Federal Trade Commission

Terra Incognita: Vertical and Conglomerate Merger and Interlocking Directorate Law Enforcement in the United States

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before the

University of Hong Kong

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First, let me tell you how pleased I am to be the inaugural speaker for the series of lectures sponsored by the Norton Rose law firm. It is a great privilege and honor, and I am grateful both to Norton Rose and to Dean Chan and Professor Thomas Cheng for arranging this lecture.

Second, let me warn you that I am not going to follow Professor Cheng's advice about what to say with precision. The reason for that is I've had an opportunity not only to review the proposed new antitrust regime for Hong Kong, but to talk with various Hong Kong officials about it. Before discussing the topics assigned to me by Professor Cheng, I'd like to discuss briefly my reactions to what I've read and heard.

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

My first reaction is that you are writing on a very blank slate. The new antitrust regime will be a first for Hong Kong. Moreover, Hong Kong is a unique community both in the way it is governed and the way that business is conducted. I am not clear that the American or European models are of very much use to you in writing on that blank slate.

Specifically, we in the United States frequently extol the virtues of our private treble damage regime as a beneficial adjunct to public antitrust law enforcement. I'm not going to do that because I personally do not favor opt out class actions, which are essential to attract the kind of investment by private attorneys that creates the private regime in the United States. In my view, they have lead to extortionate settlements and Supreme Court decisions that have narrowed the substantive law applicable in both private and public cases.

Beyond that, we in the United States have often sung the praises of free markets and the resulting check they impose on predation. We have said that markets are generally perfect or, if somewhat imperfect, they will correct themselves rather quickly. As a result, we have asserted that rational sellers seeking to maximize their profits (which we have said constitute almost all sellers) will generally not find it worthwhile to engage in predatory conduct. I am not going to say this either because I am concerned that the financial crisis has exposed the cracks in that thesis.

Neither am I going to preach to you the virtues of a specialized court like the FTC. For one thing, the new regime that is contemplated would include such a court. For another thing, the devil is definitely in the details: whether such a court is good or bad depends on who is appointed to it, and it is much too early to determine who that will be.

Nor am I going to wax eloquent about cartel law enforcement. That is because, apart from the criminal cases I handled as a private practitioner, I don't know anything about it. The

Department of Justice's Antitrust Division, not the FTC, engages in that kind of enforcement. The only thing I will note is that those who are engaged in preparing the new Hong Kong regime would not automatically make criminal certain practices that are criminal in both the United States and Europe—for example, price-fixing, bid-rigging and market divisions. However, even in some cases without criminal sanctions, those practices would have to be proved beyond a reasonable doubt and defendants would have a right not to incriminate themselves. It strikes me that that difference unduly burdens prosecutors with no concomitant benefits for consumers.

All of this said, I am going to discuss some things that will be relevant to the proposed new antitrust regime. The first topic will be mergers. The new regime will not create a pre-merger screening process for mergers such as exists in the United States, Europe, and many other countries. Indeed, it will not prohibit anticompetitive mergers as such. But it will prohibit agreements that are anticompetitive in effect, and that arguably would include agreements to merge. Moreover, in some respects it may be even more stringent than the United States and European regimes. Whereas those regimes would prohibit agreements that are anticompetitive in effect, the new regime contemplated would ban agreements that are anticompetitive in purpose or effect. Additionally, it would ban agreements which not only have static anticompetitive effects on prices but those that have dynamic anticompetitive effects such as anticompetitive effects on innovation.

The second topic will be interlocking directorates. While the trend in the United States is away from per se illegality, interlocking directorates in instances where the competition between the corporate entities involved is not de minimus constitute an exception to that trend, and Hong Kong may wish to consider emulating the United States in this respect because the incidence of such directorates in Hong Kong resembles that in the United States.

Finally, the Antitrust Section of the American Bar Association has urged Hong Kong not to adopt statutory immunities from antitrust prosecution. But that is a bit hypocritical because there are a number of non-statutory immunities in the United States that are alive and well. I will discuss one of them—namely the *Noerr* immunity. But in my discussions with officials, it seems that another of those immunities—namely the state action immunity—may have more relevance to Hong Kong. Specifically, I understand that one of the thorniest issues is whether government-owned entities ought to be given complete immunity. While the federal government has such immunity in the United States, that is not so for state actions. Those are subject to more stringent requirements—that the state intend to displace competition and that there be active state supervision of the conduct at issue. Perhaps that more stringent regime might be adopted by Hong Kong.

I.

I will refer to vertical and conglomerate mergers collectively as non-horizontal mergers. Very few non-horizontal mergers are investigated by the FTC and DOJ and even fewer are challenged. The most recent policy statement from the agencies on merger enforcement – the 1992 Merger Guidelines – did not mention vertical or conglomerate mergers.[1] Indeed, one has to look back to guidelines issued by the Department of Justice in 1984 for the last mention of non-horizontal mergers.[2] The part of those guidelines addressing non-horizontal mergers is still valid

[1] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines § 4 (1992, as amended 1997), *reprinted in* 4 Trade Reg Rep. (CCH) ¶ 13,104.

[2] U.S. Dep't of Justice, Merger Guidelines § 4.0, 49 Fed. Reg. 26,823 (1984), *available at* http://www.usdoj.gov/atr/public/guidelines/2614.htm [hereinafter 1984 Guidelines].

today,[3] although rarely cited. The 1984 Guidelines embrace two general theories of liability for vertical mergers.[4]

First, vertical mergers may facilitate collusion in either an upstream or downstream market.[5] For example, a vertical merger by an upstream firm into a downstream market may facilitate collusion in the upstream market by making it easier to monitor prices.[6] Also, the acquisition of a particularly disruptive buyer in a downstream market may facilitate collusion in the upstream market.[7]

Second, a vertical merger may foreclose competition by creating barriers to entry in the markets in which the acquiring and acquired firm compete.[8] However, the creation of those entry barriers is described as a viable threat only in very limited circumstances, namely, when entry into *both* markets is necessary in order to compete in one of them, when the non-horizontal

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[3] *See* U.S. Department of Justice and Federal Trade Commission Statement Accompanying Release of Revised Merger Guidelines (1992) ("Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in Section 4 of the Department's 1984 Merger Guidelines read in the context of today's revisions to the treatment of horizontal mergers.").

