option to use the Paris concert and the release of the new albums instead of the new album would not have made any sense in the context of this joint venture.

Because of the common interest that PolyGram and Warner had in preventing their op-cos from free riding on the promotional opportunity they jointly created through the Paris concert and the release of the new album, this case is fundamentally distinguishable from *Toys 'R Us.* In that case, the toy manufacturers who were paying for the services that were the subject of TRU's free riding justification did not believe that "extra services" were needed for the distribution of their products. 221 F.3d at 937. Instead, it was only TRU – a downstream retailer – who had any concern about its rivals' supposed free riding activities. *Id.* The court correctly noted that *TRU* could simply include the value of its services in the prices it charged for its products. *Id.* Here, conversely, PolyGram and Warner created both 3T3 and the

extraordinary promotional opportunity surrounding its release, and sought to prevent their affiliated distributors (*i.e.,* the op-cos) from free riding on that opportunity. As the Seventh Circuit noted in *TRU*, PolyGram's and Warner's interests were perfectly aligned with those of consumers when the spent more than $18 million to create the promotional opportunity that was the subject of their free riding concern. *Id.* ("[W]ith respect to the cost of distribution services, the interests of the manufacturer and the *consumer* are aligned.").[12]

While Complaint Counsel purport not to understand the concern that free riding by the op-cos would cause a net "negative spillover" to the Three Tenors brand, CCAB at 39, and claim that it is "unrelated to free riding as that term is used in antitrust economics," *id.*, the fact remains that their own expert economist expressly conceded that this distinction between "positive spillover" effects and "negative spillover" effects makes sense as a matter of economics. RPF 86, 141. Dr. Stockum also admitted that none of his proposed compensation schemes would have done anything to address the "negative spillover" effect that was the concern that gave rise to the moratorium. RPF 86, 141.

Moreover, none of the cases cited by Complaint Counsel involved an effort to prevent free-riding on anything remotely similar to the extraordinary, one-time promotional opportunity that was created by the Paris concert. Rather, *General Leaseways*, *CPS* and *Toys 'R Us* and Professor Hovenkamp's potato farmer hypothetical all involve claims of free riding on the routine, day-to-day expenditures of a service provider.[13] PolyGram has never claimed that

[12] PolyGram's and Warner's common interest in the promotional opportunity they created through the Paris concert and the release of the new album also distinguishes the situation that existed in 1994 during the period surrounding the release of 3T2 and in the Coke/Pepsi hypothetical offered by Complaint Counsel, CCAB at 58. In those situations, there was no joint venture, so the party making the promotional expenditures had no legitimate interest in entering into an agreement with its competitor to prevent the use of those expenditures to sell the competitor's products. Any such agreement would have been a naked price fixing agreement, and illegal *per se*. Here, conversely, it is undisputed that PolyGram and Warner were partners in a legitimate and procompetitive joint venture for the creation of new Three Tenors products at the time they entered into the moratorium.

[13] In *General Leaseways*, Judge Posner noted that the free riding argument was particularly "weak" because it was not based on any claim of free riding on hard-to-price "*information* – in the form of advertising . . . and other presale services – that free riders in previous cases were able to take advantage of because the information was being 'given away.'" 744 F.2d at 592. Instead, the argument was based on repair services that the parties already had agreed to price as part of their joint venture; insofar as the

such routine free-riding concerns could justify a restraint like the moratorium. Rather, the free riding concern here was limited to the factual circumstances surrounding this joint venture and would not justify the adoption of a similar restraint outside the context of a similar joint venture. As Dr. Stockum admitted, and as Professors Ordover and Wind confirmed, the moratorium was at least plausibly procompetitive in addressing that concern.

(2) The Moratorium Was A Reasonable And Procompetitive Effort To Increase The Aggregate Long-Term Output Of Three Tenors Products In The Context Of The Joint Venture.

