**UNITED STATES OF AMERICA**
**BEFORE FEDERAL TRADE COMMISSION**

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

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

# RESPONDENTS' OPENING BRIEF ON APPEAL FROM INITIAL DECISION AND ORDER

841785.1

## TABLE OF CONTENTS

Page


I. INTRODUCTION ..... 1

II. STATEMENT OF THE CASE ..... 2

- A. Summary of Argument ..... 2
- B. Procedural History ..... 4
- C. Factual Background Relevant to the Appeal ..... 4
  - 1. The Parties ..... 6
  - 2. The Three Tenors Joint Venture. ..... 7
  - 3. PolyGram's and Warner's Decision To Adopt The Moratorium. ..... 9
  - 4. The Procompetitive Reasons For The Moratorium. ..... 11
    - a. The Moratorium Was Designed To Prevent Free Riding And Opportunistic Behavior. ..... 11
    - b. The Moratorium Was Designed To Increase Aggregate Long Term Output. ..... 12
- D. The Potential Competitive Effects Of The Moratorium. ..... 14
- E. The Lack Of Record Evidence On Likelihood of Recurrence ..... 17

III. QUESTIONS PRESENTED ..... 17

IV. ARGUMENT ..... 18

- A. There Is No Basis For Concluding That The Moratorium Is Illegal Per Se. ..... 19
  - 1. A restraint need not be an "inevitable," "integral," or "necessary" part of a joint venture to require analysis under the rule of reason ..... 20
  - 2. The fact that the moratorium applied to products that were not created or marketed by the joint venture does not mean that it was not ancillary. ..... 26
  - 3. The fact that the moratorium was adopted after the formation of the joint venture is irrelevant to whether it was an ancillary restraint. ..... 28
  - 4. The lack of judicial experience with similar restraints mandates rule of reason analysis ..... 29
- B. Complaint Counsel Failed To Establish Any Violation Under The Rule Of Reason ..... 30
  - 1. Complaint Counsel Were Required Under The Rule Of Reason To Present Evidence Of Actual Anticompetitive Effect. ..... 32




841785.1

**TABLE OF CONTENTS**
(continued)

**Page**


2. The Moratorium Would Not Be Presumptively Anticompetitive Even If That Were The Applicable Standard ........ 39

3. PolyGram's Procompetitive Justifications Preclude Any Finding Of Liability Under The Rule Of Reason ........ 42

   a. The Moratorium Plausibly Was Procompetitive In Preventing Free Riding And Opportunistic Behavior ........ 44

   b. The Moratorium Cannot Be Assessed Apart From The Procompetitive Effects of The Overall Venture ........ 47

4. PolyGram Was Not Required to Show the Moratorium Was "Necessary" to Further its Procompetitive Objectives ........ 50

C. Complaint Counsel Failed To Demonstrate Any "Cognizable Danger" Of Recurrent Violation ........ 50

V. CONCLUSION ........ 52

## TABLE OF AUTHORITIES

**Page(s)**

### FEDERAL CASES

*Broadcast Music, Inc. v. CBS*
441 U.S. 1 (1979) .......... 22, 29, 50

*California Dental Ass'n v. FTC,*
526 U.S. 756 (1999) .......... 3, 19, 30, 31, 32, 33, 36, 42, 50

*Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n,*
961 F.2d 667 (7th Cir. 1992) .......... 3, 19, 22, 34, 45

*Engebretsen v. Hartford Ins. Co.,*
21 F.3d 721 (6th Cir. 1994) .......... 44

*EPIS, Inc. v. Fidelity and Guaranty Life Ins. Co.,*
156 F.Supp.2d 1116 (N.D. Cal. 2001) .......... 44

*Forward Communications Corp. v. United States,*
608 F.2d 485 (Ct.Cl. 1979) .......... 44

*FTC v. Indiana Fed'n of Dentists,*
476 U.S. 447 (1986) .......... 32, 38

*General Leaseways, Inc. v. National Truck Leasing Ass'n,*
744 F.2d 588 (7th Cir. 1984) .......... 21

*In re Brunswick Corp.,*
94 F.T.C. 1175 (1979) .......... 20

*In re Cal. Dental Ass'n,*
121 F.T.C. 190, 1996 FTC LEXIS 81 (1996) .......... 39

*In re Detroit Auto Dealers Ass'n, Inc.,*
111 F.T.C. 417 (1987) .......... 38

*In re Detroit Auto Dealers Ass'n, Inc.,*
955 F.2d 457 (6th Cir. 1992) .......... 39

*In re Mass. Board,*
110 F.T.C. 549 (1988) .......... 38

*In re Toys 'R Us, Inc.,*
126 F.T.C. 415 (1998), *aff'd*, 221 F.3d 928 (7th Cir. 2000) .......... 45

*Law v. NCAA,*
134 F.3d 1010 (10th Cir. 1998) .......... 34

*NCAA v. Board of Regents,*
468 U.S. 85 (1984) .......... 3, 19, 21, 28, 32, 33, 34, 36, 37, 38, 50

*Polk Bros. v. Forest City Enters., Inc.,*
776 F.2d 185 (7th Cir. 1985) .......... 3, 20, 23, 26, 27, 28, 29, 30, 45, 49

*Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*
792 F.2d 210 (D.C. Cir. 1986) .......... 22, 28, 30, 45

*The Coca-Cola Bottling Co. of the Southwest,*
118 F.T.C. 452 (1994) .......... 18

*Tokio Marine & Fire Ins. Co., Ltd. v. Norfolk & Western Ry. Co.,*

## TABLE OF AUTHORITIES
(continued)


Page(s)