[4] The 1984 Guidelines also describe how a vertical merger may facilitate evasion of rate regulations by a regulated company. *Id*. § 4.23. An example of this would be a utility purchasing a supplier and then arbitrarily increasing the transfer cost of the input and passing the inflated prices along to customers. The agencies have challenged only a handful of transactions under this theory. *See, e.g.*, *United States v. MCI Commc'ns Corp*., 1994-2 Trade Cas. (CCH) ¶ 70,730 (D.D.C. June 27, 1994) (final judgment in DOJ case alleging that British Telecommunications' proposed partial acquisition of MCI would enable rate evasion); *Entergy Corp*., 66 Fed. Reg. 9342 (FTC Feb. 7, 2001) (consent order designed to prevent utility buying gas supplier from avoiding price regulations).

[5] 1984 Guidelines § 4.22.

[6] *Id*. § 4.221.

[7] *Id*. § 4.222.

[8] *Id*. § 4.21.

merger makes simultaneous entry substantially more difficult,[9] *and* when the market of concern is concentrated.[10]

In addition to those two general vertical theories of liability, the 1984 Guidelines describe the elimination of a potential competitor as a basis for antitrust challenge under certain circumstances.[11] The concern is that the acquisition of a company that is about to enter or is perceived as likely to enter the relevant market will reduce the competitive pressure on existing competitors. A challenge to an acquisition under this theory is only appropriate under the Guidelines where (1) the market is highly concentrated, (2) entry barriers are high, (3) the entry advantage ascribed to the likely entrant is shared by two or fewer other firms, and (4) the firm in the market has at least a 5% market share.[12]

Neither the 1992 Horizontal Merger Guidelines nor the 1984 Merger Guidelines contain any traditional conglomerate merger theories, such as entrenching the position of a dominant firm. Likewise, there is no mention in either the 1984 or 1992 Guidelines of the opportunities and incentives that may exist, post-transaction, for the acquiring firm to engage in conduct that may cripple rivals in upstream or downstream markets – conduct targeting a rival such as a

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[9] *Id*. §§ 4.211 - 4.212.

[10] *Id*. § 4.213.

[11] *Id*. § 4.1. How to classify mergers raising this type of competitive harm is not altogether clear. Some consider it a type of conglomerate merger. *See, e.g.*, ABA SECTION OF ANTITRUST LAW, MONOGRAPH NO. 14, NON-HORIZONTAL MERGER LAW AND POLICY § II.B.2.c. (1988). Others treat it as a type of non-horizontal merger distinct from vertical and conglomerate mergers. *See, e.g.*, ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS § 3.C (6th ed. 2007). Furthermore, a merger between potential competitors could be viewed as a type of horizontal merger and analyzed under the 1992 Horizontal Merger Guidelines. *See* 1984 Guidelines § 4.13 (noting that the analysis of potential competition concerns is "analogous to that applied in horizontal mergers").

[12] 1984 Guidelines §§ 4.131 - 4.134.

refusal to deal, predatory pricing, or various forms of leveraging, such as tying, bundling, granting a loyalty rebate, or engaging in exclusive dealing with prospective customers of the rival.

Notwithstanding the narrow enforcement view toward non-horizontal mergers in the United States, there is support for non-horizontal merger challenges if one reads the decisions of the Supreme Court and the lower courts in the United States. For example, the Supreme Court has condemned vertical mergers that threaten to lessen competition in upstream or downstream markets.[13] Likewise, the Court has held that a conglomerate merger that entrenched a dominant supplier could be illegal.[14] As the leading U.S. antitrust treatise acknowledges, this "precedent . . . has not been overruled."[15]

Government challenges to non-horizontal mergers – particularly vertical mergers – were fairly routine at one time.[16] There is no question that time has passed. The reality is that in the past three-plus decades there have been very few challenges to non-horizontal mergers in the United States. The federal antitrust law enforcement agencies have not litigated to conclusion a

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[13] *United States v. Brown Shoe Co*., 370 U.S. 294, 323-24 (1962) ("The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition' . . . ."); *United States v. E.l. duPont de Nemours & Co*., 366 U.S. 316 (1961) (forcing divestiture of stake in GM because it enhanced DuPont's ability to foreclose competition from other suppliers); *Ford Motor Co. v. United States*, 405 U.S. 562, 570 (1972).

[14] *FTC v. Procter & Gamble Co*., 386 U.S. 568, 578-79 (1967) (acquisition of bleach company by large producer of other household products held illegal because of lower cost of advertising available to acquiring company and because "smaller firms would become more cautious in competing due to their fear of retaliation").

[15] PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1140 (3d ed. 2007, supplemented Aug. 2008).

[16] *See, e.g*., *United States Steel Corp. v. FTC*, 426 F.2d 592 (6th Cir. 1970); *Mississippi River Corp. v. FTC*, 454 F.2d 1083 (8th Cir. 1972); *Gulf & Western Indus. v. Great Atl. & Pac. Tea Co*., 476 F.2d 687 (2d Cir. 1973); *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368 (9th Cir. 1978).

single merger challenge on a vertical theory since 1979.[17] And neither agency has challenged a merger on a conglomerate theory since 1966.[18] There have been a number of consent decrees – approximately twenty by my count – where non-horizontal effects, to varying degrees, have played a role in the analysis. However, with one possible exception,[19] in all of these cases, the descriptions of liability are consistent with the theories of liability embraced by the 1984 Guidelines.

