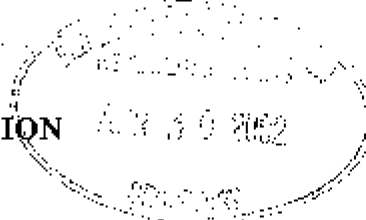


UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

In the Matter of POLYGRAM HOLDING, INC., a corporation, DECCA MUSIC GROUP LIMITED, a corporation, UMG RECORDINGS, INC., a corporation, and UNIVERSAL MUSIC & VIDEO DISTRIBUTION CORP., a corporation.	Docket No. 9298

RESPONDENTS' POST-TRIAL BRIEF

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. SUMMARY OF PROPOSED FACTUAL FINDINGS 5

A. The Parties 5

B. The Three Tenors Joint Venture 6

C. PolyGram's and Warner's Decision To Adopt Restrictions On Discounting And Promotion Of 3T1 and 3T2 As Part Of Their Marketing Plans For 3T3 9

D. The Business Rationale For The Moratorium 12

1. The Moratorium Was Part Of A Marketing Strategy Designed To Increase The Aggregate Long Term Output Of All Three Tenors Products 12

2. The Moratorium Was Designed To Prevent The Operating Companies From Free Riding And Opportunistic Behavior 15

3. The Moratorium Was Narrowly Tailored To The Specific Needs Of The Three Tenors Joint Venture 18

E. The Potential Competitive Effects Of The Moratorium. 19

F. PolyGram's Decision To Abandon The Moratorium And The Unlikelihood of Recurrence 21

III. ARGUMENT 22

A. The Moratorium Is Not Illegal Per Se 23

1. An ancillary restraint need not be "necessary" or "essential" to a joint venture to merit consideration under the rule of reason 24

2. The moratorium can be ancillary even though it applied to products that were not created or marketed as part of the joint venture 29

3. The lack of judicial experience with similar restraints mandates rule of reason analysis 32

B. Complaint Counsel Failed To Establish Any Violation Under The Rule Of Reason 35

1. Complaint Counsel's Failure To Offer Evidence Of Some Actual Anticompetitive Effect Mandates A Decision In Respondents' Favor 35

2. Respondents' Procompetitive Justifications Are Plausible And Thus Require Analysis Of The Moratorium's Actual Competitive Effects, If Any 40

TABLE OF CONTENTS
(continued)

Page

a. It Is At Least Plausible That The Moratorium Was A Reasonably Necessary And Procompetitive Part Of The Marketing Strategy For The Three Tenors Product Line. 41

b. It Is At Least Plausible That The Proposed Moratorium Was Procompetitive In Preventing Free Riding And Opportunistic Behavior 45

c. Complaint Counsel's Proposed "Alternatives" To The Moratorium Do Nothing To Undermine Respondents' Procompetitive Justifications 48

C. Complaint Counsel Failed To Demonstrate The "Cognizable Danger" Of Recurrent Violation Required To Obtain The Prospective Relief They Seek 53

IV. CONCLUSION 54

TABLE OF AUTHORITIES

FEDERAL CASES

Broadcast Music, Inc. v. CBS,
441 U.S. 1 (1979)....................26, 33

Business Electronics Corp. v. Sharp Electronics Corp.,
485 U.S. 717 (1988)....................33

California Dental Association v. F.T.C.,
128 F.3d 720 (9th Cir. 1997)....................35, 37, 38, 39, 40, 41

California Dental Association v. FTC,
526 U.S. 756 (1999)....................3, 4, 23, 33, 35, 38, 41

Chicago Prof'l Sports Ltd. P'ship v. National Basketball Association,
961 F.2d 667 (7th Cir. 1992)....................24, 27, 36, 47, 50, 51

Continental Airlines, Inc. v. United Airlines, Inc.,
277 F.3d 499 (4th Cir. 2002)....................3, 4, 23, 35, 37, 43, 53

F.T.C. v. Indiana Federation of Dentists,
476 U.S. 447 (1986)....................39

General Leaseways, Inc. v. National Truck Leasing Association,
744 F.2d 588 (7th Cir. 1984)....................26

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.)....................32

In re Toys R Us, Inc.,
126 F.T.C. 415 (1998), *aff'd*, 221 F.3d 928 (7th Cir. 2000)....................47

Law v. NCAA,
134 F.3d 1010 (10th Cir. 1998)....................25, 26, 27, 37, 39, 40

NCAA v. Board of Regents,
468 U.S. 85 (1984)....................24, 25, 26, 36, 39, 44

Northwest Wholesale Stationers Inc. v. Pacific Stationary & Printing Co.,
472 U.S. 284 (1985)....................33

Nynex Corp. v. Discon,
525 U.S. 128, 119 S. Ct. 493 (1998)....................33

Polk Brothers v. Forest City Enterprises, Inc.,
776 F.2d 185 (7th Cir. 1985) 24, 28, 30, 34, 44, 46

Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,
792 F.2d 210 (D.C. Cir. 1986) 28, 34, 44, 47

SCFC ILC, Inc. v. Visa USA, Inc.,
36 F.3d 958 (10th Cir. 1994) 31, 44

TRW, Inc. v. FTC,
647 F.2d 942 (9th Cir. 1981) 4, 5, 6, 7, 53, 54

Toys R Us, Inc. v. FTC,
221 F.3d 928 (7th Cir. 2000) 36

United States v. Gypsum Co.,
438 U.S. 422 (1978)....................26, 27

United States v. Socony-Vacuum Oil Co.,
310 U.S. 150 (1940)....................23

United States v. Visa U.S.A., Inc.,
163 F. Supp. 2d 322 (S.D.N.Y. 2001)....................24, 25, 30, 31, 39, 40, 44, 45

White Motor Co. v. United States,
372 U.S. 253 (1963)....................27

MISCELLANEOUS

Collaboration Guidelines § 2.3....................42

Collaboration Guidelines § 3.36(b)....................46

Gregory J. Werden, Antitrust Analysis of Joint Ventures: An Overview, 66 Antitrust L.J.
701 (1998)....................43

Respondents PolyGram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc. and Universal Music & Video Distribution Corp. (collectively, "PolyGram" or "Respondents"), respectfully submit this post-trial brief.

I. INTRODUCTION

The evidence adduced at trial and admitted as part of the record in this case demonstrates critical facts regarding the "moratorium" agreement at issue here. The evidence demonstrates that the moratorium was not the sort of naked restraint that may be condemned as illegal *per se* without any analysis of its actual effect, if any, on competition. Rather, it was an ancillary restraint to a pro-competitive joint venture between PolyGram and Warner Music Group ("Warner") for the creation of new Three Tenors products, including an album of a 1998 Paris concert ("3T3"), and greatest hits and box-set albums of recordings from 3T3 and the two prior Three Tenors albums. The evidence also demonstrates that the moratorium was specifically and narrowly tailored to address two legitimate and pro-competitive business concerns:

- The moratorium was a critical part of the marketing plans for the joint venture product, because it focused the attention of the parties' marketing personnel, as well as retailers and consumers, on the new product during its initial release period, and thereby increased the probability of a successful release of 3T3 that was needed to maximize the aggregate long-term output of all Three Tenors products in the long term; and,
- The moratorium sought to prevent PolyGram's and Warner's respective operating companies from using the promotional opportunity the joint venture created through the Paris concert and the release of the new album

to "free ride" on those promotional efforts by discounting and promoting 3T1 and 3T2 during its initial release period, while at the same time encouraging the operating companies to use that promotional opportunity to discount and promote 3T1 and 3T2 during the months preceding the release of 3T3.

The evidence further demonstrates that these are not after-the-fact justifications that were just made up for purposes of trial. Contemporaneous documents expressly discussed these two justifications. Moreover, Anthony O'Brien, the Atlantic Records CFO who negotiated the joint venture agreement on behalf of Warner, testified that the need develop a marketing strategy that accounted for the existence of the prior albums and to address a substantial risk of "free riding" by the Warner and PolyGram operating companies gave rise to the moratorium. Mr. O'Brien also testified that if PolyGram and Warner had "not agreed to market this release in an intelligent fashion, in all likelihood, the '98 concert wouldn't have existed, and the consumers would have had less choice." JX 100 (O'Brien 1/5/01 Depo. Tr. at 91:19-21, 70:1-5). The record testimony from PolyGram's witnesses likewise makes clear that the moratorium was adopted for these reasons and that the moratorium was an important part of the Three Tenors joint venture.

Both sides' experts' also confirmed the legitimacy and plausibility of PolyGram's proferred procompetitive justifications. PolyGram's expert witnesses – Dr. Janusz Ordover, an economist at New York University, and Dr. Yoram ("Jerry") Wind, a Professor of Marketing at the University of Pennsylvania's Wharton School of Business – opined that the moratorium was likely pro-competitive, reflected a commercially sound marketing strategy for Three Tenors products, and prevented "free riding" activities that could have undermined the launch of 3T3

and thereby harmed overall sales of all Three Tenors products in the long-term. Complaint Counsel's expert economist, Dr. Stephen Stockum, conceded that PolyGram's procompetitive justifications for the moratorium are at least plausible, that he was unaware of any competition that would have occurred in the United States absent the moratorium but that did not occur because of the moratorium, and that he had seen no evidence that the moratorium had any actual anticompetitive effect in any relevant market.

Notwithstanding this evidence, Complaint Counsel take the position that the moratorium was so plainly anticompetitive that it can be invalidated without any analysis of its actual effect on competition in any relevant market. According to Complaint Counsel, PolyGram and Warner were so clearly required by the antitrust laws to turn a blind eye to the fact that each company owned a prior Three Tenors album that competed with their joint venture that the moratorium may be found unlawful without any analysis of its actual effect, if any, on competition in the United States. Complaint Counsel is wrong for three reasons:

First, in contending that they may prevail in this case without any evidence that the moratorium had any actual effect on competition, Complaint Counsel seek to establish a precedent that no case has ever recognized. In fact, case after case has recognized that a plaintiff in any rule of reason case – "quick look" or otherwise – is required to show proof of some actual anticompetitive effect from the challenged restraint. *See, e.g., California Dental Ass'n. v. FTC* 526 U.S. 756 (1999); *Continental Airlines, Inc. v. United Airlines, Inc.*, 277 F. 3d 499, 509-10 (4th Cir. 2002). The only kind of antitrust case that permits a finding of liability without *any* showing of actual anticompetitive effect is a *per se* case, and *per se* analysis is reserved exclusively for a handful of well-established categories of restraints that do not include restraints like the moratorium that are ancillary to a procompetitive joint venture. Since Complaint

Counsel have expressly disavowed any effort to show that the proposed moratorium had any actual anticompetitive effect, Complaint Counsel's case fails as a matter of law.

Second, Complaint Counsel's case would fail even if there were some evidence that the moratorium had some actual anticompetitive effect, because Respondents' procompetitive justifications for the moratorium are plausible. When the procompetitive justification for a challenged practice is at least plausible, an antitrust plaintiff cannot prevail without establishing that the *net* effect of the practice was anticompetitive. *California Dental Assn.*, 526 U.S. 756; *Continental Airlines*, 277 F. 3d at 509-10. As noted above, the relevant PolyGram and Warner witnesses – as well as the contemporaneous documents in the record – have established that the moratorium was (a) a reasonably necessary part of the marketing plans for 3T3 and (b) a reasonably necessary measure to prevent their respective operating companies from "free riding" on the promotional efforts and expenditures of the joint venture. As noted above, *all* experts agree on these points. Respondents' experts, Professors Ordover and Wind, opined that these procompetitive justifications are sound as a matter of both economics and marketing strategy. And Complaint Counsel's own expert economist conceded that Respondents' pro-competitive justifications are economically plausible. Given the plausibility of Respondents' procompetitive justifications and Complaint Counsel's concession that they were not offering any evidence of actual anticompetitive effect, Complaint Counsel plainly failed to meet their burden of demonstrating that the moratorium had an actual, net anticompetitive effect. *See, e.g., California Dental*, 526 U.S. at 771-81.