1999 U.S.App. LEXIS 476 (4th Cir. 1999) .................... 44

*Toys 'R Us, Inc. v. FTC*,
221 F.3d 928 (7th Cir. 2000) .................... 34

*TRW, Inc. v. FTC*,
647 F.2d 942 (9th Cir. 1981) .................... 50

*United States v. Brown University*,
5 F.3d 658 (3d Cir. 1993) .................... 38

*United States v. Oregon State Med. Soc'y*,
343 U.S. 326 (1952) .................... 50

*United States v. Socony-Vacuum Oil Co.*,
310 U.S. 150 (1940) .................... 19

*United States v. Visa U.S.A., Inc.*
163 F.Supp.2d 322 (S.D.N.Y. 2001) .................... 3, 20, 27, 28, 30

*Wilk v. AMA*,
895 F.2d 352 (7th Cir. 1990) .................... 51

*Yamaha Motor Co. v. FTC*,
657 F.2d 971 (8th Cir. 1981) .................... 25


## STATUTES AND RULES


16 C.F.R. § 3.46(e) .................... 18

16 C.F.R. § 3.51 .................... 18

16 C.F.R. § 3.51(c)(1) .................... 19

16 C.F.R. §§ 3.54(a), (b) (2002) .................... 18

FTC Act, Section 5, 15 U.S.C. § 45 .................... 1, 4


## OTHER AUTHORITIES


*Antitrust Guidelines for Collaborations Among Competitors* (2000) .................... 27, 45, 48

Gregory J. Werden, *Antitrust Analysis of Joint Ventures: An Overview*, 66 Antitrust L.J. 701 (1998) .................... 48

Rule of Practice 3.33(c)(1) .................... 43

Timothy J. Muris, *California Dental Association v. Federal Trade Commission: The Revenge of Footnote 17*, 8 Sup. Ct. Econ. Rev. 265, 309 (2000) .................... 35

Timothy J. Muris, *The Federal Trade Commission and the Rule of Reason: In Defense of Mass. Board*, 66 Antitrust L.J. 773, 798 (1998) .................... 40

## EXPLANATION OF CITATIONS TO THE RECORD

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

| | |
|---|---|
| **ID** | Initial Decision (served July 8, 2002) |
| **F. __** | Finding __ from the Initial Decision |
| **Tr. (___) __:___** | Trial Transcript (Witness) Page:Line |
| **SE** | Stipulated Index of Exhibits and Witnesses, (filed April 26, 2002) |
| **RPF __** | Respondents' Proposed Finding No. __ (filed April 26, 2002) |
| **RRCPF __** | Respondents' Reply to Complaint Counsel's Proposed Finding No. ___ (filed May 15, 2002) |
| **CCPRP** | Complaint Counsel's Post-Trial Reply Brief (filed May 14, 2002) |
| **____ Dep. __:___** | Witness Deposition Page:Line |
| **CCPFF** | Complaint Counsel's Proposed Findings of Fact (filed April 26, 2002) |



841785 1

## I. INTRODUCTION

This case raises fundamental questions of antitrust law and enforcement policy. The Initial Decision held the moratorium agreement that PolyGram[1] and Warner adopted as part their Three Tenors joint venture was unlawful under Section 5 of the FTC Act, 15 U.S.C. § 45. The Initial Decision raises the following questions:

- Whether an agreement between joint venturers can be adjudged illegal *per se* on the ground that it was not absolutely "necessary" for achieving the goals of a joint venture, even if the agreement was reasonably related to the procompetitive purposes of a joint venture;
- Whether an agreement may be held unlawful under the rule of reason despite the stipulated absence of any evidence that the agreement had *any* adverse effect on price or output in the United States;
- Whether an agreement can be considered "presumptively unlawful" or "inherently suspect" despite judicial rejection of the use of any such presumption under the rule of reason and despite the absence of evidence that the agreement is likely to have any anticompetitive effect if adopted as part of a joint venture in the industry at issue or any other industry;
- Whether an agreement may be held unlawful without a more detailed analysis of actual effects under the rule of reason even though the uncontradicted evidence (including the admission by Complaint Counsel's expert economist) demonstrates that the procompetitive justifications for the agreement are plausible; *and,*
- Whether the Commission may enter a cease and desist order despite the absence of any evidence that any similar restraint previously has been

[1] The Respondents here are PolyGram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc. and Universal Music & Video Distribution Corp. (collectively "PolyGram").



841785.1

considered by the Respondents (or anyone else in the industry) or is likely to be considered in the future.

Under long-settled principles of antitrust law, the answer to each of these questions is "no," and the Initial Decision must therefore be reversed.

## II. STATEMENT OF THE CASE

### A. Summary of Argument

PolyGram and Warner were the parties to a joint venture to create, market and distribute new Three Tenors products, including the third Three Tenors album ("3T3"), the Paris concert recorded on that album, and a greatest hits and/or box set album. When the venture was formed, PolyGram and Warner believed that they were full "partners" and specifically agreed that they would "consult and coordinate" with one another regarding "all aspects" of their joint venture. At the first joint marketing meeting held after the venture was formed, PolyGram and Warner agreed to a limited "moratorium" on the discounting and promotion of two prior Three Tenors albums – the 1990 album distributed by PolyGram ("3T1") and the 1994 album distributed by Warner ("3T2") – during a ten-week period surrounding the release of the new album.