Complaint Counsel have never offered any coherent theory for their position that, in the context of their joint venture, PolyGram and Warner should have been precluded from adopting a marketing strategy for 3T3 under which they agreed that they would not simultaneously promote the prior albums. No witness testified that it would have made any sense to simultaneously promote the old albums during the launch of the new album. To the contrary, the witnesses consistently testified that simultaneous promotions would have presented a substantial risk to the launch of the new album and the long-term success of all Three Tenors products. *See* RPF 55 (Cloeckaert Dep. at 68-70; *see also* O'Brien Tr. at 99; Saintilan Dep. at 78-84; Stainer Dep. at 57-58). And PolyGram's marketing expert, Professor Wind, opined that this was a sound strategy for maximizing the long-term success of the Three Tenors brand. RPF 112 (Wind Report at 16-17). Indeed, it is difficult to imagine why PolyGram and Warner would bother entering into an agreement to restrict the promotion and discounting of two older classical cd's if they did not view the agreement as an important part of the marketing plans for their joint venture product. Rather, the record evidence makes clear that the moratorium was part of an effort by PolyGram and Warner to ensure that their Three Tenors products could compete

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price was too low, the parties to the joint venture could simply adjust the price. *Id.* at 591-93. Here, there was no comparably similar way to calculate the appropriate "cost" of free riding during the brief ten-week period surrounding the release of 3T3.

effectively in the highly competitive music industry, in which thousands of recordings are constantly vying for consumers' attention.

The relevant evidence shows that the moratorium was a legitimate effort to increase the aggregate long-term output of Three Tenors product and to market the albums in a manner that was in the long-term best interests of the Three Tenors brand. RPF 108-109. Although Complaint Counsel deride PolyGram's contention that enhancing output is a legitimately procompetitive objective, the Supreme Court has squarely recognized that output-enhancing activities *are* procompetitive. *NCAA*, 468 U.S. at 103 (noting that *BMI* "squarely holds that a joint selling arrangement may be so efficient that it will *increase sellers' aggregate output and thus be procompetitive"*) (citing *BMI*, 441 U.S. at 18-23). It is equally well-established that restrictions on *intrabrand* competition such as those at issue here are of far less antitrust concern than are restrictions on *interbrand* competition, because "[i]nterbrand competition thus serves as its own check on the intrabrand restraints." *Association of Independent Television Stations, Inc. v. College Football Ass'n*, 637 F. Supp. 1289, 1298-99 (W.D. Okla. 1986) (holding that successor to television plan at issue in *NCAA* could not be condemned without analysis of its actual effects) (citing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51-57 (1977)). More generally, "[c]ooperative activities among competitors may increase the aggregate output of the sellers and thus serve the goals of competition." *Id.* Thus, in the context of a joint venture, horizontal restraints cannot be readily condemned "even though their force may be felt in usually sacrosanct areas such as price and production, [and] may be justified if their purpose and effect are to increase competition in the market as a whole." *Id.* at 1296.

Unlike Dr. Stockum, PolyGram's experts, Professors Ordover and Wind, each actually analyzed the likely effects of the moratorium in the context of the joint venture and

concluded that the moratorium likely was procompetitive in increasing the aggregate long-term output of Three Tenors products. RPF 112, 114.[14] Together with the concessions of Complaint Counsel's experts, the testimony of the witnesses involved in the joint venture, and the absence of any evidence that the moratorium had (or was likely to have) any anticompetitive effect in any relevant market, the opinions of Professors Ordover and Wind plainly are sufficient to support a decision in PolyGram's favor.

c. Complaint Counsel Failed To Establish The Existence Of Any Less Restrictive Alternative To The Moratorium.

It was Complaint Counsel's burden to establish the existence of any "less restrictive alternative" to the moratorium. *County of Tuolumne v. Sonora Cmty. Hosp.*, 236 F.3d 1148, 1159-60 (9th Cir. 2001). To meet that burden, Complaint Counsel were required to show that any proposed alternative would have been "substantially less restrictive *and* [ ] virtually as effective in serving the legitimate objective *without significantly increased cost*." *Id.* (quoting 10 Phillip E. Areeda, *Antitrust Law* ¶ 1760d, at 369). Because Complaint Counsel disclaimed any effort to offer any evidence that the moratorium actually had any anticompetitive effect in the United States or elsewhere, and because PolyGram offered plausible and valid procompetitive justifications for the moratorium, there is no basis for assessing whether any alternative would

[14] Complaint Counsel – who *stipulated* to the admission of the expert reports and deposition testimony of Professors Ordover and Wind during their case-in-chief – continue to disparage these eminent experts and to assert meritless reasons for ignoring their opinions. Complaint Counsel had the expert reports of Professors Wind and Ordover – and the materials the experts considered in preparing those reports – well before they deposed the witnesses. They then had every opportunity to examine the experts in deposition. And, at trial, they did not express any need to further examine the witnesses, but rather stipulated to the admission of their reports and testimony. Those reports and testimony, which overwhelmingly demonstrate the plausibility of PolyGram's procompetitive justifications in the context of the joint venture, are entitled to a full consideration during the Commission's *de novo* review of the record rather than the dismissive treatment now urged by Complaint Counsel. *Weil v. Long Island Savings*, 2001 U.S. Dist. Lexis 22915 (E.D.N.Y. 2001), which Complaint Counsel cite for the proposition that the ALJ "properly discounted the reports," provides no support whatsoever for Complaint Counsel's position. The case involved the issue of whether attorney work product provided to an expert in preparing his report is discoverable, and held that such is discoverable because it provides insight into the bases for the expert's opinions. Id. at * 10-11 There is no remotely similar issue here. Complaint Counsel's continued reliance on this patently irrelevant case is particularly troubling in view of the fact that it was discussed in the parties' post-trial briefing, during which PolyGram noted that the case simply has nothing to do with any of the issues here.