Third, to obtain prospective relief such as that sought in the proposed cease and desist order, Complaint Counsel must prove that "'there exists some cognizable danger of recurrent violation.'" *See TRW, Inc. v. FTC*, 647 F.2d 942, 954-55 (9th Cir. 1981) (quoting

United States v. W.T. Grant Co., 345 U.S. 629, 632 (1953)). Complaint Counsel made no such showing. Rather, the record evidence demonstrates that the central features of Three Tenors joint venture were unique in the music industry – indeed, no witness was aware of any other joint venture in which two record companies who owned pre-existing products by an artist agreed to share the risks and benefits of new albums by an artist on a 50/50 basis and to coordinate the worldwide marketing plans for those new albums. The justifications for the moratorium are tied directly to the unique features of the Three Tenors joint venture, and there is no evidence that PolyGram or Warner or any other record company has used similar justifications to justify any other restraint on pricing or promotion. Since the moratorium was adopted, PolyGram has been through two mergers, and there is no basis for concluding that the companies that currently own the relevant PolyGram entities have ever considered entering into any agreement like the moratorium. Finally, the record evidence shows that PolyGram itself abandoned the moratorium before it was implemented, providing another basis for finding that there is no substantial likelihood that the challenged conduct will recur.

II. SUMMARY OF PROPOSED FACTUAL FINDINGS.

A. The Parties

Respondents all are part of Universal Music Group, the music business of Vivendi Universal, S.A. ("Vivendi"). Respondents' Proposed Finding ("RPF") No. 9. The events at issue took place in 1998, when Respondents were part of PolyGram Music Group, the music business of PolyGram N.V. *Id.* No. 10. Vivendi acquired Respondents through a merger with the Seagram Company Ltd., which had acquired PolyGram N.V. in December 1998. *Id.*

In 1998, Decca Music Group Limited ("Decca") was a PolyGram label that specialized in classical music and was part of a business division called PolyGram Classics &

Jazz that included other PolyGram labels. *Id.* No. 11. PolyGram distributed Decca recordings throughout the world through a network of operating company subsidiaries, or "op-co's." *Id.* No. 15. The United States operating company was PolyGram Group Distribution, Inc., the predecessor to Universal Music & Video Distribution Corp. *Id.* No. 16.

Warner Music Group ("Warner") was PolyGram's partner in the joint venture at issue in this case. Two Warner entities were involved in the conduct at issue: Atlantic Records ("Atlantic"), a Warner label responsible for marketing Warner products in the United States; and Warner Music International ("WMI"), the Warner entity responsible for marketing Warner products outside the United States and coordinating the distribution efforts of Warner's operating company subsidiaries, or "op co's" outside the United States. *Id.* Nos. 12-14.

B. The Three Tenors Joint Venture.

PolyGram and Warner adopted the "moratorium" agreement at issue in this case in the context of a pro-competitive joint venture for the creation of new Three Tenors products. RPF No. 17. In this joint venture, PolyGram and Warner – along with the Tenors themselves (who include the opera stars Luciano Pavarotti, Placido Domingo and Jose Carreras) and their manager, Tibor Rudas – collaborated in the creation of a Three Tenors concert in Paris in July 1998 and the Three Tenors album of that concert that was released in August 1998. *Id.* Nos. 17-18, 21. The Three Tenors previously had recorded two albums: a 1990 album, called *The Three Tenors* ("3T1"), which was distributed by PolyGram; and a 1994 album, called *The Three Tenors in Concert 1994* ("3T2"), which was distributed by Warner. *Id.* No. 22. The 1998 Album (3T3), like 3T1 and 3T2, was recorded at a live concert event held in conjunction with the final match of the World Cup soccer tournament and televised throughout much of the world. *Id.* Nos. 23, 25. As part of the joint venture, PolyGram and Warner also planned to release a Greatest

Hits album and/or a "box set" containing recordings from all three Three Tenors albums. *Id.* No. 28.

The initial formation of the joint venture was documented in two contracts: (1) the "Master Recording License Agreement" between Warner and Resorts Production Ltd. ("RPL"), an entity affiliated with Mr. Rudas, under which Warner obtained the rights to the Paris concert and agreed to pay an $18 million advance to the Three Tenors (JX 11, the "Rights Agreement"); and (2) the "The Three Tenors/1998 Concert/License Agreement" (JX 10, the "Concert/License Agreement") between PolyGram and Warner. RPF No. 32.

The Concert/License Agreement set forth the general terms of the joint venture between PolyGram and Warner for the creation of products relating to the 1998 Three Tenors concert. RPF No. 38. The Concert/License Agreement contemplated that Atlantic would distribute the joint venture products in the United States, and that PolyGram would distribute the joint venture products throughout the rest of the world. *Id.* Under the Agreement, PolyGram agreed to reimburse Warner for one-half of the $18 million advance paid RPL under the Rights Agreement. RPF No. 39. Additionally, the Concert/License Agreement recognized that Messrs. Carreras and Pavarotti were party to exclusive recording contracts with labels affiliated with Warner and PolyGram, respectively, and accordingly required Warner and PolyGram to waive those exclusive contracts so that the artists could participate in the venture. RPF No. 40 (JX 10 ¶¶ 3(b), (c)).

As part of the Concert/License Agreement, PolyGram and Warner agreed to cooperate in creative issues relating to the venture, such as the selection of the songs to be included on the 1998 Album. RPF No. 41 (JX10 ¶ 4). The same provision of the contract also required PolyGram and Warner to "consult and coordinate" with one another regarding "all

marketing and promotion activities . . . ." *Id.* According to Anthony O'Brien and Rand Hoffman, the Warner and PolyGram executives who negotiated the agreement, this provision contemplated that PolyGram and Warner would work together in developing the marketing plans for 3T3 and that each would have access to the other's confidential plans relating to the marketing and promotion of 3T3. RPF No. 43.

The revenue sharing provision of the Concert/License Agreement provided that each party would be entitled to a fifty-percent royalty on any net profits (and an obligation to pay a royalty at the same rate for any net losses) derived from sales of any products made pursuant to the venture, and thus gave each party a substantial interest in the other's sales of Three Tenors products made as part of the venture. RPF No. 44.

Finally, the Concert/License Agreement required that the parties use the joint venture as the exclusive vehicle for the release of new Three Tenors products until June 1, 2002. RPF No. 45 (JX10 ¶ 9). This "holdback" provision was designed to made it clear that the parties could continue to sell the 1990 and 1994 Albums during the term of the joint venture; however, as noted above, the agreement contemplated that the recordings embodied on those prior albums would be included in the box set and greatest hits albums that were to be released during the life of the venture and generally required the parties to "consult and coordinate" their marketing and promotional activities with respect to Three Tenors products during the life of the joint venture. Mr. Hoffman and Anthony O'Brien each testified that the "holdback" provision must be read in conjunction with the other provisions of the contract and was not intended to allow either party to market its prior album in any way that might have undermined the success of the joint venture. RPF No. 46-47.

Notably, the Concert/License Agreement did not specify, and was not intended to specify, all of the material terms of the joint venture. RPF No. 48. For instance, the parties recognized that, after the joint venture was formed, they would need to reach further agreements regarding the repertoire to be included on 3T3; all of the necessary marketing and promotional plans for 3T3; the release dates for the album; and all of the other necessary elements for the release of the album. *Id.* In negotiating the Concert/License Agreement, Mr. O'Brien and Mr. Hoffman left the specifics of the marketing plan to the relevant PolyGram and Atlantic marketing personnel. *Id.* No. 49. As Mr. O'Brien explained at trial, he believed that PolyGram and Warner would develop the specifics of their marketing plan in a commercially reasonable manner, because they were "partners" in their joint venture for new Three Tenors products. Mr. O'Brien further explained that the "need and desire to work together" was "inherent in this agreement, inherent in this joint venture agreement." *Id.* No. 50.

C. PolyGram's and Warner's Decision To Adopt Restrictions On Discounting And Promotion Of 3T1 and 3T2 As Part Of Their Marketing Plans For 3T3.

PolyGram and Warner discussed alternative strategies for marketing the catalog 3T1 and 3T2 products in conjunction with the new album from the outset. At the first joint meeting the relevant PolyGram and Atlantic marketing personnel regarding the marketing plans for the joint venture, which was held on January 28, 1998 (one week *before* the Concert/License Agreement was executed), the parties recognized the need to develop a "strategy on promotion of 3T1 and 3T2," and suggested an "ad moratorium until November 15." RPF No. 57. As Bert Cloeckaert, PolyGram's Vice President for Continental Europe testified, it is standard in the music industry for a record company to discuss and develop a strategy for marketing an artist's catalog products as part of the marketing plans for a new release by that artist. RPF No. 51-52.

Complaint Counsel's marketing expert, Dr. Catherine Moore, also acknowledged that record companies typically consider an artist's catalog products in developing their marketing plans for a new release by that artist. *Id.* No. 51.

In discussing the 3T1 and 3T2 catalog products as part of their marketing plans for 3T3, PolyGram and Warner focused on the promotional opportunity that the Paris concert and the release of the new album would create for *all* Three Tenors products, and the need to manage that opportunity in a manner that would maximize sales of all Three Tenors products in the long term. RPF Nos. 52-55. PolyGram and Warner were particularly concerned about the initial "release period" -- the brief time period surrounding the release of the new album. RPF No. 53. PolyGram and Warner believed that maximizing sales of 3T3 during the release period was critical to the success of 3T3, and to the long-term success of the Three Tenors brand. RPF Nos 54-55. Respondents' marketing expert, Professor Wind, testified that this focus on the release, or "launch," period for 3T3 was commercially sound and reasonable:

> [T]he success of the launch of the new product, especially in a very crowded market, really depends on focus, on the single dedicated focus to of the specific product. And any distraction that will prevent this focus of all involved, which means the manufacturers, the retailers, everybody involved in the launch, [it] is absolutely critical that we have this focus here.

JX 91, Wind Depo. Tr. at 9:23-10:10.

PolyGram and Warner were concerned that their operating companies – which had less direct interest in the new album (indeed, in the case of WMI, *no* financial interest in the new album) – would not be adequately focused on the new release and would use the

promotional opportunity provided by the Paris concert and the release of the new album to aggressively discount and promote 3T1 and 3T2 during the 3T3 release period. RPF Nos. 54-55. PolyGram and Warner believed that any aggressive discounting and promotion of 3T1 or 3T2 during the initial release period would harm 3T3 and the Three Tenors brand, leading to fewer sales of all Three Tenors products in the long term. *Id.* That is, PolyGram and Warner believed that the potential *negative* effect on long-term sales of all Three Tenors products from promoting and discounting 3T1 and 3T2 during the 3T3 release period outweighed any *positive* effect on sales of 3T1 and 3T2 that might have been achieved by promoting and discounting those products during the 3T3 release period. *Id.* No. 55. Mr. O'Brien testified that he saw the threat posed by aggressive discounting and promotion of 3T1 and 3T2 during the initial release period for 3T3 as sufficiently significant that he "would not have continued with the deal" if PolyGram had suggested it intended to discount and promote 3T1 during that time period. RPF No. 56.