Because the moratorium did not have any adverse effect on competition in the United States, Complaint Counsel developed a theory that the moratorium could be found to violate the antitrust laws without *any* analysis of its actual competitive effects. Instead, Complaint Counsel argued that the moratorium was subject to a "presumption" of anti-competitive effects, and that it was PolyGram's burden to establish the "validity" of its procompetitive justifications by proving that the moratorium was "necessary" to the joint venture and actually procompetitive. Accepting Complaint Counsel's novel theory, the Initial Decision held that the moratorium was unlawful under either *per se* analysis or the rule of reason.

The moratorium obviously is not illegal *per se*. Indeed, the conclusion that *per se* analysis is appropriate here apparently is not even shared by Complaint Counsel, who argued in

their Post-trial Reply Brief that the moratorium was subject to an "abbreviated rule of reason analysis," not any *per se* rule. CCPRP at 5. The moratorium plainly does not fall into any of the well-established categories of restraints that are subject to *per se* analysis. Rather, the relevant case law uniformly holds that because the moratorium was reasonably related to the procompetitive purposes of a joint venture, the moratorium must be analyzed under the rule of reason. *See NCAA v. Board of Regents*, 468 U.S. 85 (1984); *Chicago Prof'l Sports Ltd. P'ship v. National Basketball Ass'n*, 961 F.2d 667 (7th Cir. 1992); *Polk Bros. v. Forest City Enters., Inc.*, 776 F.2d 185 (7th Cir. 1985); *United States v. Visa U.S.A., Inc.*, 163 F. Supp.2d 322 (S.D.N.Y. 2001).

The Initial Decision is equally at odds with the case law in its reliance on a "presumption" of anticompetitive effects. As the Commission will recall, the Supreme Court in *Cal. Dental Ass'n v. FTC*, 526 U.S. 756 (1999), specifically rejected this burden-shifting approach to the rule of reason. *CDA* requires an analysis of the actual competitive effects of the challenged practice unless its anticompetitive effects are "obvious" based on the record evidence. *CDA*, 526 U.S. at 771-81. Here, there was no evidentiary basis for concluding that anticompetitive effects were "obvious," because Complaint Counsel offered no evidence that the moratorium or any other remotely similar agreement has resulted in any anticompetitive effect and because Complaint Counsel's own expert economist admitted he was unaware of any actual anticompetitive effect.

Even if the likely anticompetitive effects of the moratorium had been "obvious," moreover, the presence of any "plausible" procompetitive justification would still require a balancing of competitive effects under the rule of reason. The PolyGram and Warner witnesses involved in the joint venture testified that the moratorium was adopted for procompetitive reasons and served the procompetitive purposes of the venture. PolyGram's expert witnesses – Professor Janusz Ordover and Professor Yoram ("Jerry") Wind – testified that the moratorium was plausibly procompetitive in the context of the joint venture because it was designed to prevent the PolyGram and Warner operating companies from "free riding" on the promotional

opportunity created by the Paris concert and the release of the new album and to maximize the overall long-term output of the various Three Tenors products. And Complaint Counsel's expert economist even admitted that these procompetitive justifications *are* "plausible." In the absence of any evidence of anticompetitive effect, the plausibility of PolyGram's procompetitive justifications was sufficient to support a decision in PolyGram's favor.

Finally, the Initial Decision improperly concluded that a cease and desist order should issue despite the absence of any conceivable basis for concluding that PolyGram is likely to engage in similar conduct in the future.

**B. Procedural History**

The Commission issued its complaint on July 31, 2001, alleging that the moratorium constituted an unlawful restriction on pricing and advertising in violation of Section 5 of the FTC Act, 15 U.S.C. § 45. Trial commenced on March 5, 2002. Four witnesses testified live: Anthony O'Brien, the CFO of Atlantic Records; Rand Hoffman, a PolyGram executive; Professor Catherine Moore, a marketing expert from N.Y.U.; and Dr. Stephen Stockum, an economist. Additionally, the parties stipulated to the admission of deposition testimony from a number of fact witnesses, including the testimony of a number of current or former PolyGram employees who were involved in the Three Tenors joint venture. RPF 5; SE. The parties also stipulated to the admission of the deposition testimony of PolyGram's experts, Dr. Ordover, an economist at N.Y.U, and Dr. Wind, a marketing professor at the Wharton School of Business. RPF 6; SE. Finally, the parties stipulated to the admission of numerous documents, including the four experts' reports. *See* SE. With the testimony of all its witnesses, its trial exhibits, and its experts' reports already in evidence, PolyGram rested at the close of Complaint Counsel's case-in-chief.

The Initial Decision was served on July 8, 2002. This appeal followed.

### C. Factual Background Relevant to the Appeal

The Initial Decision contains 50-pages of factual findings that are copied largely *verbatim* from Complaint Counsel's proposed findings. Many of the findings are irrelevant to the central substantive issue in this case: *i.e.*, whether the moratorium may be found to violate the antitrust laws without *any* consideration of its actual net effect on competition. Moreover, the Initial Decision reflects no rulings on the findings submitted by PolyGram or the objections PolyGram properly made to Complaint Counsel's proposed findings.