have been less restrictive of competition under the well-established framework for analyzing a challenged practice under the rule of reason.

The alternatives discussed by Complaint Counsel, CCAB at 43-44, fail to satisfy the controlling legal standards in any event. First, there is no evidence that a Europe-only moratorium – a suggestion first raised in Complaint Counsel's post-trial briefing, that was not discussed by any witness, and that reflects an apparent concession that the moratorium may have been procompetitive in Europe – would have been less restrictive or as effective as the moratorium. PolyGram and Warner adopted the moratorium as part of their single, worldwide marketing plan for their worldwide joint venture for the creation and distribution of Three Tenors products. The costs of developing that plan obviously would have been significantly increased if PolyGram and Warner had been forced to evaluate the benefits of controlling free riding in every territory throughout the world, as Complaint Counsel apparently believe they should have done. The record evidence showed that there were significant efficiencies in developing a uniform marketing plan in the context of this worldwide joint venture, and that the adoption of different rules for different territories could have led to substantial inefficiencies. RPF 130. Moreover, as the moratorium itself was not shown to have had *any* anticompetitive effect in the United States, there is no basis for concluding that a Europe-only moratorium would have been substantially less restrictive of competition, as the law requires.

Complaint Counsel's other set of alternatives – "creating a unique identity for 3T3, employing the ordinary tools of marketing and product design," CCAB at 44 – are not alternatives at all. Instead, Complaint Counsel are really suggesting that PolyGram and Warner should have developed a better product than 3T3. However, there is no evidence that PolyGram and Warner failed to use the "ordinary tools of marketing and product design" in seeking to make 3T3 as attractive as possible, or that the parties would not have viewed the moratorium as an important part of the marketing plans in this joint venture even if 3T3 had benefited from a better "product design." There is no record evidence that different packaging, different repertoire, a guest artist, or any other change to 3T3 would have done *anything* to address the

concerns that gave rise to the moratorium. As the relevant witnesses (including Complaint Counsel's own marketing expert, Professor Moore) consistently testified, record companies generally consider the presence of catalog products in developing their marketing plans for any new release, and often decide not to promote the catalog products alongside the new release. RPF 51-53. Thus, a decision that the moratorium was unlawful would deprive PolyGram of one of the "ordinary tools of marketing and product design" solely because its product happened to be created in the context of a joint venture.

D. There Is No Evidentiary Support The Cease And Desist Order Issued By The ALJ.

Complaint Counsel do not dispute that a cease and desist order may be entered only if there is a "real threat" that similar conduct will recur. *United States v. Oregon State Med. Soc'y*, 343 U.S. 326, 333 (1952); *TRW, Inc. v. FTC*, 647 F.2d 942, 954-55 (9th Cir. 1981). If that standard is satisfied here, it is difficult to imagine any situation in which it would not be satisfied. It is undisputed that PolyGram has not adopted any similar agreement, viewed the reasons for adopting this agreement as being closely related to the unique features of the Three Tenors joint venture, and is unaware of any similar joint venture in the music industry. RPF 103-104, 109. There is no evidence that any aspect of the "Pressplay" joint venture between Universal and Sony – which was evidence solely by a one page printout of a press release describing the joint venture, and was not the subject of any testimony at trial or in deposition – could possibly give rise to any concern similar to those that led to the decision to adopt the moratorium as part of the Three Tenors joint venture.