At a joint venture marketing meeting held on March 10, 1998, PolyGram and Warner agreed on their strategy for discounting and promoting 3T1 and 3T2 during the period surrounding the release of the new album. Minutes of the March 10, 1998 meeting state:

> <u>3T1 AND 3T2 CAMPAIGNS</u>
>
> Agreement reached that on initial POS [point of sale] materials, neither company will feature the earlier albums. However, space will be allowed in free standing display units and counter stands, for the later inclusion of back catalogue. Agreement that a big push on catalogue shouldn't take place before November 15.

RPF Nos. 59-60 (JX 5 at 5). PolyGram and Warner subsequently referred to the agreement reached at this March 10, 1998 meeting as a "moratorium" on promotion and discounting of 3T1 and 3T2 that would be implemented during the 3T3 release period. RPF No. 62.

After agreeing to this marketing strategy, the parties subsequently modified their strategy so that the moratorium would apply only during a ten-week period running from August 1, 1998 through October 15, 1998. RPF No. 63 (JX 3 (July 13, 1998 E-mail from Paul Saintilan to Chris Roberts, Rand Hoffman, *et al.*)). PolyGram and Warner agreed that, during the moratorium period, "prices should be 'normal' and not subject to any special discounts or promotions." *Id.* No. 64.

D. The Business Rationale For The Moratorium.

The relevant PolyGram and Warner witnesses identified two explanations for their decision to adopt the moratorium: (1) PolyGram and Warner believed that the moratorium reflected a commercially sound marketing strategy that was necessary to the long-term success of all Three Tenors products; and (2) PolyGram and Warner believed the moratorium was necessary to prevent their respective operating companies from "free riding" on the promotional opportunity created by the Paris concert and the release of the new album. RPF No. 65.

1. The Moratorium Was Part Of A Marketing Strategy Designed To Increase The Aggregate Long Term Output Of All Three Tenors Products.

PolyGram and Warner thought it was critical to focus on 3T3 during the initial release period, and that the best way to maximize the potential long-term success of the Three Tenors brand was to create a clear "window" for the new album during the release period. RPF

No. 66. PolyGram and Warner were concerned that promoting and discounting the prior albums during the period surrounding the release of the new album could have jeopardized the potential success of the new album by sending a confusing message to consumers and the trade and diverting the operating companies' focus away from the new album, which was of far greater commercial significance to both PolyGram and Warner in 1998. RPF No. 68. Paul Saintilan, the former Decca marketing executive responsible for 3T3, testified that this concern over consumer confusion was specific to 3T3 and the prior Three Tenors albums because the parties believed that the target audience for 3T3 was comprised of infrequent classical music purchasers who were particularly susceptible to potential confusion among the various Three Tenors products, and that this confusion could lead to lower sales of all Three Tenors products. RPF No. 69.[1]

PolyGram and Warner did not believe that there was any need to impose restrictions on promotion and discounting of 3T1 and 3T2 outside the initial release period for 3T2. RPF No. 70. Thus, the moratorium was designed to balance the interest in discounting and promoting the prior albums during the period surrounding the Paris concert against the paramount interest in maximizing the chance that the new album would be successful. RPF No. 72. The moratorium specifically allowed the PolyGram and Warner operating companies to aggressively discount and promote 3T1 and 3T2 during the periods before and after the critical release period for 3T3. RPF Nos. 72-73.

[1] Complaint Counsel's expert economist, Dr. Stockum, testified that he had "no factual basis to disagree with [Mr. Saintilan], he certainly knows his business better than I know his business --." Trial Tr. at 726:1-10. Complaint Counsel's marketing expert, Professor Moore, also validated Mr. Saintilan's concerns by testifying if all three albums were displayed together in record stores as a result of promotional activities relating to the prior albums during the period surrounding the release of the new album, it was possible that some consumers would be confused by the three albums and not buy any Three Tenors album at all. *Id.* at 176:20-177:2.

Accordingly, after several of its European operating companies requested permission to discount 3T1 in June and July (*i.e.*, before the release of 3T3), PolyGram informed the operating companies that they were authorized to "aggressively promote the '3 Tenors 1' album and video . . . around the time of the 3 tenors concert." RPF No. 75. (April 29, 1998 Memorandum from Stephen Greene and Paul Saintilan to European Classical MDs/European Label Managers). The April 29, 1998 memorandum stressed the reasons why discounting should not be permitted to occur during the initial period following the release of the new album:

> The key point to observe is that the "original" album should not interfere with the launch of the new album (August 10) and all price discounting activity should be discontinued from July 24 to allow a cooling off period. Further to this, we also have an agreement with Atlantic Records that no advertising or point of sale material originated for the launch of the new album will feature packshots of the previous albums. This will help ensure that when purchasers walk into retail on the day of release they face a simple, uncluttered selling proposition . . . . This agreement (which includes price discounting) will be enforced from July 24 until the Christmas campaigns hit the shops, when the original album will undoubtedly be promoted as a priority release (as it always has been). . . . [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 No. 76.[2]

Mr. Cloeckaert testified that this strategy of promoting the catalog product during the months preceding the release of the new album, and then focusing all attention on the new album once it release, "ma[de] commercial sense" and was consistent with PolyGram's general practices in situations where it owns both the catalog products and the new release. RPF No. 81. Mr.Cloeckaert believed that this was the most commercially reasonable strategy for 3T3 in 1998. *Id.* Complaint Counsel's marketing expert, Professor Moore, agreed that it makes sense for a record company to consider an artist's catalog albums in developing the marketing plans for a new album by that artist, *Id.* (Trial Tr. at 153:12-154:11), and that Mr. Cloeckaert's strategy for promoting Three Tenors products in Summer 1998 by promoting the prior albums in June and July, and then focusing on the new album when it came out, "makes sense." *Id.* (Trial Tr. at 165:10-175:17). Professor Moore testified that this strategy of discontinuing promotional activities during a period surrounding the release of a new album by an artist is a reasonable marketing strategy for a new album. RPF No. 81 (Trial Tr. at 158:5-163:4.)

2. The Moratorium Was Designed To Prevent The Operating Companies From Free Riding And Opportunistic Behavior.

PolyGram and Warner also were concerned that, absent a clear message regarding their marketing strategy with respect to the catalog products, their respective operating companies throughout the world – and particularly their European operating companies – would exploit the

[2] Many PolyGram operating companies discounted and promoted 3T1 during the June-July 1998 period preceding the release of 3T3. RPF Nos. 77. In some countries, the vast majority of unit sales of 3T1 for the entire year were made during that two-month time period. RPF No. 79. The United States operating company, which has sold 3T1 as a top-price album since its initial release in 1998, did not discount 3T1 any relevant time period. RPF No. 80.

promotional opportunity surrounding the Paris concert and the release of 3T3 in ways that would undermine the initial success of 3T3 and the long-term success of the Three Tenors brand. RPF No. 83.

The parties recognized that the Paris concert and the release of the new album created an important opportunity for promoting Three Tenors products that existed only because the joint venture existed and wanted to ensure that their substantial expenditures that created this opportunity were directed towards sales of the new album rather than the prior albums. RPF No. 92. PolyGram and Warner were concerned that their respective operating companies – which had access to the confidential marketing plans for the joint venture – would exploit that opportunity to the detriment of the joint venture absent clear instruction on the marketing strategy for 3T3. *Id.* This concern was particularly acute with respect to WMI – the Warner entity responsible for distribution and marketing outside the United States - because WMI marketed and distributed 3T2 but had no financial interest in 3T3. RPF No. 93 (Trial Tr. at 502-512, 527-38).

WMI's interest in free riding on the promotional opportunities created by the joint venture was clear from the outset. Even before the Concert/License Agreement was signed, Ramon Lopez of WMI sought to condition Atlantic's use of 3T2 as part of the greatest hits and box set albums that were to be produced as part of the joint venture on an agreement to allow WMI to significantly discount 3T2 during the period surrounding the release of 3T3. RPF No. 94. Mr. O'Brien believed that the condition sought by Mr. Lopez would "blow the deal"; accordingly, he wrote to Bob Daly, the most senior executive of Warner Music Group, to explain that the condition sought by Mr. Lopez was unreasonable. RPF No. 95 (CX 566). Mr. O'Brien entered into the Concert/License Agreement believing the issue had been resolved and "very

confident that [Atlantic and PolyGram] would be able to use the [3T2] repertoire without the conditions that would seriously undermine the launch and viability of [3]T3." RPF No. 96 (Trial Tr. (O'Brien) at 511:15-512:1).

However, WMI persisted with its plans to free ride on the joint venture even as Atlantic and PolyGram developed the marketing plans for 3T3. WMI developed plans to discount 3T2 in Europe from May 17, 1998 through December 31, 1998, a period that included the proposed moratorium period. RPF No. 97. Atlantic explained to Mr. Lopez that WMI's proposed European discounting campaign, under which WMI would be seeking to "take advantage of [Atlantic's] and PolyGram's massive publicity campaign to sell [its] catalog album," "could have a serious impact on PolyGram's marketing of the new Three Tenors album," RPF No. 98 (JX 7 (Memorandum from Val Azzoli to Ramon Lopez)). Mr. O'Brien testified that WMI's proposed European discounting campaign "could have had a seriously negative effect on our – on the launch of our '98 [album]," Trial Tr. at 536:21-537:10, and thus was not in the overall best interests of Warner Music Group. Because of the moratorium, Mr. O'Brien ultimately was able to persuade WMI not to conduct its European discounting campaign during the moratorium period. Trial Tr. at 100.

Mr. O'Brien testified that, if free riding activities such as those proposed by WMI had undermined the success of 3T3 during its initial release period, PolyGram and Warner may have spent less money promoting 3T3. RPF No. 101.[3] Aggressive discounting and promotion of 3T1 or 3T2 during the 3T3 release period also could have reduced the long-term output of Three

[3] Complaint Counsel's economist, Dr. Stockum, testified that Atlantic might have spent less money advertising and promoting 3T3 if "people were buying 3T1 and 3T2 instead." RPF No. 100 (Trial Tr. at 729:11-25; *id.* at 730:17-731:3). Complaint Counsel's marketing expert, Professor Moore, testified that PolyGram and Atlantic were likely to alter their promotional spending on 3T3 depending on how it performed during the initial period following its release. *Id.* (Trial Tr. at 197-99).

Tenors products, by making it less likely that 3T3 would be successful and less likely that the parties would release the greatest hits or box-set albums. RPF No. 83. Complaint Counsel's expert economist, Dr. Stockum, admitted that the parties could have had legitimate concerns regarding the "asymmetrical effects" aggressive promotion of 3T1 and 3T2 during the initial release period could have had upon 3T3 and the Three Tenors brand, and that the moratorium could have been procompetitive insofar as it was designed to address those concerns. RPF No. 141.

3. The Moratorium Was Narrowly Tailored To The Specific Needs Of The Three Tenors Joint Venture.

PolyGram and Warner limited the moratorium to apply only to two older catalog cd's (3T1 and 3T2) during a ten-week period surrounding the release of 3T3. RPF No. 102. The moratorium was designed to address PolyGram's and Warner's specific concerns regarding the need to ensure a successful launch of 3T3 and to prevent free riding and opportunistic behavior during the release period, while ensuring that there would be no restrictions on aggressive competition between 3T1 and 3T2 outside the moratorium period. RPF No. 103. The relevant PolyGram and Warner witnesses testified that the Three Tenors joint venture was unique in a number of respects, that the moratorium was necessary because of the unique features of the joint venture, and that they were unaware of any other situation in which a restraint like the moratorium had been considered or adopted. RPF No. 104. Complaint Counsel's marketing expert, Professor Moore, was unable to identify any other similarly structured joint venture between two record companies. *Id.* (Trial Tr. at 188:15-191:1, 258:8-259:15).