In reviewing the Initial Decision, the Commission will find that many of its findings are unsupported by the record or directly contrary to the evidence, and that it erroneously failed to adopt numerous findings that plainly are supported by the record. Some of the more egregious departures from the record include:

- The Initial Decision found that PolyGram and Warner likely would have discounted or promoted 3T1 or 3T2 in the United States absent the moratorium. F. 50, 243, 255-58. As set forth in PolyGram's proposed findings and objections to Complaint Counsel's proposed findings, those findings are based *exclusively* on evidence of the marketing plans for territories *outside* the United States. RPF 80, 97-100, 111; RRCPF 288-91. Complaint Counsel's experts conceded there was no evidence that the moratorium prevented any discounting or promotional activities in the United States, and that the economics of the music industry may be different outside the United States; those concessions were supported by the testimony of PolyGram's fact and expert witnesses. RPF 80, 120, 122; RRCPF 271-272.
- The Initial Decision copied language from Complaint Counsel's post-trial brief to find that Anthony O'Brien's testimony that Warner would not have entered into the joint venture had it believed that PolyGram would aggressively discount or promote 3T1 or 3T2 during the release period for



841785.1

3T3 was "questionable." ID at 53. Mr. O'Brien's testimony was uncontroverted. RPF 56, 95. At closing argument, the ALJ stated that Mr. O'Brien's testimony on that subject was "very credible." Tr. of 5/22/02 at 42.

- The Initial Decision found that the moratorium was adopted "months after" the joint venture was formed. ID at 53, 60-61 & F. 263. However, it is undisputed that the parties agreed they needed to adopt a strategy for marketing of the prior albums in conjunction with 3T3 at a meeting on January 29, 1998, executed the contract forming the joint venture on February 5, 1998, and adopted the moratorium at a meeting on March 10, 1998. RPF 57.[3]

Because of the many errors in the Initial Decision's consideration of the record, the factual summary set forth below closely tracks PolyGram's proposed findings and relies on the findings of the Initial Decision only when its findings were relevant and supported by the record.

**1. The Parties**

Respondents all are part of Universal Music Group, the music business of Vivendi Universal, S.A.. F. 6-10. In 1998, Respondents were part of PolyGram Music Group, the music business of PolyGram N.V. F. 11-12. Vivendi acquired Respondents through a merger with the Seagram Company Ltd., which had acquired PolyGram N.V. in December 1998. F. 18.

[3] The Initial Decision also copied portions of Complaint Counsel's briefs that argued the testimony of PolyGram's experts was entitled to "little weight" and that Professor Ordover's opinions in this case "reject[ ] the basic premises of modern antitrust law." In light of the fact that Complaint Counsel *stipulated* to the admission of Professor Wind and Professor Ordover's testimony during their case-in-chief, these findings should be stricken from the record. In particular, the notion that the opinions of Professor Ordover – who has served as the Antitrust Division's Deputy Assistant Attorney General and testified in numerous antitrust cases, and whose opinions in this case closely track the language of Supreme Court cases and the Commission's own enforcement Guidelines – are somehow inconsistent with the "basic premises of modern antitrust law" is ridiculous. Likewise, it is troubling that the Initial Decision chastises Professor Wind for supposedly failing to review "deposition testimony of any individual responsible for marketing 3T3 in the United States" when, as noted in PolyGram's objections to the proposed finding, *no such witness testified in this case*, at deposition or otherwise.

In 1998, Decca Music Group Limited ("Decca") was a classical label that was part of a business division called PolyGram Classics & Jazz. F. 15. PolyGram distributed Decca recordings through its operating company subsidiaries, or "op-co's." F. 23. Its United States op-co was PolyGram Group Distribution, Inc. F. 10, 16.

Warner was PolyGram's partner in the Three Tenors joint venture. 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 entity responsible for marketing Warner products outside the United States. *Id.* F. 20-23. WMI marketed 3T2 outside the United States, but had no financial interest in 3T3.

**2. The Three Tenors Joint Venture.**

PolyGram and Warner adopted the moratorium as part of a procompetitive joint venture for the creation of new Three Tenors products, and they each contemporaneously viewed the moratorium as an important part of that joint venture. RPF 17. In the 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 Paris concert in July 1998 and an album of that concert that was released in August 1998. RPF 17-18, 21. The Three Tenors previously had recorded two albums: a 1990 album ("3T1"), distributed by PolyGram; and a 1994 album ("3T2"), distributed by Warner. RPF 22. 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 albums. RPF 28; ID F. 60(d).

The formation of the joint venture was documented in the "The Three Tenors/1998 Concert/License Agreement." RPF 32; ID F. 58-59. The Concert/License Agreement contemplated that Atlantic would distribute the joint venture products in the United States, that PolyGram would distribute the joint venture products throughout the rest of the world, and that each party would pay one-half of an $18 million advance. RPF 38-39. The agreement provided that each party was entitled to a fifty-percent share of the net profits (or losses) 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 44.

A core provision of the agreement required PolyGram and Warner to "consult and coordinate" with one another regarding "*all* marketing and promotion activities . . . ." RPF 41 (JX10 ¶ 4). The experienced music industry executives who negotiated the agreement – Anthony O'Brien of Atlantic and Rand Hoffman of PolyGram –testified that this provision contemplated that the parties would work together in developing the marketing plans for 3T3 and that each would have access to the other's confidential marketing plans for 3T3. RPF 43. According to Mr. O'Brien, this provision reflected the principle that PolyGram and Warner were "full partners" and that, as such, each owed the other an obligation to do whatever was reasonably necessary to make the venture succeed and to not do anything to undermine the venture. RPF 50.