Apparently recognizing that there is no evidence whatsoever that there is any threat that similar conduct will recur, Complaint Counsel also seek to justify the order by reference to the fact that Warner entered into a *consent decree* with substantially similar terms. However, a "cease and desist" order in a contested case is obviously fundamentally different from a settlement that results in a consent decree. In entering into its consent decree, Warner elected to "waive further procedural steps and all rights to seek judicial review or otherwise to

challenge or contest the validity of the order." Rule of Practice 2.32. PolyGram did not waive those rights, and Complaint Counsel thus were required to establish in this case that there was a "real threat" that conduct similar to the moratorium would recur absent the entry of the order included in the Initial Decision. Complaint Counsel failed to show that *any* cease and desist order – let alone the 20-year order included in the Initial Decision, which would require that all of Respondents' current and future officers, directors and employees sign and acknowledgment that they have read the order regardless of whether they had any involvement in the conduct at issue in this case, and which would reverse the substantive and procedural burdens of the antitrust laws -- is justified. The Initial Decision can be reversed on that basis alone.

III. CONCLUSION

For all of the foregoing reasons, the Initial Decision should be reversed in its entirety and the Commission should adopt the findings and order proposed by Respondents.

Respectfully submitted,

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. ARGUMENT.. 3

A. Complaint Counsel Mischaracterize Both The Three Tenors Joint Venture And The Limited Moratorium On The Discounting And Promotion Of The Older Three Tenors Products. 3

1. The Three Tenors Joint Venture Was Not Limited To The "Distribution" Of The New Album. 3

2. The Joint Venture Agreement Did Not Establish The Scope Of Any "Covenant Not To Compete" And Did Not Identify And Define All Of The Important Aspects Of The Joint Venture. 4

3. The Moratorium Was Designed To Prevent Free Riding And Maximize The Long-Term Output Of Three Tenors Products And Was Unrelated To Any Subsequent Concern Regarding The Repertoire For 3T3. 5

4. The Moratorium Was Limited To "Special" Discounting And Advertising Campaigns. 7

5. Complaint Counsel Disclaimed Any Effort To Prove – And, In Fact, Presented No Evidence – That The Moratorium Had Any Effect On Competition In The United States. 7

B. The Moratorium Is Not Illegal Per Se. 10

C. The Moratorium Cannot Be Found Unlawful Under The Rule Of Reason Because Complaint Counsel Failed To Provide Any Evidence Of Anticompetitive Effect. 16

1. The Absence Of Any Evidence Of Anticompetitive Effect Mandates A Decision In PolyGram's Favor Because There Are No Presumptions Of Anticompetitive Effects Under The Rule Of Reason. 17

2. Any Presumption Of Anticompetitive Effect Would Not Apply On This Record. 23

3. The Procompetitive Justifications For The Moratorium Are Sufficient To Require A Decision In PolyGram's Favor........................ 28

a. The Presence Of Any Plausible Procompetitive Justification Triggers A Need For More Detailed Analysis Under The Rule Of Reason. 28

861152.1

TABLE OF CONTENTS
(continued)

Page

b. PolyGram's Procompetitive Justifications For The Moratorium Require Further Analysis Of Actual Effects Under The Rule Of Reason. 32

(1) The Moratorium Was A Reasonable And Plausibly Procompetitive Effort To Address A Specific Risk Of Free Riding. 32

(2) The Moratorium Was A Reasonable And Procompetitive Effort To Increase The Aggregate Long-Term Output Of Three Tenors Products In The Context Of The Joint Venture. 35

c. Complaint Counsel Failed To Establish The Existence Of Any Less Restrictive Alternative To The Moratorium. 38