Let me give you two examples of the types of vertical merger cases the U.S. agencies have pursued within the last two years. *United States v. Monsanto*,[20] is a case involving the foreclosure theory in the 1984 Guidelines. Monsanto Company sought to acquire Delta & Pine Land Company. Monsanto was the largest developer of cotton traits, which were used to create genetically modified cottonseed. Delta was the largest supplier of the high-quality seeds needed as a platform for developers of cottonseed traits. The DOJ claimed that the merger would eliminate the most significant independent seed supplier (Delta) to Monsanto's competitors, thus blocking or delaying development of cottonseed traits that would compete with Monsanto.[21] Put

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[17] *Fruehauf Corp. v. FTC*, 603 F.2d 345 (2d Cir. 1979).

[18] The closest the United States came to litigating non-horizontal issues since the issuance of the 1984 Guidelines was the proposed acquisition of Northrop Grumman by Lockheed. In 1998, the Department of Justice filed a complaint seeking to enjoin that transaction and that matter proceeded through four months of discovery before the parties abandoned the transaction. The government alleged significant horizontal and vertical competitive effects in a number of different markets. *See United States v. Lockheed Corp*, No. 1:98-cv-00731 (D.D.C. 1998).

[19] The decree resolving the Commission's concerns with Time Warner's acquisition of Turner is the only matter that arguably embraces a theory of effects outside of the 1984 Guidelines. *See Time Warner Inc.*, 123 F.T.C. 171 (1997).

[20] 1:07-cv-00992 (D.D.C. 2007) (competitive impact statement), *available at* http://www.usdoj.gov/atr/cases/f223600/223682.htm

[21] The DOJ also alleged a horizontal theory based on overlapping sales of genetically modified cottonseed.

differently, the merger allegedly created entry barriers in both the market for cottonseed traits and the cottonseed market itself. The DOJ was particularly concerned because the development of a single cotton trait required 8 to 12 years and $100 million to develop and commercialize. The case was resolved with a consent decree requiring Monsanto to divest a significant seed company and multiple cottonseed lines.

United States v. Premdor,[22] is an example of a merger that raised concerns that it would facilitate collusion through elimination of a disruptive seller. Masonite was a vertically-integrated molded door manufacturer. Premdor was a significant supplier of the upstream product, molded doorskins, to independent door makers but was not vertically integrated into the production of molded doors. The combination of the two companies would have resulted in the markets for doorskins and interior molded doors being dominated by two similarly-sized vertically-integrated firms. The DOJ alleged that, as a result, the industry would be prone to coordination. The DOJ's objections were resolved with a consent decree under which Premdor divested a doorskin manufacturing plant.

Compared to the United States, the European Commission has shown a greater willingness and determination to challenge non-horizontal mergers that threaten competition. Last year, the EC issued new guidelines for reviewing non-horizontal mergers.[23] The guidelines posit liability where, post-transaction, the acquiring firm will have the ability and incentive to

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[22] 1:01-cv-01696 (D.D.C. 2001) (competitive impact statement), *available at* http://www.usdoj.gov/atr/cases/f9000/9017.pdf.

[23] Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings § 5, 2008 O.J. (C 265) 6 (2008) [hereinafter EC Non-Horizontal Merger Guidelines]; *see also* Case T-210/01, *General Elec. v. Commission* [2005] ECR II-000 ¶ 73; Case C-12/03 P, *Commission v. Tetra Laval BV* [2003], ECR I-000 ¶¶ 74-76.

cripple rivals in upstream and downstream markets by raising their costs or engaging in exclusive dealing, predatory pricing, or leveraging.

Specifically, the guidelines focus on the likelihood that a transaction will foreclose rivals from competing effectively to the disadvantage of consumers.[24] For example, the guidelines focus on whether a vertical or conglomerate merger will give the acquiring firm the ability and the incentive to engage in conduct that will disadvantage its rivals – whether that is complete foreclosure or a strategy designed to increase its rivals' costs.[25] Yet foreclosure alone is not enough. The guidelines then ask whether competition – and consumers – will be harmed by the foreclosure.[26]

Furthermore, the guidelines place the burden on the parties to demonstrate that there are cognizable efficiencies to the conduct that outweigh any potential for harm, rather than

[24] EC Non-Horizontal Merger Guidelines ¶ 18 ("Non-coordinated effects may principally arise when non-horizontal mergers give rise to foreclosure. In this document, the term 'foreclosure' will be used to describe any instance where actual or potential rivals' access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies' ability and/or incentive to compete. As a result of such foreclosure, the merging companies – and, possibly, some of its competitors as well – may be able to profitably increase the price charged to consumers.").

[25] *Id.* ¶ 29 ("Foreclosure can thus be found even if the foreclosed rivals are not forced to exit the market: It is sufficient that the rivals are disadvantaged and consequently led to compete less effectively.").

[26] *Id*. ¶ 29 (in the context of a vertical merger, "foreclosure is regarded as anti-competitive where the merging companies – and, possibly, some of its competitors as well – are as a result able to profitably increase the price charged to consumers"); *id*. ¶ 93 (conglomerate merger condemned only if the "foreclosure strategy would have a significant detrimental effect on competition, thus causing harm to consumers").

presuming that they will exist.[27] The parties must demonstrate that the efficiencies will benefit consumers.[28]

What accounts for the difference in attitude about non-horizontal merger enforcement between the United States and Europe? I suggest the principal reason is the different economic approaches underlying merger policy in the two regions. The jurisprudence of our courts, particularly that of our current Supreme Court, and the policy of our enforcement agencies are heavily influenced by Chicago School economics. The 1984 Guidelines are an example. Those guidelines were authored under the leadership of then Assistant Attorney General William Baxter, who was a strong supporter of Chicago School economics. Chicago School economic thinking is clearly reflected in the 1984 Guidelines. For example, the 1984 Guidelines suggest that non-horizontal mergers are almost always efficiency-enhancing, a tenet of the Chicago school.[29] Likewise, the 1984 Guidelines' concern with vertical mergers facilitating collusion is consistent with Chicago School economics, since collusion is one of the few kinds of conduct that is considered to be inefficient and hence, pernicious.

In contrast, the European Commission's non-horizontal merger guidelines draw heavily from post-Chicago economic theory,[30] which questions some of the fundamental assumptions

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[27] *Id*. ¶ 52 ("[T]he effect on competition needs to be assessed in light of efficiencies substantiated by the merging parties.").