The Concert/License Agreement also contained a "holdback" term that required the parties to use the joint venture as the exclusive vehicle for the release of new Three Tenors products until June 1, 2002. RPF 45 (JX10 ¶ 9). The Initial Decision seized upon a proviso to this term that clarified that the parties were not precluded from "exploiting" 3T1 and 3T2 as supposedly demonstrating the "holdback" was a "limited covenant not to compete" that was intended to set forth the full extent of "[t]he parties' non-compete obligation" with respect to their joint venture – and, according to the Initial Decision, was therefore inconsistent with the moratorium agreement. F. 61-65. That interpretation was not shared by any witness and is not reflected in the contemporaneous documents – which contain no reference to any notion that the "holdback" provision sets forth the full extent of "the parties' non-compete obligation" or any "covenant not to compete." JX10; CX357, 359, 361. Rather, the uncontroverted witness testimony demonstrated that the provision was merely designed to clarify that the parties could continue to sell 3T1 and 3T2, but that they could not "re-package" or "re-release" those albums or any other Three Tenors album during the term of the joint venture. *Id.* As Messrs. O'Brien and Hoffman testified, the 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 ways that might have undermined the success of the joint venture. RPF 46-47.

The Initial Decision fails to mention that the Concert/License Agreement did not specify, and was not intended to specify, all of the material terms of the joint venture. RPF 48. For instance, the parties recognized that, after forming the joint venture, they would need to reach further agreements regarding the repertoire to be included on 3T3; the 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.* As Mr. O'Brien testified, PolyGram and Warner believed the specific marketing plans would be developed in a commercially reasonable manner, because they were "partners" in their joint venture. RPF 50. 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.*

**3. PolyGram's and Warner's Decision To Adopt The Moratorium.**

PolyGram and Warner began discussing alternative strategies for marketing 3T1 and 3T2 in conjunction with the new album even before the Concert/License Agreement was finalized. At the first joint meeting regarding the marketing plans for the joint venture, which was held on January 28, 1998 (one week *before* the 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 57.

In discussing their marketing plans for 3T3, PolyGram and Warner focused on the promotional opportunity 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 the long-term success of all Three Tenors. RPF 52-55. PolyGram and Warner were particularly concerned about the "initial release period" – the brief time surrounding the release of the new album. RPF 53. Respondents' marketing expert, Professor Wind, testified that this focus on the release period was consistent with sound marketing practices:

> [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.

JX91, Wind Dep. at 9:23-10:10.

As they developed their marketing plans for 3T3, PolyGram and Warner became increasingly concerned that their respective op-cos would not adequately appreciate the importance of the release period to the long-term success of the Three Tenors brand. RPF 54-55. PolyGram and Warner believed that aggressive discounting and promotion of 3T1 or 3T2 during the release period would harm 3T3 and the Three Tenors brand, leading to fewer sales of all Three Tenors products in the long term. *Id.* That is, PolyGram and Warner believed that the potential *negative* effect on long-term sales of all Three Tenors products from discounting and promoting 3T1 and 3T2 during the release period outweighed any *positive* effect on sales of the prior albums that might have been achieved by promoting those products during the release period. *Id.* 55. Mr. O'Brien testified that he saw the threat posed by aggressive discounting and promotion of 3T1 and 3T2 during the release period 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 period. RPF 56.

At a joint venture meeting held on March 10, 1998 to discuss the marketing plans for the new album, PolyGram and Warner agreed on a strategy under which the promotional materials for the new album would not feature the prior albums and there would not be any "big push" on the prior albums until after the release period. RPF 59-60. PolyGram and Warner subsequently referred to this portion of their marketing plans for the new album as the "moratorium." RPF 62. PolyGram and Warner later agreed the moratorium should apply only during a ten-week period running from August 1, 1998 through October 15, 1998. RPF 63. PolyGram and Warner also agreed that, during the moratorium, "prices should be 'normal' and

not subject to any special discounts or promotions." *Id.* 64; F. 45. In other words, the moratorium was designed only to prevent *extraordinary* efforts to promote 3T1 or 3T2 during the release period.

**4. The Procompetitive Reasons For The Moratorium.**

The moratorium was not a naked agreement designed to "shield 3T3 from competition," ID at 60 & F 268-75, but instead was closely related to the procompetitive purposes of the Three Tenors joint venture. The moratorium was designed to serve two procompetitive purposes: (1) preventing the op-cos from free riding and opportunistic behavior that could have undermined the joint venture; and (2) ensuring 3T3 was marketed in accordance with a sound marketing strategy that would maximize the long-term output of Three Tenors products.

**a. The Moratorium Was Designed To Prevent Free Riding And Opportunistic Behavior.**

The parties recognized that the Paris concert and the release of the new album created an opportunity to promote Three Tenors products that existed only because the joint venture existed, and they wanted to ensure that the substantial expenditures that created this opportunity were directed toward sales of the new album. RPF 92. PolyGram and Warner were concerned that their op-cos – 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 93. 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 on an agreement that Atlantic would allow WMI to significantly discount 3T2 during the 3T3 release period. RPF 94. Mr. O'Brien believed that the condition sought by Mr. Lopez would "blow the deal," and sought assistance from Bob Daly, the

most senior executive of WMG, to ensure the condition would not be included in the agreement. RPF 95 (CX566). Mr. O'Brien entered into the 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 96 (Tr. (O'Brien) at 511:15-512:1).

WMI persisted with plans to free ride on the joint venture, however, even as Atlantic and PolyGram developed the marketing plans for 3T3. WMI developed plans to discount 3T2 in Europe from May through December 1998, a period that included the moratorium period. RPF 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 98 (JX7). Mr. O'Brien testified that WMI's proposed campaign "could have had a seriously negative effect on our – on the launch of our '98 [album]," Tr. at 536:21-537:10, and thus was not in Warner's overall best interests. Because of the moratorium, Mr. O'Brien ultimately was able to persuade WMI not to conduct its European campaign during the moratorium period. Tr. at 100.