E. The Potential Competitive Effects Of The Moratorium.

Complaint Counsel have not alleged the moratorium had any actual anticompetitive effect in any relevant market, and Complaint Counsel's expert economist, Dr. Stockum, testified that he did not conduct any of the analyses necessary to evaluate the actual, net competitive effects, if any, of the moratorium. RPF No. 123 (JX 85, Stockum Depo. Tr. at 42:22-43:16); Trial Tr. at 649:25-652:18). Dr. Stockum acknowledged that to do a "complete and comprehensive analysis of the Three Tenors moratorium," he would need to take into account "many additional factors," including: market definition, market share, analysis of actual advertising practices and discounting practices, to name a few." *Id.* (Trial Tr. 647:10-649:17). Dr. Stockum also recognized that any economic analysis of these factors would need to consider the overall effects, if any, of the moratorium on competition, and that an economic analysis would be insufficient if it considered only any effects the moratorium may have had on sales of 3T1 and 3T2 during the ten weeks it was to be in effect. RPF No. 105 ("[W]e are not just concerned about the ten weeks."). With respect to the United States market, Dr. Stockum was unable to identify any competition that was likely to occur absent the moratorium but that did not occur because of the moratorium. RPF No. 122.

The PolyGram and Warner witnesses involved in marketing 3T3 believed that the moratorium likely would have led to increased output. According to the relevant witnesses, any increase in sales associated with discounting and promotion of 3T1 and/or 3T2 during the moratorium likely would have been outweighed by the decreased sales of 3T3 associated with such discounting and promotional activities, and that the moratorium thus was likely to increase

the aggregate output of Three Tenors products. RPF No. 109.[4] Additionally, insofar as the moratorium was successful in ensuring a successful launch for 3T3, it would have led to additional promotional expenditures on 3T3. RPF No. 108.

PolyGram's expert witnesses – Professor Jerry Wind of the Wharton School and Professor Janusz Ordover of N.Y.U. – confirmed the PolyGram and Warner witnesses' views regarding the potential procompetitive effects of the moratorium. Professor Wind opined that the moratorium represented a reasonable commercially sound marketing strategy for developing the Three Tenors brand and maximizing the potential for the long-term success of Three Tenors products. RPF No. 112 (Wind Report at 16-17; JX 91, Wind Depo. Tr. at 9:7-10, 16:3-23:12. 26:7-27:8, 36:22-37:13, 49:2-50:24, 60:15-63-22). Professor Wind also opined that, because retailers were free to adjust their purchasing patterns in light of the moratorium's limited duration, this strategy was unlikely to have any adverse effect on consumers. RPF No. 113 (RX 717, Wind Report at 16-17). PolyGram's expert economist, Professor Ordover of New York University, opined that the moratorium was "reasonably related" to the joint venture and "reasonably necessary" to achieve its procompetitive benefits because it was designed to prevent the PolyGram and Warner operating companies from free riding on the promotional efforts of the joint venture. RPF No. 114 (RX 716, Ordover Report at 3, 12-20; JX 90, Ordover Depo. Tr. at 52:11-77-7). Complaint Counsel's expert economist, Dr. Stockum, testified that Respondents' "efficiency justifications" for the moratorium are "plausible" as a matter of

[4] The relevant witnesses did not believe the moratorium would have any effect on the price of 3T1 or 3T2 in the United States, because those products never have been sold at mid-price in the United States and continued to be sold with the normal range of discounts and allowances in the United States during the moratorium period. Complaint Counsel's marketing expert, Professor Moore, also testified that temporary price reductions to mid-price are not used to promote records in the United States, and thus implicitly conceded that the moratorium would not have had any effect on the price of 3T1 or 3T2 in the United States. RPF No. 111 (Trial Tr. at 186:17-22, 188:6-14).

economics. RPF No. 117 (Stockum Depo. Tr. at 155:17-21; Trial Tr. at 641:13-644:9). Dr. Stockum also identified as the basis for his conclusion that those justifications were not sufficient to trigger a need for more detailed analysis under the rule of reason was the fact that he had not seen any contemporaneous documentation identifying those justifications. RPF No. 110 (Trial Tr. at 627:4-628:6, 637:15-638:21, 721:24-722:13, 813:5-815:8, 835:2-838:14). However, as discussed above, there was extensive contemporaneous documentation discussing the parties' views that aggressive discounting and promotion of 3T1 and 3T2 during the initial release period posed a substantial threat to the joint venture and the long-term success of the Three Tenors brand and that the moratorium was needed to address that threat.

F. PolyGram's Decision To Abandon The Moratorium And The Unlikelihood of Recurrence.

PolyGram ultimately chose to abandon the moratorium before it was implemented. Before the moratorium was implemented, PolyGram informed its operating companies that:

> With immediate effect Decca has concluded that it is appropriate to adopt a flexible position that allows operating companies the chance to make their own commercial decisions on the optimum pricing of the 1990 album. We would emphasize, however, that in deciding on how to market and price the 1990 album, operating companies should take full account of PolyGram's massive investment in the 1998 album and the need to maximize returns on this investment.

> Contrary to any previous suggestion, there has been no agreement with Atlantic Records in relation to the pricing and marketing of the previous Three Tenors albums. Clearly it is in our interests to protect the 1998 album, but if other commercial considerations so dictate, you have the discretion to act as you best see fit.

RPF No. 146 (JX 76 (July 30, 1998 Memorandum from Paul Saintilan to Distribution List)).[5] Consistent with that memorandum, several PolyGram operating companies discounted 3T1 during the would-be moratorium period. RPF No. 148.

Complaint Counsel have not alleged or provided any evidence that Respondents have entered into, or have considered entering into, any agreement similar to the moratorium, either in the context of another joint venture or otherwise. RPF No. 149. The relevant witnesses testified that the central features of the Three Tenors joint venture were unique in their decades of collective experience in the music industry, and that they were unaware of any other circumstance in which two record companies considered or adopted any similar agreement. RPF No. 150.

III. ARGUMENT

The moratorium cannot be evaluated under the abbreviated form of antitrust analysis on which Complaint Counsel exclusively relies. This is not a *per se* case. The moratorium was not a naked agreement – it was an integral part of a pro-competitive joint

---

[5] PolyGram's decision to abandon the moratorium was communicated to Warner, which also indicated to PolyGram that it was not going to implement the moratorium, but that it nonetheless would not be discounting 3T2 during the period surrounding the release of the new album because Mr. Rudas (who had a contractual right to approve any discounting campaign) had not approved WMI's request to discount 3T2 during that time period. RPF No. 147.

venture for the creation of new Three Tenors products, an ancillary restraint that must be analyzed under the rule of reason. Under the rule of reason, the moratorium cannot be found unlawful without at least some showing that it had some actual anticompetitive effect in a relevant market. The rule of reason also precludes any finding of illegality absent evidence of an actual, net anticompetitive effect where, as here, there are plausible procompetitive justifications for the challenged practice. Because Complaint Counsel offered no evidence of any actual anticompetitive effect, and because the procompetitive justifications in the record are both plausible and valid, Complaint Counsel failed to establish a violation under the rule of reason. Complaint Counsel's case also fails because they failed to provide evidence of the "cognizable danger of recurrent violation" that is needed to support prospective relief such as that sought here.

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

The rule of reason – under which a violation may be found only where an alleged restraint results in some actual, net anticompetitive effect in a relevant market -- is the presumptive mode of antitrust analysis. *California Dental Ass'n v. FTC* 526 U.S. 756 (1999); *Continental Airlines, Inc. v. United Airlines, Inc.*, 277 F.3d 499, 509-10 (4th Cir. 2002). An alleged restraint qualifies for *per se* condemnation only if it falls within the handful of well-established categories of naked agreements between competitors with which economists and the courts have substantial experience and, based on that experience, can conclude with confidence both that they are likely to cause substantial harm to competition and that they have no procompetitive potential. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940) (finding horizontal price-fixing agreement per se illegal). *Without exception*, courts have refused invitations to apply *per se* labels to alleged restraints that were adopted in the context of

joint ventures and other forms of legitimate collaborations among competitors. *See, e.g., NCAA v. Board of Regents*, 468 U.S. 85, 100-13 (1984) (applying "quick look" version of rule of reason to restraints adopted as part of college football joint venture); *Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n*, 961 F.2d 667, 673 (7th Cir. 1992) (holding that "the Rule of Reason supplies the framework for antitrust analysis" of restraints adopted in the context of joint ventures; invalidating restraint under "quick look" version of rule of reason); *Polk Bros. v. Forest City Enters., Inc.*, 776 F.2d 185, 189 (7th Cir. 1985) (concluding that agreement not to compete adopted as part of joint venture was lawful under rule of reason); *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 343-406 (S.D.N.Y. 2001) (holding that restrictions on competition adopted as part of Visa joint venture were illegal under full rule of reason). There simply is no authority that supports Complaint Counsel's position that an agreement that was adopted in the context of a joint venture and that was ancillary to the purposes of the joint venture ever can be invalidated without any analysis of the anticompetitive effects of the restraint or its potential procompetitive justifications. Rather, Complaint Counsel's position is directly at odds with both controlling law and the Commission's own guidelines.

1. An ancillary restraint need not be "necessary" or "essential" to a joint venture to merit consideration under the rule of reason.

Although Complaint Counsel have repeatedly suggested that the moratorium may be invalidated if it was not "necessary" or "essential" to the formation of the Three Tenors joint venture or its efficient operation, it is clear that an agreement adopted in the context of a joint

venture may be ancillary – and thus subject to analysis under the rule of reason, not the *per se* rule – even if it was not "necessary" or "essential" to the formation or efficient operation of a joint venture. Under Complaint Counsel's contrived "necessity" requirement, *every* restraint related to a joint venture would necessarily be either *per se* illegal (because it was *not* "necessary" or "essential" to the integration) or "*per se*" lawful (because it *was* "necessary" or "essential" to a procompetitive integration). There would never be a need for rule of reason analysis of the net competitive effects of a joint venture restraint. Complaint Counsel's own economist admits that this rule would lead to inefficient results, because a practice may contribute to the efficiencies of a joint venture (and thus benefit consumers) even if it is not "necessary" or "essential." RPF at 128. And the Commission's own *Guidelines for Collaborations Among Competitors* ("Guidelines") (April 2000) state that a restraint need only be "reasonably necessary" to a pro-competitive collaboration for it to be exempt from *per se* analysis. *Id.* at 8-9.

The many cases in which courts (including the Supreme Court) already have applied the rule of reason to alleged joint venture restraints without requiring any showing that the restraint was "necessary" or "essential" demonstrate that Complaint Counsel's "necessity" requirement is baseless. In *NCAA v. Board of Regents*, 468 U.S. 85 (1984), for instance, the Supreme Court did not consider whether the restrictions on college football telecasts at issue there were "necessary" or "essential" to the formation, existence or continued operation of the NCAA. The restriction at issue in *NCAA* plainly was *not* necessary to the formation or efficient operation of the NCAA because they were adopted decades after the organization was formed and related only to one of the many functions that the organization serves. The Court nevertheless 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." *Id.* at 100-101. The *NCAA* Court did not hold, as Complaint Counsel suggest, that the rule of reason applies only if the "particular" restraint is "necessary" or "essential" to the joint venture. As Judge Posner has explained

> [T]he court in *NCAA* did *not* condition the applicability of the Rule of Reason on proof that the particular restriction that had been challenged was necessary if the product was to be brought to market at all. There was, however, a *plausible connection* between the specific restriction and the essential character of the product. . . . It was arguable, in other words, that the television output restriction was '*ancillary*' to a lawful main purpose.