[28] *Id*. ¶ 53 ("[F]or the Commission to take into account of efficiency claims in its assessment of the merger, the efficiencies have to benefit consumers, be merger-specific and be verifiable.").

[29] 1984 Guidelines §§ 4.0, 4.24; *see also* United States submission to the Organization for Economic Cooperation & Development "Roundtable on Vertical Mergers (Feb. 15, 2007) (urging endorsement of a presumption that nonhorizontal mergers are efficiency-enhancing), *available at* http://www.ftc.gov/bc/international/docs/07RoundtableonVerticalMergers.pdf.

[30] *See generally* Jeffrey Church, Impact of Vertical and Conglomerate Mergers (2004) (report written for the European Commission (Directorate General for competition and Directorate B

underpinning the Chicago School's teachings. Post-Chicago School scholars have presented scenarios in which leveraging monopoly power can not only be a profitable strategy for the monopolist but also one with significant anticompetitive effects. Others have shown that concerted refusals to deal, tying, and exclusive dealing may be more readily explained not as devices for destroying a rival altogether but rather for making the rivals' production or distribution more costly, thereby impairing the competitive process and injuring consumers.[31] Thus, post-Chicago School economics in general is more concerned about conduct that hobbles rivals as competitors and tends to eschew presumptions that conduct is efficiency-enhancing. Post-Chicago School thinking appears to be reflected in a number of recent European judicial decisions, including *France Telecom*, *British Airways*, *General Electric*, and *Tetra Laval*.[32]

Another possible reason for the difference is that there is an institutional difference in the law enforcement agencies in the United States and Europe. Our regime is adversarial. The European regime is administrative. Under the administrative model (the European Commission being the administrator), interested private parties may appeal EC decisions with which they

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Merger Task Force) on the effects of vertical and conglomerate mergers), *available at* http://ec.europa.eu/competition/mergers/studies_reports/merger_impact.pdf.

[31] *See* Thomas Krattenmaker & Steve Salop, *Antitrust Analysis of Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209 (1986); Michael H. Riordan & Steve Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1995); Janusz Ordover, Garth Saloner & Steven Salop, *Equilibrium Vertical Foreclosure*, 80 AM. ECON. REV. 127 (1990).

[32] *Tetra Laval BV v. Commission*, T-5/02, 2002 ECR II 4381 (CFI), *aff'd*, *Case Commission v. Tetra Laval BV*, C-12/03P, 2005 ECR I 987 (CJ); *General Electric Company v. Commission*, T-210/01, 2005 ECR II 5575 (CFI); *British Airways plc v. Commission*, T-219/99, 2003 ECR II 5917 (CFI); *France Télécom SA v. Commission of the European Communities*, T-340/03, 2007 ECR _(CFI).

disagree to the European Court of First Instance and the European Court of Justice.[33] Thus, the EC must be concerned about whether a decision not to challenge any merger, whether horizontal or non-horizontal, that is within its jurisdiction will be subject to judicial review. That is something that the U.S. antitrust enforcement agencies need not worry about.

There is reason to believe that we are about to witness a resurgence in non-horizontal merger enforcement in the United States. In other words, past may not be prologue. The new head of the Department of Justice's Antitrust Division, Christine Varney, stated in her confirmation hearings that "both horizontal and vertical mergers must be reviewed with rigor. . . . I will not shy away from considering whether the vertical integration resulting from a merger or acquisition is likely to substantially lessen competition."[34] She also stated that the DOJ needed to "rebalance legal and economic theories in antitrust analysis" and noted her skepticism for the Chicago-school approach.[35] These remarks were not surprising, given her

[33] For example the Commission's July 2004 clearance of the Sony/Bertelsmann AG (BMG) joint venture was annulled by the Court of First Instance after a group of rival music labels appealed the Commission's decision. Ultimately, the venture was approved after re-review by the Commission and the judgment of the Court of First Instance was set aside by the European Court of Justice.

[34] Christine A. Varney, Answers to Questions for the Record from Senator Charles Schumer Before the Senate Judiciary Committee (Mar. 10, 2009), *available at* http://judiciary.senate.gov/nominations/ChristineVarney/upload/QFRsSchumer.pdf. She reiterated this sentiment in a speech shortly after assuming the helm at the Antitrust Division. *See* Christine A. Varney, Assistant Att'y General, Antitrust Division, U.S. Department of Justice, Vigorous Antitrust Enforcement in This Challenging Era, Remarks as Prepared for the United States Chamber of Commerce (May 12, 2009) (noting that she intends "to explore vertical theories" in merger enforcement).

[35] *Hearing of the S. Judiciary Comm.: The Nomination of Christine Anne Varney to be Assistant Attorney General in the Antitrust Division*, FED. NEWS SERVICE, Mar. 10, 2009 ("I think that what we've seen in the last eight years is that a lot of economic theory has been used to inhibit prosecuting mergers and other activity that may be impermissible. . . . [T]he Chicago school analysis is a real reluctance for government to go forward and attempt to block mergers in the marketplace. And that's really what I mean when I talk about rebalancing economic theory.").

support for vertical merger enforcement while she was an FTC Commissioner in the 1990s.[36] In a 1995 speech, for example, she explained how vertical mergers could cause vertical foreclosure and/or raise rivals' costs, as well as facilitate collusion, and she asserted that the antitrust agencies "have the tools available" to determine which vertical mergers are worthy of condemnation.[37]

The FTC may also be on the verge of more aggressive enforcement of non-horizontal mergers. In the recent *Ovation Pharmaceuticals* case,[38] I suggested that if a merger or acquisition will result in a change in incentives to substantially lessen competition or exercise monopoly power, the transaction may be challenged on that basis as well.[39] Whether such a

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[36] Then-Commissioner Varney supported several vertical merger enforcement decisions while at the FTC. *See, e.g.*, Cadence Design Systems, Inc., FTC File No. 971-0033 (May 8, 1997) (Statement of Chairman Pitofsky and Commissioners Steiger and Varney), *available at* http://www.ftc.gov/os/1997/05/state01.htm; Time Warner Inc., FTC File No. 961-0004 (Sept. 12, 1996) (separate statement of Chairman Pitofsky and Commissioners Steiger and Varney), *available at* http://www.ftc.gov/os/1996/09/twother.htm; Press Release, Fed. Trade Comm'n, FTC Settlement Would Preserve Competition on Price and Innovation for Entertainment Graphics Software and Hardware (June 9, 1995), *available at* http://www.ftc.gov/opa/1995/06/sgi.shtm.