Mr. O'Brien testified that WMI's campaign could have caused the parties to spend less money promoting 3T3. RPF 101.[3] Aggressive discounting and promotion of 3T1 or 3T2 during the moratorium period also could have reduced the long-term output of *all* Three 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 83.

[3] Complaint Counsel's economist, Dr. Stockum, testified that Atlantic might have spent less money promoting 3T3 if "people were buying 3T1 and 3T2 instead." RPF 100 (Tr. at 729:11-731:3). Professor Moore also testified that PolyGram and Atlantic were likely to alter their promotional spending depending on how 3T3 performed during the initial period following its release. *Id.* (Tr. at 197-99).

### b. The Moratorium Was Designed To Increase Aggregate Long Term Output.

PolyGram and Warner believed that the best way to manage the Three Tenors brand was to create a clear "window" for the new album during the release period. RPF 66. PolyGram and Warner were concerned that promoting the prior albums during the release period could have jeopardized the potential success of 3T3, which was of far greater commercial significance than the prior albums in 1998. RPF 68. Paul Saintilan, the former Decca marketing executive responsible for 3T3, testified that this concern was specific to Three Tenors products because the parties believed the target audience for 3T3 was comprised of infrequent classical music purchasers who were particularly susceptible to confusion among the various Three Tenors products, and that this confusion could lead to lower sales of all Three Tenors products. RPF 69.[4]

Although PolyGram and Warner believed that it was critical to create a clear release "window," they also wanted to maintain the ability to promote the prior albums outside the window. RPF 70. Thus, the moratorium balanced this desire to discount and promote the prior albums against the paramount interest in maximizing the prospect that the new album would be successful. RPF 72. Accordingly, the moratorium specifically allowed the op-cos to aggressively discount and promote 3T1 and 3T2 during the weeks before and after the release period. RPF 72-73.

An April 29, 1998 memorandum explained this strategy and stressed the reasons why discounting should not be permitted to occur during the release period:

> 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

[4] 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 --." Tr. at 726:1-10.

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 76.[5]

As Bert Cloeckaert, PolyGram's Vice President for Continental Europe testified, it is standard practice for a record company to develop a strategy for marketing an artist's catalog products as part of the marketing plans for a new release. RPF 51-52. Mr. Cloeckaert testified that the moratorium was consistent with PolyGram's general practices in situations where it owns both the catalog products and the new release. RPF 81. Mr. Cloeckaert believed that this was the most commercially reasonable strategy for 3T3. *Id.* Complaint Counsel's marketing expert, Dr. 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 and that the strategy reflected in the moratorium was reasonable. *Id.* 51, 81 (Tr. at 158:5-175:17).

**D. The Potential Competitive Effects Of The Moratorium.**

There is no evidence that the moratorium had any actual adverse effect on competition in the United States. Complaint Counsel specifically chose not to claim that it did.

[5] Many PolyGram op-cos discounted and promoted 3T1 during the period preceding the release of 3T3. RPF 77. The United States op-co, which has sold 3T1 as a top-price album since its initial release, did not aggressively discount 3T1 at any time from 1990 through 1998. RPF 80.

Rather, Complaint Counsel contended that the moratorium is unlawful because their economist, Dr. Stockum, testified that the agreement was "likely" (or had the "potential") to be anticompetitive. Complaint Counsel argued that Dr. Stockum's testimony triggered a "presumption" of anticompetitive effect under which it was PolyGram's burden to establish that the moratorium actually was procompetitive. Indeed, the section of the Initial Decision that bears the heading "Competitive Effects of the Moratorium" is drawn largely *verbatim* a section of Complaint Counsel's proposed findings with the heading "The Three Tenors Moratorium Is *Presumptively* Anticompetitive." *Compare* ID F. 235-61 *with* CCPFF 268-294.

Dr. Stockum admitted that he did not conduct any of the analyses necessary to evaluate the actual effects, if any, of the moratorium. RPF 123 (JX85, Stockum Dep. at 42:22-43:16; 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.* (Tr. 647:10-649:17). Dr. Stockum recognized that any analysis of these factors would need to consider the overall effects, if any, of the moratorium, and that any 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 105 ("[W]e are not just concerned about the ten weeks."). Dr. Stockum was unable to identify any competition that was likely to occur in the United States absent the moratorium but that did not occur because of the moratorium. RPF 122.

In offering his opinions regarding the "likely" or "potential" effects of the moratorium, Dr. Stockum failed even to mention the existence of the joint venture. JX104 (Stockum Report). At trial, Complaint Counsel did not ask Dr. Stockum to offer an opinion regarding the "likely" or "potential" effects of the moratorium in the context of the Three Tenors joint venture. Instead, Dr. Stockum was asked to opine about the "possible likely effects of an agreement not to discount," Tr. at 583:16-17, and the "likely effect of an agreement between competitors not to advertise," *Id.* at 591:11-13. Dr. Stockum's opinions regarding "likely"

effects were thus not based on any analysis of the actual effects of similar agreements adopted in similar circumstances. For instance, Dr. Stockum provided no testimony regarding the "likely" competitive effects of agreements between joint venture partners not to engage in aggressive price competition against their joint venture products, let alone the effects of such a restriction that applied to two of many products in the market for a period as short as ten weeks. And, while Dr. Stockum testified regarding various studies of the effects of advertising restrictions, none of those studies related to joint ventures or the music industry, and all of them involved restrictions that were broader in scope and/or duration than the moratorium. Tr. at 655:12-617. Dr. Stockum conceded that the academic literature he relied upon would indicate that there are circumstances in which an agreement like the moratorium "would have no effect whatsoever." *Id.* at 652:19-655:6, 834:9-835:1.