General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d 588, 595 (7th Cir. 1984) (citing *NCAA*, 441 U.S. at 100-01) (emphasis added).[6]

Likewise, nothing in *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979), suggests that a restraint must be "necessary" or "essential" to a collaboration to be subject to the rule of reason. In considering whether the ASCAP and BMI blanket licenses were illegal *per se*, the Court asked "whether the effect and . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy – that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of the market, or instead one designed to 'increase economic efficiency and render markets more, rather than less, competitive." *Id.* at 19-20 (quoting *United States v. Gypsum Co.*, 438 U.S. 422, 436 n. 13, 441 n. 6 (1978)). The Court's conclusion that the

[6] The *NCAA* Court held the television restrictions were unlawful under the rule of reason because "NCAA football could be marketed *just as* effectively without the television plan." 468 U.S. at 114.

blanket licenses were not illegal *per se* – *i.e.*, that it was "not a 'naked restrain[t] of trade with no purpose except stifling of competition," *id.* at 20 (quoting *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963) – was not triggered by any finding that the blanket license was "necessary" or "essential" to the joint ventures, but rather was based on the finding that the licenses "*accompanie[d]* the integration" included in the joint ventures and provided a "substantial lowering of costs" in comparison to individually negotiated licenses. *Id.* at 20-21 (emphasis added). The Court recognized that ASCAP and BMI could have adopted individually negotiated licenses with the television networks, but held that it was *not* necessary for ASCAP and BMI to pursue that alternative because the "blanket license" provided a "substantial lowering of costs" and was thus "*potentially beneficial* to both sellers and buyers." *Id.* at 21 (emphasis added).[7]

Numerous other cases make clear that there is no basis for requiring a restraint to be "necessary" or "essential" to the formation or efficient operation of a joint venture to be subject to the rule of reason. In *Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n*, 961 F.2d 667, (7th Cir. 1992), the Seventh Circuit addressed restrictions on the televising of NBA basketball games – again a restriction that was unquestionably not "necessary" or "essential" to the formation or operation of the NBA itself. The court held: "[i]f the NBA is a joint venture, then the Rule of Reason supplies the framework for antitrust analysis . . . *NCAA* leaves no room for debate." 961 F.2d at 673.

[7] The *BMI* Court did note that joint ventures are not unlawful as price-fixing agreements "where the agreement on price is necessary to market the product at all," but only as one of several illustrations of the more general point that "[n]ot all arrangements among actual or potential competitors that have an impact on price are *per se* violations of the Sherman Act or even unreasonable restraints." *Id.* at 24. In light of the Court's recognition that ASCAP and BMI could have adopted individually negotiated licenses, this passage plainly cannot be read to suggest that the rule of reason applies *only* where a restraint is "necessary" to a joint venture.

In *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986), the D.C. Circuit evaluated a prohibition on competition by members of a "joint venture" of van lines with that venture. Judge Bork held that, to avoid application of the *per se* rule, a restraint need only be "ancillary" to the joint venture:

> To be ancillary, and hence exempt from the per se rule, an agreement eliminating competition must be subordinate and collateral to a separate, legitimate transaction. The ancillary restraint is subordinate and collateral in the sense that it serves to make the main transaction more effective in accomplishing its purpose. Of course, the restraint imposed must be related to the efficiency sought to be achieved.

792 F.2d at 224; *see also id.* ("the challenged agreements are ancillary in that they enhance the efficiency of [the] union by eliminating the problem of the free ride"); *id.* at 229 ("these restraints are ancillary to the contract integration or joint venture . . . [because they] preserve the efficiencies of the nationwide van line by eliminating the problem of the free ride"). Nowhere does Judge Bork suggest that the particular restraint must be "necessary" or "essential" in order to avoid *per se* condemnation.

Similarly, in *Polk Bros., Inc. v. Forest City Enters., Inc.*, 776 F.2d 185, 189 (7th Cir. 1985), Judge Easterbrook emphasized that "[a] court must distinguish between 'naked' restraints, those in which the restriction on competition is unaccompanied by new production or products, and 'ancillary' restraints, those that are part of a larger endeavor whose success they promote." 776 F.2d at 188-89. "A restraint is ancillary [and therefore subject to the rule of reason] when it may contribute to the success of a cooperative venture that promises greater productivity and output." *Id.* In *Polk Bros.* itself, the court *upheld* under the rule of reason an

agreement between the partners in the building of a joint retail facility that they would not compete by selling any products sold by each other in that facility. Obviously, that agreement not to compete was no more "necessary" or "essential" to the building of a joint facility than the alleged moratorium here was to the release of the third Three Tenors album; it was, however, "ancillary" to the joint venture because it eliminated the potential for "free riding" by one venturer on the promotional efforts of the other.

In short, the case law makes clear that, because the alleged moratorium was adopted in the context of and was ancillary to the joint venture between PolyGram and Warner, it is not *per se* illegal but must be evaluated under the rule of reason – and that there is no basis for considering whether it was "necessary" or "essential" to anything.

2. The moratorium can be ancillary even though it applied to products that were not created or marketed as part of the joint venture.

Complaint Counsel's contention that the moratorium may be found unlawful without any consideration of its actual anticompetitive effects simply because it applied to products that were not created or marketed as part of the joint venture is equally wrong. First, as a factual matter, it is not the case that 3T1 and 3T2 were "outside" the joint venture – as part of the joint venture, PolyGram and Warner agreed to collaborate in producing Greatest Hits and Box Set albums that would include recordings from all three Three Tenors albums, RPF Nos. 28, 35, and plainly had a legitimate interest in maximizing the success of the entire Three Tenors product line so that those later products could be successful. The relevant PolyGram and Warner witnesses testified that an artist's catalog products typically are considered in developing the marketing plans for a new album by the artist. RPF No. 51. Complaint Counsel's marketing

expert, Professor Moore, testified that it "made sense" for PolyGram and Warner to consider 3T1 and 3T2 in developing their marketing plans for 3T3. *Id.* And Complaint Counsel's economist, Dr. Stockum, testified that a restraint adopted in the context of a joint venture may be efficient (and thus procompetitive) even if it applies to products that are not created or marketed as part of the joint venture. RPF No. 129.

More fundamentally, there is no legal rule that precludes the parties to a joint venture from reaching ancillary agreements relating to products that are not themselves created or marketed as part of the joint venture. Thus, in *Polk Bros.*, two retail firms – one that sold appliances and home furnishings and one that sold building materials, lumber, tools and related products – entered into a collaboration to finance the building of a store large enough to house both. 776 F.2d at 187. The firms could have but did *not* integrate their assets in any other respect: they did not agree jointly to produce, distribute, sell, advertise, or promote any product whatsoever. Thus, the sole integration of assets was a pooling of financial resources to build the store and the partitioning of the space in that store. In connection with that limited integration of assets, the firms agreed that neither would sell certain types of products sold by the other – products that were "outside" the integration of the firm's assets. The Seventh Circuit nevertheless held that the non-competition agreement was subject to the rule of reason, not the *per se* rule. *Id.* at 188-191.[8]

Similarly, in *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d 322 (S.D.N.Y. 2001), the court applied the rule of reason to agreements among the members of the Visa and

MasterCard joint ventures that no member would compete with the joint venture by offering American Express or Discover cards. In that case, the United States "*agree[d]* that analysis of the defendants' . . . exclusionary rules involves application of the rule of reason." *Id.* at 343. Obviously, American Express and Discover cards were not "inside" the integration of assets by the Visa and MasterCard joint ventures; they (like 3T1 and 3T2) were unquestionably "non-venture products." Complaint Counsel's position in this case is squarely at odds with that of the United States and the district court in the *Visa* case.

Complaint Counsel's position is also inconsistent with the Commission's own Guidelines. In Example 10 of those Guidelines, the Commission (and the Department of Justice) hypothesize a collaboration between two computer firms to develop and market new word-processing software. Guidelines at 34. Both firms have pre-existing word processing software, but that software is not integrated into the parties' joint venture (although it presumably could have been). Instead, the joint venture partners agree "that neither will sell its previously designed word-processing program once their jointly developed product is ready to be introduced." *Id.* The Guidelines do not indicate that this agreement would be *per se* illegal simply because it involves a restraint on "non-venture products." To the contrary, the Guidelines expressly provide that the agreement may be subject to analysis under the rule of reason, depending upon the extent

[8] As explained below, the alleged moratorium here was *more* closely related to the parties' integration of assets than the restraint in *Polk Bros.* Here, the "free riding" concern that motivated the alleged moratorium related to potential free riding on the advertising and promotional expenditures and confidential marketing plans of the joint venture – that is, on the integrated assets of the venturers – whereas in *Polk Bros.* the concern related to potential free riding on the independent advertising and promotional expenditures (made from unintegrated assets) of the individual retail firms.

of inquiry needed to determine its relationship to the procompetitive benefits of the joint venture itself.[9]

Another case Complaint Counsel have previously cited, *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), *is* relevant to this case – but it plainly supports Respondents' position. The consent decree in that case – which precluded GM and Toyota from exchanging information regarding products that were not part of the joint venture – subsequently was *vacated* by the Commission. It was vacated because the Commission concluded the restriction contained in the consent decree was not necessary to prevent any anticompetitive conduct, and indeed may have prevented procompetitive benefits of the joint venture by "increase[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. Thus, rather than establishing a rule that restrictions on products "outside" a joint venture are impermissible, *GM/Toyota* instead stands for the precisely the opposite proposition in demonstrating that such restraints may be procompetitive and are thus subject to the rule of reason.[10]

3. The lack of judicial experience with similar restraints mandates rule of reason analysis.

[9] Complaint Counsel's expert, Dr. Stockum, testified that the non-competition agreement posited in Example 10 of the Guidelines would be substantially more restrictive of competition than the alleged moratorium agreement at issue here, because (1) it would prohibit sale of the pre-existing products altogether, as opposed to leaving those products on the market, and (2) it would be a permanent ban on sales, as opposed to a 10-week moratorium. RPF No. 124.

The complete lack of judicial experience with any similar restraint adopted in circumstances comparable to those surrounding the moratorium provides yet another reason that the agreement is subject to the rule of reason. Courts have repeatedly frowned upon efforts to pigeonhole novel situations into the few well-established and narrowly-defined categories of agreements that are illegal *per se*, holding that any abbreviated form of antitrust analysis must be deferred until after courts have had extensive and consistent experiences demonstrating that the agreements at issue are of a type that virtually always have anticompetitive effects and lack any redeeming value. *See, e.g., California Dental*, 526 U.S. 756, 771-81 (holding that courts must "look[ ] to the circumstances, details, and logic" surrounding any alleged restraint before making any finding that it is in violation of the antitrust laws); *Broadcast Music*, 441 U.S. at 7-8 (*per se* rule is limited to practices that are "so plainly anticompetitive" and so "lack[ing] . . . any redeeming virtue" that they can be "conclusively presumed" to violate the antitrust laws).