[37] Christine A. Varney, Vertical Merger Enforcement Challenges at the FTC, Remarks before the PLI 36th Annual Antitrust Institute (July 17, 1995), *available at* http://www.ftc.gov/speeches/varney/varta.shtm.

[38] In 2005 and 2006, Ovation purchased the rights to the only two drugs approved for the treatment of a life-threatening heart defect in premature babies. The FTC challenged the second acquisition as a horizontal merger on the grounds that it was a merger to monopoly. I would have gone further and also challenged the first transaction because there was "reason to believe" that it eliminated certain reputational constraints on the prices charged by the prior owner. Indeed, there was evidence that the prior owner knew full well that it had monopoly power but chose not to exercise it out of a fear of hurting its image and losing sales of other products. There was also evidence that Ovation substantially increased the price of the first drug after the acquisition. In short, my concern with the first transaction was that it changed the drug owner's *incentives* – rather than changing the market structure – in a way that would harm consumers.

[39] Concurring Statement of Commissioner J. Thomas Rosch, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., FTC File No. 0810156 (Dec. 16, 2008), *available at* http://www2.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf.

theory would be accepted by our courts was unclear but I thought there was "reason to believe" that it would, which is the operative standard.[40] Only one of the other Commissioners concurred in my approach, but he has since been elevated to Chairman of the Commission.

II.

Next I'd like to talk about how U.S. antitrust law addresses interlocking directorates. An interlocking directorate occurs when a person sits on two or more boards of directors. We frequently think of two types of interlocks. A direct interlock is when the same individual sits on both boards. An indirect interlock occurs when different people from the same entity sit on two or more boards.

Interlocking directorates are a common feature of boardrooms in the United States. A few years ago, the newspaper *USA Today* reported that:

- One-fifth of the 1,000 largest U.S. companies share at least one board member with another top 1,000 company
- More than 1,000 board members from the top U.S. companies sit on four or more corporate boards
- 235 of these board members sit on seven or more corporate boards[41]

Interlocking directorates are also a common feature of Hong Kong businesses. A study whose authors included two professors from the Chinese University of Hong Kong found that the extent of interlocking directorates in Hong Kong was remarkably similar to that of the United States. For example, the study found that:

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[40] 15 U.S.C. § 45(b).

[41] Matt Krantz, *Web of Board Members Ties Together Corporate America*, USA TODAY, Nov. 24, 2002, *available at* http://www.usatoday.com/money/companies/management/2002-11-24-interlock_x.htm.

- The proportion of multiple directors in Hong Kong was 17%, compared to 18% in the United States.
- The mean number of positions per director in Hong Kong was 1.29, compared to 1.28 for the United States.[42]

On the other hand, the study found that interlocked firms in Hong Kong are linked together tighter than their American counterparts.[43] Hong Kong has three times the rate of what the authors called "heavy linkers," i.e., board members who sit on more than five boards.[44] In addition, where an interlock exists between two firms, the number of overlapping directors between the two firms tends to be higher for Hong Kong firms.[45]

To be sure, there are a number of differences between the U.S. and Hong Kong economy, but these data suggest that America's experience with interlocking directorates may have some relevance to Hong Kong.

For the most part, interlocking directorates are perfectly legal in the United States. But when a person is affiliated with two competing companies, a number of antitrust concerns can arise. An interlocking officer or director can injure competition by facilitating coordination between competing companies or by providing a conduit for the exchange of competitively sensitive information. These concerns have, if anything, only grown in recent years as the government's burden of investigating and litigating price fixing cases has multiplied.

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[42] Kevin Au, Mike W. Peng & Denis Wang, *Interlocking Directorates, Firm Strategies, and Performance in Hong Kong: Towards a Research Agenda*, 17 ASIA PAC. J. MGMT. 29, 31-34 (2000). The study was based on data from just before the transfer of Hong Kong's sovereignty from the United Kingdom to the People's Republic of China.

[43] *Id*. at 34.

[44] *Id*.

[45] *Id.*

Section 8 of the Clayton Act prohibits any "person" from simultaneously serving as an officer or director of two competing corporations of a certain size.[46] The Act does not apply where the competitive overlap between the companies is de minimis.[47] As explained by one court, the purpose of Section 8 "was to nip in the bud incipient violations of the antitrust laws by removing the opportunity or temptation to such violations through interlocking directorates."[48]

The Act was enacted in 1914, a time in American history when there was widespread mistrust toward large corporations. The person perhaps most responsible for the Act was Louis Brandeis, who penned a series of magazine articles critical of interlocking directorates. Mr. Brandeis at the time was an advisor to President Wilson and would later become a Supreme Court justice. Interlocking directorates became such a hot-button political issue in the 1912 election that all three political party platforms called for legislation to address the subject. The public's concern about interlocks was not just for antitrust reasons, but also due to concerns that they caused conflicts of interest between board members and shareholders.

Despite the Act's almost century-long existence, it has generated surprisingly little litigation. Section 8 can be enforced by the Federal Trade Commission, U.S. Department of Justice, state attorneys general, and private parties.[49] Violations of the Act are treated as per se

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[46] 15 U.S.C. § 19.

[47] The de minimis exemption was added in 1990 in response to concerns that companies were having difficulty attracting qualified directors on their boards, especially women and minorities, as a result of minor competitive overlaps. The de minimis exemption applies if "(A) the competitive sales of either corporation are less then $1,000,000 as adjusted . . ., (B) the competitive sales of either corporation are less than 2 per centum of that corporation's total sales; or (C) the competitive sales of each corporation are less than 4 per centum of that corporation's total sales." 15 U.S.C. § 19(a)(2). The $1 million threshold is adjusted annually.