Complaint Counsel studiously chose not to ask Dr. Stockum about the likely competitive effects of the moratorium in the context of the Three Tenors joint venture. Instead, Dr. Stockum was asked to opine whether the moratorium was "*necessary* to the formation of the joint venture," *Id.* at 617:21-621:17, or "*necessary* to the efficient operation of the joint venture," *Id.* at 621:18-638:24 (emphasis added). Dr. Stockum conceded that he would need to consider actual effects to reach any economic conclusions if there were any "ambiguity about the likely effect of the restraints at issue." Tr. at 640:2-13. On cross-examination, Dr. Stockum conceded that it was "plausible" that the moratorium was procompetitive, Tr. at 643:7-644:9 – *i.e.*, that there was indeed some "ambiguity" regarding the actual competitive effects of the agreement.

The PolyGram and Warner witnesses involved in marketing 3T3 believed that the moratorium likely would have been procompetitive in increasing the long-term output of all Three Tenors products. RPF 108-109. At the same time, the relevant witnesses did not believe the moratorium would have any adverse effect on the price or output of Three Tenors products in the United States. *Id.* Complaint Counsel's marketing expert, Professor Moore, testified that temporary price reductions to mid-price are not used in the United States, and she thus implicitly conceded that the moratorium would not have had any effect on the price of 3T1 or 3T2 in the

United States. RPF 111 (Tr. at 186:17-188:-14). In making a series of findings regarding the plans of various PolyGram and Warner op-co's to discount and advertise 3T1 and 3T2 in 1998, F. 50, 242, 255-258, the Initial Decision completely fails to mention that each of those op-co's was *outside* the United States, and that Dr. Stockum conceded the relevant market conditions may be different outside the United States. RPF 120, 122; RRCPF 275-76, 288-91.

Professors Wind and Ordover confirmed the fact witnesses' views regarding the potential procompetitive effects of the moratorium. Professor Wind opined that the moratorium represented a sound strategy for maximizing the potential for the long-term output of Three Tenors products. RPF 112 (Wind Report at 16-17; JX91, Wind Dep. at 26:7-37:13, 49:2-50:24, 60:15-63-22). Professor Ordover 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 op-cos from free riding on the promotional efforts of the joint venture. RPF 114 (RX716, Ordover Report at 3, 12-20; JX90, Ordover Dep. at 52:11-77-7).

### E. The Lack Of Record Evidence On Likelihood of Recurrence

There is no 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 149. The relevant witnesses testified that the central features of the Three Tenors joint venture were unique in their decades of collective experience. RPF 150. Nonetheless, the Initial Decision concluded that the likelihood of recurrence was sufficient to merit the issuance of a cease and desist order because: (1) recording artists sometimes switch labels; and (2) according to a press release that was not the subject of any testimony, Universal Music Group is a party to a joint venture for distributing music over the Internet. F. 331-34.

## III. QUESTIONS PRESENTED

This appeal presents the following questions:

1. May the moratorium that PolyGram and Warner adopted as part of their procompetitive Three Tenors joint venture be condemned as illegal *per se* even though it was reasonably related to the lawful and procompetitive purposes of the joint venture?

2. May the moratorium be held unlawful under the rule of reason in the absence of any evidence of actual anticompetitive effects?

3. Is it possible to conclude that the moratorium is "presumptively anticompetitive" without any evidence that the moratorium or any prior similar restraint adopted in the context of a joint venture had any actual adverse effect on competition?

4. Does the presence of procompetitive justifications that Complaint Counsel's own economist conceded were "plausible" preclude any conclusion that the moratorium was unlawful in the absence of any evidence of actual anticompetitive effect?

5. Does evidence that PolyGram has entered into other procompetitive collaborations without adopting any agreement similar to the moratorium provide a sufficient basis for the entry of a cease and desist order?

## IV. ARGUMENT

The Initial Decision is subject to *de novo* review. *See, e.g., The Coca-Cola Bottling Co. of the Southwest*, 118 F.T.C. 452, 534 (1994); 16 C.F.R. §§ 3.54(a), (b) (2002). A searching review is particularly appropriate here in light of the nature of the Initial Decision in this case. The Rules of Practice require that initial decisions "shall be based on a consideration of the whole record relevant to the issues to be decided, and shall be supported by reliable and probative evidence." 16 C.F.R. § 3.51. The Rules of Practice also require the ALJ to "rul[e] on each proposed finding and conclusion, except when the order disposing of the proceeding otherwise informs the parties of the action taken, 16 C.F.R. § 3.46(e), and that the initial decision must "include a statement of findings (with specific page references to principal supporting items of evidence in the record) and conclusions, as well as the reasons or basis therefor, upon *all the*

*material issues of fact, law, or discretion presented on the record.*" *id.* § 3.51(c)(1) (emphasis added).

Without mentioning the applicable evidentiary standards, the Initial Decision here adopted *verbatim* the vast majority of the findings proposed by Complaint Counsel, and it did so without adopting a single finding proposed by PolyGram or explaining its basis (if any) for overruling the vast majority of PolyGram's objections. As explained below, the record evidence and the controlling case law cannot support any of the main conclusions reached by the Initial Decision.