Courts have had no prior experience with alleged restraints like the proposed moratorium. Indeed, the Three Tenors joint venture is itself unique. Respondents' witnesses -- with decades of experience in the music industry -- were aware of no other joint venture whereby two record companies have worked together to develop, record, market and distribute an album of new recordings by artists who have pre-existing recordings distributed by each company and have agreed to share equally in the costs and benefits of the venture. RPF No. 150. As the relevant PolyGram and Warner witnesses explained, the moratorium arose in the unique context

[10] The fact that the moratorium was adopted shortly after PolyGram and Warner executed the contracts underlying their joint venture is irrelevant to the issue of whether the moratorium was ancillary to the joint venture. As discussed in more detail below, Complaint Counsel's and PolyGram's expert economists agree that a rule requiring a restraint to be adopted upon the formation of a joint venture for it to be considered ancillary would create substantial disincentives to entering into joint ventures in the first place, and the case law has repeatedly analyzed restraints as ancillary restraints subject to the rule of reason even when they were adopted after the formation of a joint venture.

of the Three Tenors joint venture and was motivated by the unique circumstances of that joint venture – a joint venture between the owners of the two prior Three Tenors album that created a promotional opportunity for the two prior products that would not have existed absent the venture and that threatened the success of the joint venture if it was not managed properly. RPF No. 71. The duration and scope of the moratorium were specifically limited to addressing the unique concerns that arose in the context of this unique joint venture. RPF Nos. 102-03. Complaint Counsel's own expert economist admitted that he is not aware of any prior academic or judicial analysis of a restraint like the proposed moratorium, RPF No. 125, and Complaint Counsel's own marketing expert was unable to identify any similarly structured joint venture in the music industry, RPF No. 104. This unique and unprecedented alleged restraint, which, by its terms, would have affected only the marketing of two among thousands of classical music albums during a brief ten-week period when the marketing of those albums was particularly relevant to the potential success of the new Three Tenors album, plainly is not subject to *per se* analysis. Indeed, in analyzing other restraints adopted by joint venturers faced with potential free-riding that might have undermined the success of their ventures, courts consistently have found those restraints to be subject to the rule of reason even when they were far broader in scope and duration than the moratorium. *See Polk Bros. v. Forest City Enters., Inc.*, 776 F.2d 185, 189 (7th Cir. 1985) (concluding that agreement not to compete adopted as part of joint venture was lawful under rule of reason); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 214 (D.C. Cir. 1986) (concluding that agreement not to compete against van line joint venture was subject to rule of reason).

B. Complaint Counsel Failed To Establish Any Violation Under The Rule Of Reason.

To establish that the proposed moratorium violates the antitrust laws under the rule of reason, Complaint Counsel must show (1) that it had some actual anticompetitive effect and, (2) if the procompetitive justifications offered by PolyGram are at least plausible, that the actual *net* effect was anticompetitive. *California Dental*, 526 U.S. at 771-81; *Continental Airlines*, 277 F.3d at 514-17.[11] Complaint Counsel utterly failed to meet their burden on both counts.

1. Complaint Counsel's Failure To Offer Evidence Of Some Actual Anticompetitive Effect Mandates A Decision In Respondents' Favor.

Complaint Counsel offered absolutely no evidence that the moratorium had any actual anticompetitive effect in any relevant market. Some showing of actual anticompetitive effect is required to establish an antitrust violation in any rule of reason case – "quick look" or otherwise. *California Dental*, 526 U.S. at 771-81; *Continental Airlines*, 277 F.3d at 514-17. Indeed, the law requires an analysis of the actual competitive effects of the challenged practice in the relevant market unless the actual anticompetitive effects of the practice are "obvious" based on the record evidence. *California Dental*, 526 U.S. at 771-81. This case contrasts sharply with

those cases in which antitrust violations have been found under a "quick look" version of the rule of reason, because here there is *no* record evidence of any actual anticompetitive effect, *no* basis for concluding that there was any adverse effect on price or output in the United States, and record evidence that the moratorium actually had a procompetitive effect, whereas the actual, net anticompetitive effects of the challenged practices on price or output were "obvious" in all of the "quick look" cases. *See Chicago Prof'l Sports Ltd. P'Ship v. National Basketball Assn.*, 961 F.2d 667 (7th Cir. 1992) (applying "quick look" to restriction that limited Chicago Bulls telecasts in Chicago); *NCAA v. Board of Regents,* 468 U.S. 85 (1985) (applying "quick look" to restriction that limited broadcasts of Oklahoma Sooners football games in Oklahoma); *Toys 'R Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000) (applying "quick look" to invalidate restrictions under which the "dominant" toy retailer coordinated a group boycott of rival retailers by leading toy manufacturers). It is absurd for Complaint Counsel to suggest that the anticompetitive effects of the moratorium – which affected two among thousands of compact discs for a brief ten-week period as part of a marketing plan that *encouraged* the aggressive promotion and discounting of those same compact discs during the two months preceding the moratorium period – are comparably obvious.

[11] *Continental Airlines* makes clear that the standards set forth in *California Dental* are not limited to the professional services context, as Complaint Counsel have suggested. In *Continental Airlines*, the Fourth Circuit applied the standards articulated in *California Dental* in reversing a district court decision that had found a horizontal agreement to restrict the size of carry-on luggage through the use of a common security "template" unlawful without any analysis of its net effect on competition. *Continental Airlines*, 277 F.3d at 508-517. Because it was not "indisputably implausible" that the restraint was procompetitive (or had no competitive effect at all), the Fourth Circuit instructed the district court to evaluate the net effect of the challenged restraint under a more detailed version of the rule of reason. *Id.* at 514-17. ("The Supreme Court has held that the 'plausibility of competing claims as to the net effect of the challenged restriction – that is, the possibility that the restriction might have procompetitive effects or no effect at all – 'ruled out [ ] indulgently abbreviated review [of the challenged restraint' . . . ."; "we cannot conclude that these justifications are indisputably implausible.") (citing *California Dental*, 526 U.S. at 778).

Nor do Complaint Counsel benefit from any "presumption" of anticompetitive effect that somehow would relieve them of their burden of showing actual anticompetitive effect. Nothing in *California Dental* or *NCAA* any other Supreme Court decision supports the presumption Complaint Counsel seeks to invoke. Rather, *California Dental*, as recognized by lower court cases like the recent Fourth Circuit decision in *Continental Airlines*, stands for the well-established principle that an antitrust plaintiff must offer *evidence* that the challenged restraint caused an *actual* anticompetitive effect (or market power as a surrogate for such effect) as part of its initial showing in *any* rule of reason case. Respondents are aware of no rule of reason case in which a restraint was held unlawful, or the burden of proof was shifted to the defendant, simply because the restraint was "presumptively anticompetitive" and without any evidence either of an actual anticompetitive effect or of market power.

Because this is a rule of reason case, a decision in Respondents' favor must issue absent some showing of *actual* anticompetitive effect. Complaint Counsel made no such showing. Rather, Complaint Counsel's expert economist, Dr. Stockum, testified that "without considering [market definition, market share, analysis of actual advertising practices and pricing and discounting practices, and other factors], one could not determine what the actual competitive effect of the Three Tenors moratorium was." RPF No. 123. Complaint Counsel expressly disclaimed any effort to conduct such analyses here -- undoubtedly upon recognizing that any such economic analysis of the actual effects of the alleged moratorium would almost certainly indicate that it would have no anticompetitive effect. The alleged moratorium related to two compact discs, one eight years old and the other four, and restricted advertising and discounting for a brief 10-week period. One need not have more than a rudimentary understanding of economics – and particularly of how economists define a relevant market – to

see that, in a world in which *thousands* of compact discs are released each year and *thousands* more remain as active catalogue releases, such a restriction is not likely to have any actual effect on prices.

Complaint Counsel's decision not to attempt to develop any evidence of actual anticompetitive effect is fatal to their case under any version of the rule of reason, whether it be "quick look," "abbreviated" or "full." As the Supreme Court explained in *California Dental*:

> [B]efore a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of procompetitive effects, as quick-look analysis in effect requires, there must be 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.*

526 U.S. at 775 n.12. In *California Dental*, the Supreme Court remanded the case to the Ninth Circuit for further proceedings, even though the Commission had made and the Ninth Circuit had affirmed some findings both of actual anticompetitive effect and market power. *See California Dental Ass'n v. F.T.C.*, 128 F.3d 720, 729-730 (9th Cir. 1997); *see also* Brief for the Respondent (Federal Trade Commission) in the United States Supreme Court in *California Dental Ass'n* (emphasizing that the Commission had found both actual anticompetitive effects and market power). Here, of course, Complaint Counsel have presented evidence of neither.

That proof of actual anticompetitive effect (or of market power as a surrogate for such effect) is required in *any* rule of reason case is confirmed by other Supreme Court decisions as well. In *Indiana Federation of Dentists*, the Supreme Court held that "the Commission's failure to engage in detailed market analysis is not fatal to its finding of a violation of the Rule of

Reason," but only because the Commission had made a "finding of actual, sustained adverse effects on competition." F.T.C. v. Indiana Fed'n of Dentists, 476 U.S. 447, 460-61 (1986). As the Court stated, "[s]ince the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects, such as a reduction of output,' can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'" *Id.*

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 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.

Lower court cases both before and after *California Dental* likewise have consistently recognized that, under the rule of reason, the plaintiff must prove an actual anticompetitive effect before the burden shifts to the defendant to prove any procompetitive justification. *See, e.g., Law v. NCAA*, 134 F.3d 1010, 1019 (10th Cir. 1998) (under the rule of reason, "the plaintiff bears the initial burden of showing that an agreement had a substantially adverse effect on competition"; "[a] plaintiff may establish anticompetitive effect indirectly by proving that the defendant possessed the requisite market power within a defined market or directly by showing actual anticompetitive effects"); *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d at 345 ("Under the rule of reason, the Government bears the initial burden . . . of

demonstrating that each restraint has substantial adverse effects on competition"); *id.* at 399 ("once a plaintiff succeeds in establishing the actual adverse effects of an alleged restraint, the burden shifts to the defendant to establish its pro-competitive redeeming virtues"). This rule applies even under an abbreviated or "quick look" version of the rule of reason. *Law v. NCAA*, 134 F.3d at 1020 ("Under a quick look rule of reason analysis, anticompetitive effect is established . . . where the plaintiff shows that a horizontal agreement to fix prices exists, that the agreement is effective, *and that the price set by such an agreement is more favorable to the defendant than otherwise would have resulted from the operation of market forces.*") (emphasis added).

There is simply no basis for holding a restraint unlawful, or for shifting to the defendant to prove its procompetitive justifications, absent evidence either of market power or of actual anticompetitive effect. Complaint Counsel have presented no evidence of market power or actual anticompetitive effect, and Respondents are therefore entitled to a decision in their favor.

2. Respondents' Procompetitive Justifications Are Plausible And Thus Require Analysis Of The Moratorium's Actual Competitive Effects, If Any.

Respondents would be entitled to a decision in their favor even if Complaint Counsel were entitled to some "presumption" of anticompetitive effect because Respondents' procompetitive justifications for the moratorium plainly require analysis of its actual, net competitive effects under the rule of reason and thus would rebut any conceivable presumption. In *California Dental*, the Supreme Court repeatedly emphasized that the presence of a

"plausible" efficiency justification mandates analysis of the actual, net competitive effects of the challenged practice. 526 U.S. at 771 (holding that actual, net competitive effects of challenged restraint must be considered where it "might plausibly be thought to have a net competitive effect, or possibly no effect at all on competition"); *id.* at 773 (noting that procompetitive justifications were "arguably" valid); *id.* at 775 (noting that justifications were "not implausible"); *id.* at 778 (criticizing Court of Appeals' failure to consider "plausible" claim that restrictions had a procompetitive effect); *id.* at 778 (holding that "plausibility of competing claims about the effects" precluded abbreviated analysis of restraint). The procompetitive justifications here plainly are plausible – Complaint Counsel's expert economist admitted they are, RPF No. 117 -- and, under *California Dental*, preclude the extremely abbreviated form of antitrust analysis urged by Complaint Counsel.

a. It Is At Least Plausible That The Moratorium Was A Reasonably Necessary And Procompetitive Part Of The Marketing Strategy For The Three Tenors Product Line.