[48] *United States v. Sears, Roebuck & Co.*, 111 F. Supp. 614, 616 (S.D.N.Y. 1953).

[49] In certain regulated industries, other agencies enforce industry-specific regulations on interlocking directorates.

violations. That is, parties cannot justify violations of the Act based on a lack of competitive injury. A sitting officer or director that becomes ineligible to serve under the statute due to some intervening event has a one-year grace period from the date of the event in which to resign his or her position.[50] The penalties for violating the Act are fairly modest and typically are limited to elimination of the interlock.

Despite the Act's seemingly broad reach, it does not cover a number of interlocks that could facilitate violations of the Sherman Act. For example, the Act does not cover:

- Interlocks between potential competitors[51]
- Interlocks between suppliers and customers (a vertical interlock)[52]
- Interlocks where individuals from competing corporations sit on a board of a non-competing company
- Interlocks involving family or close friends[53]
- Interlocks involving entities other than corporations[54]

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[50] 15 U.S.C. § 19(b).

[51] *See Paramount Pictures*, 1966 Trade Cas. (CCH) at 82,065-66; *TRW, Inc*., 647 F.2d 942, 946 n.4 (9th Cir. 1981) (expressing "no opinion about whether section 8 encompasses interlocking directorates between corporations that are merely potential competitors").

[52] *See BankAmerica Corp v. United States*, 462 U.S. 122, 128 (1983); *Paramount Pictures*, 1966 Trade Cas. (CCH) at 82,065; *TRW, Inc*., 93 F.T.C. 325, 379 (1979), *rev'd in part on other grounds*, 647 F.2d 942 (9th Cir. 1981).

[53] The prohibition against interlocks applies to "persons," which includes "corporations and associations" but not familial relationships. *See* 15 U.S.C. § 12. By contrast, spouses and minor children are treated collectively in the premerger notification rules. *See* 16 C.F.R. § 801.1 (a)(c)(2) ("The holdings of spouses and their minor children shall be holdings of each of them.").

[54] *See* 15 U.S.C. § 19(a)(1) ("No person shall, at the same time, serve as a director or officer in any *two corporations* . . . ." (emphasis added)); *BankAmerica*, 462 U.S. at 128 (holding that Section 8 does not apply if at least one of the entities involved is exempt from the coverage of the Act, such as a bank); *North Am. Soccer league v. NFL*, 670 F.2d 1249, 1262 (2d Cir. 1982) (holding that Section 8 has no application to sports leagues). On the other hand, Section 8 may

Indirect interlocks are another possible loophole. The FTC and DOJ take the position that these are covered by the Act and have pursued enforcement actions based on this approach, but the courts have not yet spoken definitively on this issue.[55] There is a similar debate as to whether Section 8 applies to corporations that do not compete but whose subsidiaries do.[56]

Fortunately, the FTC has a tool for addressing these loopholes: Section 5 of the FTC Act.[57] This statute prohibits "unfair methods of competition"[58] and can reach conduct not

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apply when the entity between two corporations is a union, trust, or other type of association. *See United States v. Int'l Ass'n of Machinists*, 1994 Trade Cas. (CCH) ¶ 70,813 (D.D.C. 1994) (consent decree resolving union having representatives simultaneously serving on competing airlines); Advisory Opinion, United Auto Workers, 97 F.T.C. 933 (1981) ("[A] corporation or association may violate may violate Section 8 of the Clayton Act if it has representatives or deputies serving simultaneously on the boards of two competing corporations.").

[55] *See, e.g.*, *Pocahontas Supreme Coal Co. v. Bethlehem Steel Corp.*, 828 F.2d 211, 217 (4th Cir. 1987) (dismissing Section 8 claim based on indirect interlock theory because plaintiff failed to identify the interlocked boards and directors); *United States v. Cleveland Trust Co.*, 392 F. Supp. 699, 710-12 (N.D. Ohio 1974) (whether a corporation may be deemed to sit on another company's board through a "deputy" is "entirely unsettled"), *aff'd mem.*, 513 F.2d 633 (6th Cir. 1975). A straightforward reading of the statute shows that it applies to any "person," the definition of which includes corporations. *See* 15 U.S.C. § 12 ("The word 'person' or 'persons' wherever used in this Act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.").

[56] *Compare United States v. Crocker Nat'l Corp.*, 656 F.2d 428, 450-51 (9th Cir. 1981) (finding violation of Section 8 where one of the interlocked corporations competed with the other's subsidiary*), rev'd on other grounds sub nom. BankAmerica Corp v. United States,* 462 U.S. 122 (1983), *with Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195 (2d Cir. 1978) (holding that Section 8 does not apply to companies whose subsidiaries are competitors but leaving open possibility of liability where the parent company "closely controls and dictates the policies of its subsidiary").

[57] Where interlocks are part of a broader conspiracy, they may also violate Section 1 of the Sherman Act.

[58] 15 U.S.C. § 45.

prohibited by the other antitrust statutes.[59] On several occasions, the FTC has challenged interlocks that did not violate Section 8.[60]

I do not mean to suggest that Section 5 should be employed to every interlock between competitors that occurs outside the scope of Section 8. An important limiting principal for application of Section 5 in these circumstances is a likelihood of consumer injury or an adverse effect on competition.

Finally, let me touch briefly on the treatment of interlocking directorates in other countries. The Clayton Act's per se prohibition on interlocking directorates between competitors has, for the most part, not been emulated by other countries. To my knowledge, there is no per se prohibition on interlocking directorates in China, the European Union, Australia, or Canada. On the other hand, Article 13 of the Japanese Anti-Monopoly Law specifically prohibits directors and employees of a company from being a director of another company if the effect "may be substantially to restrain competition in any particular field of trade."[61] Indonesia

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[59] In *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972), the Supreme Court held that Section 5 empowered the FTC to "define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws" and to "proscribe practices as unfair or deceptive in their effect on competition." For my views on the scope of Section 5, see J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, The FTC's Section 5 Hearings: New Standards for Unilateral Conduct?, Remarks before the ABA 57th Antitrust Law Section Spring Meeting (Mar. 25, 2009), *available at* http://www.ftc.gov/speeches/rosch/090325abaspring.pdf; J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, Remarks Before FTC Section 5 Workshop **(**Oct. 17, 2008), *available at* http://www.ftc.gov/speeches/rosch/081017section5wksp.pdf.