D. There Is No Evidentiary Support The Cease And Desist Order Issued By The ALJ. 39

III. CONCLUSION 41

FEDERAL CASES

Association of Independent Television Stations, Inc. v. College Football Assn.,
637 F. Supp. 1289 (W.D. Okla. 1986) 37
Blue Cross & Blue Shield of Wisc. v. Marshfield Clinic,
65 F.3d 1406 (7th Cir. 1995) 13
Broadcast Music, Inc. v. CBS,
441 U.S. 1 (1979) 14, 19, 20, 36
Cal. Dental Ass'n v. FTC,
526 U.S. 756 (1999) 2, 17, 18, 23, 24, 31, 32
Cal. Dental Assn. v. FTC,
224 F.3d 942 (9th Cir. 2000 18
Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n,
961 F.2d 667 (7th Cir. 1992) 2, 10, 21, 22, 32
Columbia Broadcasting System, Inc v. American Soc. Of Composers Authors & Publishers,
620 F.2d 930 (2d Cir. 1980) 20
Continental T.V., Inc. v. GTE Sylvania Inc.,
433 U.S. 36 (1977) 37
County of Tuolumne v. Sonora Community Hosp.,
236 F.3d 1148 (9th Cir. 2001) 38
Denny's Marina, Inc. v. Renfro Productions, Inc.,
8 F.3d 1217 (7th Cir. 1993) 26
Detroit Auto. Dealers Ass'n,
111 F.T.C. 417 (1987) 23
FTC v. Superior Court Trial Lawyers Assn.,
493 U.S. 411 26
FTC v. Ticor Title Ins. Co.,
504 U.S. 621 (1992) 26
General Leaseways, Inc. v. National Truck Leasing Assn.,
744 F.2d 588 (7th Cir. 1984) 14, 35
In re Brunswick Corp.,
94 F.T.C. 1174 (1979) 13
In re Cal. Dental Ass'n,
121 F.T.C. 190, 1996 FTC LEXIS 81, at *93 (1996) 23, 24
In re Detroit Auto Dealers Ass'n,
955 F.2d 457 (6th Cir. 1992) 23
In re General Motors Corp. and Toyota Motors Corp.,
103 F.T.C. 374 (1984, *vacated* 5 Trade Reg. Rep. (CCH) ¶ 23,491 1993 WL 767061 (F.T.C.) (Oct. 29, 1993) 12
In re Schering-Plough Corp,
FTC Docket No. 9297 (filed June 26, 2002) 24, 25
In re Toys 'R Us, Inc.,
126 F.T.C. 415, (1998), *aff'd*, 221 F.3d 928 (7th Cir. 2000) 32, 34, 35
Mass. Board of Registration in Optometry,
110 F.T.C. 603 (1988) 23, 27

NCAA v. Board of Regents,
468 U.S. 85 (1984) 2, 10, 14, 16, 20, 21, 22, 23, 36
New York v. Hendrickson Bros., Inc.,
840 F.2d 1065 (2d Cir. 1988) 12
New York v. Saint Francis Hospital,
94 F. Supp. 2d 399 (S.D.N.Y. 2000) 11
Palmer v. BRG of Georgia, Inc.,
498 U.S. 46 (1990) 11
Polk Bros., Inc. v. Forest City Enters., Inc.
776 F.2d 185 (7th Cir. 1985) 14, 15, 22, 32
Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,
792 F.2d 210 (D.C. Cir. 1986) 14, 15, 22, 32
TRW, Inc. v. FTC,
647 F.2d 942 (9th Cir. 1981) 39
United States v. Brown University,
5 F.3d 658 (3d Cir. 1993) 22, 30
United States v. Columbia Pictures Indus., Inc.,
507 F. Supp. 412 (S.D.N.Y. 1980) 26
United States v. Metropolitan Enters.,
728 F.2d 444 (10th Cir. 1984) 12
United States v. MMR Corp.,
907 F.2d 489 (5th Cir. 1990) 12
United States v. National Football League,
116 F. Supp. 319 (E.D. Pa. 1953) 26
United States v. Oregon State Med. Soc'y,
343 U.S. 326 (1952) 2, 39
United States v. Richer,
983 F.2d 168 (10th Cir. 1992) 26
United States v. Socony Vacuum Oil Co.,
310 U.S. 150 (1940) 26
Weil v. Long Island Savings,
2001 U.S. Dist. Lexis 22915 (E.D.N.Y. 2001) 37
Yamaha Motor Co. v. FTC,
657 F.2d 971 (8th Cir. 1981) 13, 14

OTHER AUTHORITIES

Collaboration Guidelines ¶ 3.36(b) (April 2000) 30

EXPLANATION OF CITATIONS TO THE RECORD

The following abbreviations are used in this appeal brief for citations to the record:

ID	Initial Decision (served July 8, 2002)
F. __	Finding __ from the Initial Decision
Tr. (___) __:___	Trial Transcript (Witness) Page:Line
SE	Stipulated Index of Exhibits and Witnesses, (filed April 26, 2002)
RPF __	Respondents' Proposed Finding No. __ (filed April 26, 2002)
RRCPF __	Respondents' Reply to Complaint Counsel's Proposed Finding No. ___ (filed May 15, 2002)
CCAB	Complaint Counsel's Appeal Brief (filed September 11, 2002)
CCPRB	Complaint Counsel's Post-Trial Reply Brief (filed May 14, 2002)
CCSR	Complaint Counsel's Status Report and Statement of the Case (filed Nov. 27, 2001)
CCOSJ	Complaint Counsel's Opposition to Motion for Summary Judgment (filed Feb. 14, 2002)
____ Dep. __:___	Witness Deposition Page:Line
CCPFF	Complaint Counsel's Proposed Findings of Fact (filed April 26, 2002)