In arguing that the proposed moratorium was not plausibly procompetitive, Complaint Counsel ask the Court to ignore the joint venture context in which the proposed moratorium arose, and to impose a rule under which the parties to a joint venture would be *required* to engage in conduct they viewed as completely antithetical to the purposes of their venture. The uncontroverted evidence provided by the testimony from the relevant PolyGram and Warner witnesses and the contemporaneous documents show that the proposed moratorium was an integral part of the marketing plans for the joint venture product, 3T3. The moratorium was inextricably intertwined with the rest of the Three Tenors joint venture, and consequently cannot be analyzed apart from the overall procompetitive benefits of the venture. *See*

Collaboration Guidelines § 2.3, at 6-7 ("Two or more agreements are assessed together if their procompetitive benefits or anticompetitive harms are so intertwined that they cannot meaningfully be isolated and attributed to any individual agreement.").

The proposed moratorium would have allowed PolyGram and Warner to adopt a commercially sound marketing strategy – a strategy Complaint Counsel concede might well have been adopted by a single firm owning all three Three Tenors albums and seeking to maximize the long-term output of Three Tenors products.[12] Under their chosen marketing strategy, PolyGram and Warner allowed their operating companies to aggressively promote 3T1 and 3T2 during June and July, but instructed them to discontinue those promotional efforts by August so that they could focus on the new album. As the PolyGram and Warner relevant witnesses have testified, promoting and discounting the prior albums rather than the new albums during the period surrounding the August release of the new album could have jeopardized the potential success of the new album by sending a confusing message to consumers and the trade and diverting the operating companies' focus away from the new album, which was of far greater commercial significance by 1998. *See* RPF No. 55 (Cloeckaert Depo. Tr. at 68-70; *see also* O'Brien Tr. at 99; Saintilan Tr. at 78-84; Stainer Tr. at 57-58). Respondents' marketing expert, Professor Wind, opined that this was a commercially reasonable strategy for maximizing the long-term success of the Three Tenors brand. RPF No. 112 (Wind Report at 16-17). It is indisputably plausible that this marketing strategy maximized the chance the new album would succeed and thereby could have increased the aggregate output of all Three Tenors products and increased the likelihood

[12] The fact that a single firm owning all three albums might have adopted the same marketing strategy as the parties adopted here strongly suggests that the proposed moratorium was viewed as a reasonably necessary part of the joint venture, and not as a stand-alone measure designed to restrict sales of the prior albums. *See* RX 717, Ordover Report at 17-19.

that the parties ultimately would release the greatest hits and box-set albums. It is indisputably plausible that, by allowing their operating companies to exploit the promotional opportunity provided by the Paris concert by aggressively discounting and promoting 3T1 and 3T2 in June and July, this marketing strategy allowed competition that would not have occurred absent the joint venture and that may not have occurred absent an agreement on that strategy. And it is perfectly clear that the only competition arguably affected by the moratorium was potential competition between 3T1 and 3T2 that existed only because of the promotional opportunity the joint venture created through the Paris concert and the release of the new album.[15] The plausibility of these procompetitive effects compels a decision in Respondents' favor. *Continental Airlines*, 277 F.3d at 514 (holding that rule of reason is required where procompetitive justifications are not "indisputably implausible")

Complaint Counsel's suggestion that the Court should ignore the procompetitive effects of the overall Three Tenors joint venture, the clear relationship between the moratorium and the venture itself, and the parties' contemporaneous views that the moratorium was a necessary part of the marketing plans for 3T3 is at odds with controlling law. There is no support whatsoever for the proposition that the legality of a challenged restraint depends on whether it was adopted before or after the formation of a joint venture. To the contrary, courts consistently have allowed joint venture partners substantial leeway to adopt or modify specific measures they

[15] On this point, an article by Gregory J. Werden – who, at the time, was Director of Research, Economic Analysis Group in the Antitrust Division – is particularly instructive. *See* Gregory J. Werden, *Antitrust Analysis of Joint Ventures: An Overview*, 66 Antitrust L.J. 701 (1998). After a thoroughgoing analysis of the relevant case law and academic commentary on antitrust issues arising in the joint venture context, the article concludes that "a joint venture and its ancillary restraints are not subject to a quick look when the only competition restrained would not have occurred absent the joint venture." *Id.* at 735. Here, the only competition that possibly could have been restrained by the proposed moratorium – discounting and promoting 3T1 and 3T2 during the period surrounding the Paris concert and the release of the new album – clearly existed only because of the joint venture.

view as necessary to ensure the success of the venture even after the venture has been formed. Thus, the restraint at issue in *Polk Bros.*, which barred each party to a shopping center joint venture from competing in certain product lines, had a 50-year term and was adopted six years after the venture was formed. *Polk Bros.*, 776 F.2d at 187-88. Despite the fact the restraint was adopted after the formation of the joint venture, the Seventh Circuit concluded that it "ma[de] it easier for people to cooperate productively in the first place," and that it enabled each retailer to prevent the other from free riding on promotional and marketing efforts made in the context of the joint venture. *Id.* at 190; *see also NCAA*, 468 U.S. at 101 (applying rule of reason in analyzing restraint adopted well after formation of joint venture); *Rothery Storage*, 792 F.2d at 212, 229-30 (concluding that restraint adopted after the formation of the joint venture was a legitimate means to address risk that parties would free ride on services provided by joint venture); *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 970-72 (10th Cir. 1994) (holding that by-law adopted approximately forty years after formation of Visa joint venture was reasonably necessary to prevent free riding and protect investment in the venture); *United States v. Visa U.S.A., Inc.*, 163 F. Supp.23d at 343-406 (concluding that same by-law was subject to rule of reason analysis).

Complaint Counsel's proposed requirement that any ancillary restraint be identified in the initial joint venture documentation also is at odds with the realities of the business world. As Mr. Hoffman and Mr. O'Brien testified, PolyGram and Warner entered into the joint venture as "full partners" and saw no need to specify all of the material details of their agreement in the contract, and no risk in allowing their respective marketing personnel to develop the marketing plans for 3T3 after the joint venture was formed. RPF No. 50. Indeed, Complaint Counsel's own expert economist admits that, as matter of economics, whether an

alleged restraint was adopted before or after the formation of the joint venture is not determinative of whether it is reasonably necessary to the venture. RPF No. 127. The artificial rule suggested by Complaint Counsel – under which the mere fact that a restraint was adopted after the formation of a joint venture would foreclose any claim that the restraint was a reasonably necessary part of the joint venture – would create a substantial disincentive to entering into joint ventures in the first place. *Id.* (Stockum Depo. at 149-50; RX 716, Ordover Report at 9-10). As Respondents' expert economist, Professor Ordover, explained:

> From a public policy perspective, a rule that treated as *per se* unlawful restrictions reasonably linked to the objectives and success of the joint venture, simply because those restrictions were adopted after the formation of the joint venture, would create a significant disincentive for parties to form joint ventures in the first place. In many cases, it is unrealistic to expect joint venture partners to fully articulate all pertinent terms and provisions at the time of a joint venture's formation. Such a requirement would preclude the parties from making additions or revisions to the terms of the joint venture that might only become clear once the JV is in operation.

Id. at 9.

b. It Is At Least Plausible That The Proposed Moratorium Was Procompetitive In Preventing Free Riding And Opportunistic Behavior.

The record evidence shows that the moratorium also would have served a second, and equally plausible, procompetitive interest by preventing the PolyGram and Warner operating companies from using the promotional opportunity the joint venture created through the Paris

concert and the release of the new album, as well as the confidential marketing plans developed by the joint venture partners for the new album, to "free ride" on the efforts of the joint venture partners. The contemporaneous documents and subsequent witness testimony make clear that PolyGram and Warner were deeply concerned that the potential for opportunistic behavior on the part of the operating companies posed a serious threat to 3T3 during the initial release period that could have undermined the long-term success of the Three Tenors brand. RPF No. 83. In particular, the parties believed that any short-term increase in sales associated with aggressive promotion of 3T1 or 3T2 during the initial release period for 3T3 would be more than offset by decreased sales of 3T3 both during the moratorium period and thereafter, and that an unsuccessful 3T3 would make it less likely that they would ever release the greatest hits or box set albums. RPF Nos. 55, 72. Complaint Counsel's expert economist, Dr. Stockum, acknowledged that this sort of "asymmetrical" effect from free riding activities would be a legitimate concern for the joint venture partners, but professed not to have seen any of the contemporaneous documentation in which the relevant PolyGram and Warner employees made clear that this was precisely the concern that gave rise to the moratorium. RPF No. 141.

The Commission's Guidelines, the relevant case law, and Complaint Counsel's own expert all recognize that preventing "free riding" and other opportunistic behavior can have procompetitive benefits and that an agreement designed to prevent such behavior might be justified in a joint venture even if it would be unlawful outside the context of a joint venture. *See* Collaboration Guidelines § 3.36(b), 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 of a system of distribution" 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 (stating that free riding is "an accepted justification for cooperation)"; RPF No. 84 (Stockum Depo. at 56:13-15) (recognizing that "free riding can at least potentially create inefficiency in the market").

The testimony of Atlantic's CFO, Mr. O'Brien, demonstrated that, absent the proposed moratorium, free riding and opportunistic behavior by the PolyGram and Warner operating companies easily could have resulted in "driving [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). Mr. O'Brien described a specific threat by WMI to exploit the promotional opportunity surrounding the Paris concert and the release of the new album by running a discount campaign for 3T2 in Europe from May – December 1998. RPF No. 94. Mr. O'Brien first became aware of WMI's threatened free riding activities before entering into the joint venture agreement, and entered into the joint venture believing that WMI would not be discounting 3T2 during the period surrounding the release of 3T2. *Id.* Mr. O'Brien believed that WMI's discounting proposal threatened to "blow the deal" - and, indeed, testified that PolyGram and Warner would not have entered into the joint venture agreement at all had either side believe the other would aggressively discount and promote its prior Three Tenors album during the initial release period for 3T3. RPF No. 95. When WMI later continued to seek to discount 3T2 during the period surrounding the release of 3T3, the moratorium enabled Mr. O'Brien to persuade WMI that its proposed discounting campaign posed a serious threat to the potential success of 3T3 and thus was not in the best interests of Warner Music Group. RPF No. 100. Mr. O'Brien also made

clear that the parties' total promotional expenditures for 3T3 depended on its success during the initial release period – and thus that aggressive discounting and promotion of the prior albums during the initial release period could have led to lower promotional spending for 3T2. RPF No. 101.[14]

The uncontroverted record evidence clearly demonstrates that PolyGram and Warner were legitimately concerned that free riding activities by their respective operating companies posed a threat to their joint venture, and that the moratorium was designed to address that concern. The presence of this procompetitive justification, again coupled with Complaint Counsel's failure to provide any evidence of any actual anticompetitive effect, must lead to a decision in Respondents' favor.[15]

c. Complaint Counsel's Proposed "Alternatives" To The Moratorium Do Nothing To Undermine Respondents' Procompetitive Justifications.