[60] *See, e.g.*, *Perpetual Fed. Sav. & Loan Ass'n*, 90 F.T.C. 608, 657 (1977), *withdrawn,* 94 F.T.C. 401 (1979); *Kraftco Corp*., 89 F.T.C. 46, 63-64 (1977).

[61] Act on Prohibition of Private Monopolization and Maintenance of Fair Trade Chapter IV, Art. 13 (1947, revised 2005) (unofficial translation by Japan Fair Trade Commission).

follows a similar approach.[62] Hence, these countries do not follow the per se approach of the Clayton Act, but rather permit companies to demonstrate a lack of competitive injury from the interlock. Even some jurisdictions without a specific prohibition may still be able to challenge interlocks that harm competition through their general competition laws, such as Articles 81 and 82 of the EC Treaty.[63]

In addition, many jurisdictions including the European Union,[64] Japan,[65] South Korea,[66] Canada,[67] and South Africa[68] consider the creation of interlocking directorates in the course of

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[62] Indonesia Competition Law art. 26 (Law No. 5 of 1999) ("A person concurrently holding a position as a member of the Board of Directors or as a commissioner of a company, shall be prohibited from simultaneously holding a position as a member of the Board of Directors or a commissioner in other companies, in the event that such companies: a) are in the same relevant market; or b) have a strong bond in the field and or type of business activities; or c) are jointly capable of controlling the market share of certain goods or services, which may result in monopolistic practices and or unfair business competition.").

[63] Case 142 and 156/84, *British-American Tobacco Company Ltd & R. J. Reynolds Industries Inc. v. EC of the European Communities*, [1986] ECR 1899 (stating that acquisitions not conferring effective control can be analyzed under Articles 81 and 82).

[64] Case M. 1080, *Thyssen/Krupp* (June 2, 1998); Case M. 1712, *Generali/INA* (Jan. 12, 2000); Case M. 2431, *Allianz/Dresdner* (July 19 2001); Case M. 2567, *Nordbanken/Postgirot* (Nov. 8 2001).

[65] *Hiroshima Railway Co. & Four Others*, 20 Shinketsushu 62 (FTC July 17, 1973) (ordering officers from railway company that had acquired competing bus company to resign their board positions from bus company).

[66] Korean Monopoly Regulation and Fair Trade Act art. 7 (prohibiting acquisitions including those through an interlocking directorate that may substantially restrict competition in a specific relevant market).

[67] Competition Bureau Canada, Merger Enforcement Guidelines pt. 5 (Sept. 2004) ("The Bureau also examines the competitive effects of a merger resulting from, or enhanced by, the existence of particular relationships such as interlocking directorships between and among the merging parties or their affiliates and their competitors, customers and suppliers.").

[68] *Main Street 333 (Pty) Ltd Kumba Resources, Ltd*., Case No. 14/LM/feb06 (Sept. 14, 2006) (evaluating interlocking directorates in context of merger of thermal coal producers; Competition

merger review. Likewise, the creation of an interlock may trigger pre-merger notification filings in some jurisdictions when the interlock gives the acquiring company substantial influence over the target company[69] or hits notification thresholds specific to interlocks.[70] The existence of an interlocking relationship can also be a factor in other aspects of a jurisdiction's competition law, such as the assessment of a company's market power or dominance.[71]

III.

The final topic I would like to discuss is the nature and scope of antitrust immunity in the United States for seeking government action.

In a series of cases, the Supreme Court held that petitioning the government is immune from the antitrust laws, regardless of whether the petitioning seeks legislative, regulatory, or

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Commission stated that it was watchful for "the competition problems posed by interlocking directorships between rival firms").

[69] *See, e.g.*, EC Merger Regulation art. 3(2) (definition of reportable concentration includes acquiring "decisive influence" over an undertaking "by rights, contracts or any other means"); Anti-monopoly Law of the People's Republic of China art. 20 (2007) (definition of a reportable concentration includes "acquiring control over other business operators or possibility of exercising decisive influence on other business operators by virtue of contact or any other means"); Competition Bureau Canada, Merger Enforcement Guidelines pt. 1 (Sept. 2004) (creation of interlocking directorate potentially reportable as a merger "when the person acquiring or establishing the interest obtains the ability to materially influence the economic behaviour of the business").

[70] *See, e.g.*, Japan Fair Trade Commission, Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination § I.2 (2004, revised 2007) (setting forth criteria for notification of interlocks); Korean Monopoly Regulation and Fair Trade Act art. 12(1)-3 (requiring merger notification for creation of certain interlocks).

[71] The European Commission may consider the existence of interlocking directorates when assessing an undertaking's dominance. *See also* Act Against Restraints of Competition (Germany) § 19(2) (a factor in assessing whether an undertaking is dominant is the extent of any "links with other undertakings"). South Africa discourages the use of interlocks by creating a rebuttable presumption that all per se violations of the Competition Act also apply to any firm in an interlocking relationship with the violator. *See* Competition Act 89 of 1998 (South Africa) § 4(2).

judicial action. As a result, under the so-called *Noerr-Pennington* doctrine,[72] parties that engage in such protected conduct are generally immune from antitrust liability, even if anticompetitive intent motivated the conduct. Although the *Noerr-Pennington* doctrine initially only immunized conduct from the federal antitrust laws, it has since been applied to immunize conduct from other types of state and federal laws.

The Supreme Court in the *Noerr* case explained that the doctrine is based on a statutory interpretation of the Sherman Act. The Court stated that "under our form of government the question of whether a law [restraining competition] should pass, or if passed be enforced, is the responsibility of the appropriate legislative or executive branch of government."[73] The Court went on to say that allowing the antitrust laws to reach petitioning conduct "would impute to the Sherman Act a purpose to regulate, not business activity, but political activity, a purpose which would have no basis whatever in the legislative history of that Act."[74] To this extent, the *Noerr* doctrine would seem to apply with equal force to Hong Kong antitrust law.

The *Noerr* Court noted, however, that there were also "important constitutional questions" implicated in the right to petition the government,[75] but in a footnote stated that it was "unnecessary to consider" whether the "activities complained of were constitutionally protected under the First Amendment" to the United States Constitution.[76] If rooted in the United States

[72] *Eastern Railroad Presidents Conference v. Noerr Motor Freight Inc.*, 365 U.S. 127, 137-38 (1961) (creating immunity for efforts to influence the legislative process); *United Mine Workers v. Pennington*, 381 U.S. 657, 670 (1965) (extending *Noerr* immunity to efforts to influence the administrative process even when "intended to eliminate competition").

[73] *Noerr*, 365 U.S. at 136.

[74] *Id*. at 137.

[75] *Id*. at 138.

[76] *Id*. at 132 n.6.

First Amendment, the doctrine would appear to have little or no application to Hong Kong antitrust law except to the extent that Hong Kong has a constitutional provision like the U.S. First Amendment. This footnote seems to have been overlooked by some lower courts and commentators who have claimed—contrary to *Noerr*'s express statement that the immunity derives from the scope of the Sherman Act—that the *Noerr* decision rested on First Amendment grounds.

Nevertheless, in a subsequent decision, the Supreme Court clarified that *Noerr-Pennington* immunity is based not just on a prudential interpretation of the Sherman Act, but also on First Amendment grounds. In *California Motor Transport*, the Court held that the *Noerr-Pennington* doctrine immunized a trucking company's attempt to prevent a rival shipper from obtaining operating permits by filing appeals to state and federal courts. The Supreme Court explained that "it would be destructive of the [First Amendment's] rights of association and of petition" to permit lawsuits predicated on the anticompetitive use of the adjudicative process.[77]

Since then, the lower courts have often emphasized that the First Amendment provides the primary source of the immunity, while downplaying (or ignoring completely) the statutory basis for the immunity.[78] This has sometimes led to conflicting decisions over whether the

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[77] *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510-11 (1972); *see also Bill Johnson's Restaurants, Inc. v. NLRB*, 461 U.S. 731, 741 (1983) (stating that *California Motor Transport* "recognized that the right of access to the courts is an aspect of the First Amendment right to petition").

[78] *See, e.g.*, *United States v. Philip Morris USA Inc.*, 566 F.3d 1095, 1123 (D.C. Cir. 2009) (the *Noerr-Pennington* doctrine is "rooted in the Petition Clause of the First Amendment"); *Kearney v. Foley & Lardner, LLP*, 566 F.3d 826, 832 (9th Cir. 2009) ("The *Noerr-Pennington* doctrine derives from the Petition Clause of the First Amendment . . . ."); *Theme Promotions, Inc. v. News America Marketing FSI*, 546 F.3d 991, 1006 (9th Cir. 2008) ("The doctrine derives from two Supreme Court cases holding that the First Amendment Petition Clause immunizes acts of petitioning the legislature from antitrust liability."); *Campbell v. PMI Food Equip. Group, Inc.*, 509 F.3d 776, 790 (6th Cir. 2007) ("The doctrine is, at bottom, founded upon a concern for the First Amendment right to petition and, therefore, has been applied to claims implicating that

immunity should apply in some situations, such as the petitioning of foreign governments. Specifically, if the immunity were based solely on First Amendment grounds, then it would not apply to the petitioning of foreign governments.[79] But since the immunity also reflects a limit on the scope of the Sherman Act, then it might well apply to petitioning other governments.[80]

To be sure, *Noerr-Pennington* immunity is not without its limits. The Supreme Court has held that *Noerr-Pennington* immunity does not extend to those cases where the defendant's act of petitioning the government is considered a "sham." In these cases, the defendant uses "the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon."[81] The sham exception is frequently applied to claims that an antitrust defendant engaged in anticompetitive behavior by filing meritless litigation.

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right."); *Tal v. Hogan*, 453 F.3d 1244, 1259 (10th Cir. 2006) ("The doctrine is grounded in the First Amendment . . . ."); *Freedom Holdings Inc. v. Spitzer*, 357 F.3d 205, 233 (2d Cir. 2004) ("The *Noerr-Pennington* immunity is a First Amendment-based doctrine . . . ."); *Telecor Commc'ns, Inc. v. Sw. Bell Tel. Co.*, 305 F.3d 1124, 1137 (10th Cir. 2002) ("The *Noerr-Pennington* doctrine is rooted in the First Amendment.").

[79] *Bulkferts Inc. v. Satalin Inc.*, 574 F. Supp. 6, 9 (S.D.N.Y. 1983) ("It is questionable, however, whether the doctrine applies to activities influencing foreign governments such as those herein alleged."); *Occidental Petroleum Corp. v. Buttes Gas & Oil Co.*, 331 F. Supp. 92 (C.D. Cal. 1971) ("Examination of the premises underlying *Noerr* indicates that the case's rationales do not readily fit into a foreign context, such as the facts of this case."), *aff'd per curiam on other grounds*, 461 F.2d 1261 (9th Cir. 1972).

[80] *Coastal States Mktg. v. Hunt*, 694 F.2d 1358, 1365 (5th Cir. 1983) ("[T]he Sherman Act simply does not extend to joint efforts to influence government officials.").

[81] *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 380 (1991); *see also California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972); *Professional Real Estate Investors v. Columbia Pictures Industry*, 508 U.S. 49, 60-61 (1993).

V.

In sum, the United States antitrust agencies and courts take a largely hands-off approach to non-horizontal mergers in comparison to the European Commission. In contrast, the United States takes a more proactive approach toward interlocking directorates between competitors. I would be surprised to see much convergence in either of these areas in the near future.