There is no need to consider any of the "alternatives" to the moratorium suggested by Complaint Counsel and their expert witnesses. These alternatives would be relevant only in weighing the anticompetitive effects, if any, of the moratorium against its procompetitive justifications. In the context of such a balancing inquiry, the presence of a less restrictive alternative might provide support for condemning an alleged restraint under the rule of reason. But Complaint Counsel here have not met – and made no attempt to meet – their threshold

[14] Complaint Counsel's marketing expert, Professor Moore, confirmed that one reasonably would expect a record company to spend more money promoting a product if it was successful following its initial release. RPF No. 108.

burden of showing that the moratorium actually had some anticompetitive effect in a relevant market, and there thus is no basis for engaging in any balancing inquiry.

Even if Complaint Counsel's proferred alternatives were relevant, they do nothing to undermine Respondents' procompetitive justifications for the moratorium. Professor Moore, Complaint Counsel's marketing expert, offered a number of proposals that might have made 3T3 a different, and perhaps more commercially attractive product – including different repertoire, a guest performer, different packaging, *etc.* RPF No. 132. Professor Moore's efforts to second-guess the marketing efforts of the relevant business people are completely beside the point. Different repertoire, different packaging, different advertising or even a guest performer could not have changed the fundamental and immutable fact that this was the third Three Tenors album owned by the parties to the joint venture, and none of those alternatives would have enabled the parties to ignore the existence of the fact that they each owned a prior Three Tenors album in developing their marketing plans for the new Three Tenors album. Professor Moore conceded that record companies routinely consider an artist's catalog albums in developing their marketing plans for a new album by that artist. RPF No. 51.

Moreover, Professor Moore was unable to opine that *any* of her suggested alternatives would have had any effect on sales of Three Tenors products, let alone that any of the alternatives would have been as effective as the moratorium in addressing the concerns that gave rise to the moratorium. Professor Moore did not analyze whether her alternatives were practicable, and she made no attempt to quantify how many consumers would have changed their

[15] Although the record evidence makes clear that the principal free riding concern for the Three Tenors joint venture was based on the risk that WMI and the PolyGram operating companies would discount 3T2 and 3T1 outside the United States, and that record companies do not use temporary price discounting to promote records in the United States, the record evidence also made clear that there were efficiencies associated with adopting a single, uniform marketing plan for the worldwide release of 3T3. RPF No. 130.

purchasing decisions if her alternatives had been adopted. RPF No. 136. Professor Moore's alternatives thus only confirm that a more detailed analysis would be required to assess the actual competitive effects, if any, of the moratorium.

Dr. Stockum's suggested alternatives fare no better. Dr. Stockum's first suggestion – apparently derived from the statement in *Chicago Prof'l Sports* that free riding concerns will not justify a restraint where a payment scheme is available to address the concerns, 961 F.2d at 669-70 – is that PolyGram and Warner could have adopted a licensing arrangement under which the operating companies would have compensated the joint venture for sales resulting from the promotional efforts of the joint venture. RPF No. 139. In *Chicago Prof'l Sports,* which involved restrictions on local telecasts of Chicago Bulls games, the court held that the NBA could simply charge the local station for the benefits derived from its promotional efforts, as Major League Baseball already did. 961 F.2d at 669-70.

However, as Dr. Stockum acknowledged on cross-examination, no licensing arrangement could have adequately addressed the free riding concerns that gave rise to the moratorium. First, unlike in *Chicago Prof'l Sports*, *both* parties here had the ability and incentive to free ride on the joint venture's expenditures. Thus, for example, if PolyGram had agreed to pay 60% of the costs of promoting 3T3 in the United States (rather than 50%), Warner would have had *even more* incentive to free ride by selling 3T2, for which it would retain 100% of the revenue. Thus, Warner's and PolyGram's respective operating companies would, collectively, have had the same incentive to free ride on the promotional efforts of the venture in connection with 3T3 regardless of how Warner and PolyGram allocated their financial responsibility for those promotional activities. Indeed, Complaint Counsel's economic expert admitted that the parties' aggregate incentive to free ride might be the same regardless of how

Warner and PolyGram chose to allocate their respective financial responsibilities for the costs of the joint venture. *See* Stockum Depo. at 72-73, 78-79. With that concession, Complaint Counsel's expert eliminated the sole reason he offered for why, in his opinion, there was no free riding problem to be addressed by the parties in the United States. *Id.* at 61-63 (identifying the ability to adjust payments within the venture as a means of eliminating the free riding problem).

Second, Dr. Stockum admitted that his licensing proposal would have done nothing to address what he referred to as "negative free riding" – the negative effect on 3T3 caused by aggressive promotion of 3T1 and 3T2 during the initial release period, as opposed to the positive effect on sales of 3T1 and 3T2 caused by the Paris concert and the release of the new album. RPF No. 141. Dr. Stockum acknowledged that concerns about potential "negative free riding" effects could be significant, particularly if the negative effects were disproportional to the positive effects on sales of 3T1 and 3T2. *Id.* These concessions completely undermine Dr. Stockum's licensing proposal, because the witness testimony and contemporaneous documents make clear that the free riding concern that gave rise to the moratorium *was* a concern about the negative effect that aggressive promotion and discounting of 3T1 and 3T2 during the initial release period would have on 3T3, and that any increased sales of 3T1 and 3T2 would be insufficient to compensate from the lost 3T3 sales that likely would result from aggressive promotion of the prior albums during the initial release period. RPF Nos. 54-55, 65.

Dr. Stockum's other two alternatives merit even less attention. Under one of these proposals, Dr. Stockum suggested that, rather than entering into the moratorium, PolyGram and Warner instead should have entered into vertical agreements with retailers throughout the

---

[16] As Dr. Stockum ultimately admitted, regardless of any "adjustment" to the 50/50 split in benefits in costs set forth in the joint venture agreement, any change in that formula would not have altered the parties' incentive to

world restricting *the retailers'* ability to discount and promote 3T1 and 3T2 during the initial release period for 3T3. RPF No. 139. In addition to the obvious practical difficulties associated with the suggestion that PolyGram and Warner could have entered into countless vertical agreements regarding the pricing and promotion of 3T1 and 3T2 for a ten-week period, it is difficult to imagine how this alternative would have been *less* restrictive than the actual moratorium – which Dr. Stockum acknowledged placed no limitation on retailers' pricing and promotional activities. RPF No. 143. In any event, as Dr. Stockum did not analyze either the actual effects of the moratorium or the likely effects of this alternative, it is impossible to assess whether this alternative would have been more or less restrictive than the moratorium. *See, e.g.*, Stockum Depo. at 94-96 (conceding that an alternative proposed by him might be at least as restrictive of competition as the moratorium, but that he could not tell without doing a full analysis of the market).

Dr. Stockum's final proposal, under which PolyGram and Warner would have constructed "firewalls" to shield their respective marketing personnel responsible for 3T1 and 3T2 from information pertaining to 3T3, RPF No. 139, was offered for the first time on the stand. The proposal completely failed to take into account the reality that the *same* marketing personnel were responsible for marketing both new and catalog classical albums at PolyGram and Warner. As Dr. Stockum acknowledged, that fact would make his proposed "firewalls" "a lot less effective." RPF No. 145.

Most fundamentally, however, Complaint Counsel's suggestion that there might be less restrictive alternatives suffers from the same fundamental defect as the rest of its case –

free ride on the joint venture services. *Id.* at 72-73, 78-79.

that is, it is impossible to assess whether some suggested alternative course of conduct might be more or less restrictive than the proposed moratorium without some evidence regarding the actual effect of the moratorium as compared with the effects the proposed alternatives likely would have had on competition in the relevant market. Again, Complaint Counsel have offered absolutely no evidence regarding the actual effect of either the proposed moratorium or any alternative course of conduct. There is thus no basis for concluding that the proposed moratorium had a *net* anticompetitive effect in comparison with the alternative measures suggested by Complaint Counsel. And, as Professors Wind and Ordover testified, there is substantial reason for concluding that the moratorium in fact was procompetitive. As the record is clear that the proposed moratorium was either procompetitive or had no competitive effect at all, summary decision in Respondents' favor should be granted. *Continental Airlines*, 277 F.3d at 514-17.

C. Complaint Counsel Failed To Demonstrate The "Cognizable Danger" Of Recurrent Violation Required To Obtain The Prospective Relief They Seek.

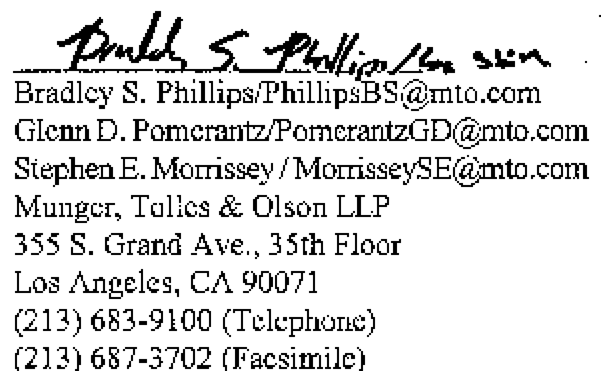
The relief sought be Complaint Counsel in this case is exclusively *prospective* – an order requiring PolyGram to "cease and desist" certain categories of conduct, and to provide periodic reports regarding various joint venture-related activities. *See* Notice of Contemplated Relief. However, to obtain prospective relief, Complaint Counsel must show that "'there exists some cognizable danger of recurrent violation.'" *TRW, Inc. v. FTC*, 647 F.2d 942, 954-55 (9th Cir. 1981) (quoting *United States v. W.T. Grant Co.*, 345 U.S. 629, 632 (1953)). There is no basis for such a finding here. The central elements of the Three Tenors joint venture – the agreement to split costs and benefits on a 50/50 basis between two record companies, the existence of prior albums by the same artist distributed by both companies, the potential for free

riding created by specific events that occurred only because of the existence of the joint venture (*i.e.*, the Paris concert and the release of the new album), *etc.* – were unique and unprecedented in the music industry. It is unclear when, if ever, a similar set of facts might converge and lead to a situation where another measure like the moratorium might be considered. There is no evidence that PolyGram – let alone the Universal entities who now, two mergers later, control the relevant PolyGram entities have ever considered any similar agreement or argued that similar justifications apply to any other agreement. Indeed, the fact that PolyGram unambiguously abandoned the moratorium before it was implemented shows how unlikely it is that any similar agreement will be entered into in the future. Complaint Counsel's contention that there is some danger of recurrence here is, as in *TRW*, purely speculative and is not sufficient to support the relief they seek here.

IV. CONCLUSION

For all of the foregoing reasons, the Court should adopt Respondents' Proposed Findings of Fact and Conclusions of Law, issue an initial decision in Respondents' favor, and deny all of the relief sought by Complaint Counsel as set forth in Respondents' Proposed Order.

Respectfully Submitted,



Bradley S. Phillips/PhillipsBS@mto.com
Glenn D. Pomerantz/PomerantzGD@mto.com
Stephen E. Morrissey / MorrisseySE@mto.com
Munger, Tolles & Olson LLP
355 S. Grand Ave., 35th Floor
Los Angeles, CA 90071
(213) 683-9100 (Telephone)
(213) 687-3702 (Facsimile)

Counsel for Respondents

Dated: April 26, 2002

CERTIFICATE OF SERVICE

I, Stephen Morrissey, hereby certify that on April 26, 2002, I caused a copy of the **RESPONDENTS' POST-TRIAL BRIEF** to be served upon the following persons by Federal Express:

Geoffrey M. Green / John Roberti
Cary Zuk / Richard Dagen
Federal Trade Commission
6th & Pennsylvania Ave., N.W.
Washington , D.C. 20580
Complaint Counsel

Hon. James P. Timony
Chief Administrative Law Judge
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington , D.C. 20580

Donald S. Clark, Secretary
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington , D.C. 20580

STEPHEN MORRISSEY

{757415.2}