### A. There Is No Basis For Concluding That The Moratorium Is Illegal *Per Se*.

The rule of reason is the presumptive mode of antitrust analysis. *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999). An alleged restraint qualifies for *per se* condemnation only if economists and courts have had substantial experience with similar agreements adopted in similar circumstances and, based on that experience, can conclude with confidence both that the agreement will always or almost always have net anticompetitive effects. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940). Judicial reluctance to apply *per se* rules is particularly strong with respect to restraints arising in the context of joint ventures. Prior to the Initial Decision, no court had ever held an alleged restraint that was reasonably related to the procompetitive purposes of a legitimate joint venture to be subject to *per se* condemnation. Rather, courts uniformly have applied the rule of reason to any "ancillary restraint" that is reasonably related to the purposes of a joint venture. *See, e.g., NCAA v. Board of Regents*, 468 U.S. 85 (1984) (applying "quick look" version of rule of reason to restraints adopted as part of 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); *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210 (D.C. Cir. 1986) (holding that agreement adopted as part of joint venture was lawful under rule of reason); *Polk Bros. v. Forest*

*City Enters.*, 776 F.2d 185 (7th Cir. 1985) (same); *United States v. Visa U.S.A., Inc.*, 163 F. Supp.2d 322 (S.D.N.Y. 2001) (same). Under this unbroken line of cases, the moratorium was an ancillary restraint and must be analyzed under the rule of reason. There is no contrary authority.

The Initial Decision departed from these controlling authorities by manufacturing a series of hurdles that a joint venture partner supposedly must overcome to escape *per se* treatment. For its conclusion that the moratorium was a "naked agreement," the Initial Decision relies solely on highly selective and out-of-context quotations from *In re Brunswick Corp.*, 94 F.T.C. 1175 (1979), and *Polk Bros.* for the proposition that a restraint must be an "inevitable," "integral," "essential" or absolutely "necessary" part of a joint venture before it will be considered under the rule of reason. ID at 51-52. However, the relevant authorities (including *Brunswick* and *Polk Bros.*) make clear that this was the wrong legal standard and that the correct legal standard requires only that the conduct be reasonably related to the procompetitive purposes of the joint venture for the rule of reason to apply.

**1. A restraint need not be an "inevitable," "integral," or "necessary" part of a joint venture to require analysis under the rule of reason.**

In assessing whether the moratorium was an ancillary restraint, the Initial Decision asked whether it was "necessary," "inevitable," "integral" or "essential" for achieving the overall purposes of the Three Tenors joint venture. ID at 51-53. The Initial Decision used those terms interchangeably to mean that a restraint can be considered ancillary only if the joint venture would not have existed or achieved any of its procompetitive objectives absent the agreement. *Id.* Under this remarkably narrow formulation of the ancillary restraints doctrine, *every* restraint related to a joint venture would necessarily be either *per se* illegal (because it was not "necessary") or "*per se*" lawful (because it was). There would never be a need for rule of reason analysis of a joint venture restraint, and restraints automatically would be found unlawful *even if they were "supportive of the overall joint venture"* (ID at 53 n.10) (emphasis added) unless they were proven to be "*necessary to market the product.*" ID at 52-53 n.9-10 (emphasis added). At trial, Complaint Counsel's own economist admitted that such a 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" for the overall venture. RPF 128.

Courts consistently have rejected this narrow version of the ancillary restraints doctrine. Many cases (including Supreme Court cases) have recognized that an agreement adopted in the context of a joint venture may be ancillary and thus subject to analysis under the rule of reason– even if it was not "necessary" or "essential." In *NCAA*, which the Initial Decision inexplicably cites as *support* for its novel view of ancillary restraints (ID at 53 n.10), the Supreme Court did not consider whether the restrictions on college football telecasts at issue there were "necessary" or "essential" to the formation or efficient operation of the NCAA. The restrictions at issue in *NCAA* obviously were *not* necessary to the formation or efficient operation of the NCAA because they were adopted decades after the organization was formed and related to only one of its many functions. 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." 468 U.S. at 100-101 (emphasis added). 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]

[6] *NCAA* held the television restrictions were unlawful because "NCAA football could be marketed *just as* effectively without the television plan." 468 U.S. at 114. The Initial Decision made no finding that 3T3 could have been marketed "just as effectively" without the moratorium, and there is no evidence that would have supported any such finding.

The Supreme Court's opinion in *Broadcast Music, Inc. v CBS*, 441 U.S. 1 (1979), likewise demonstrates that an agreement need not 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's conclusion that the blanket licenses were not illegal *per se* was not triggered by any finding that the blanket licenses were "necessary" or "essential" to the joint venture; it was based on the finding that the licenses "*accompanie[d]* the integration." *Id.* at 20-21 (emphasis added). The Court recognized the parties 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). Thus, under *BMI*, the issue is whether the moratorium "accompanied" the joint venture (which it obviously did) and was "potentially beneficial" to consumers (which the record evidence, including the admission of Complaint Counsel's expert economist, clearly showed it was).[7]

Other cases also make clear that a restraint need not 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*, 961 F.2d 667, 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. Judge Posner 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. In *Rothery Storage*, 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

[7] The *BMI* Court noted that joint ventures are not unlawful "where the agreement on price is necessary to market the product at all," but only as one of several illustrations of the 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. That passage cannot be read to suggest that the rule of reason applies *only* where a restraint is "necessary" to a joint venture.



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joint venture, *i.e.,* it must only be "subordinate and collateral to a separate, legitimate transaction . . . in the sense that it serves to make the main transaction more effective in accomplishing that purpose . . . ." and is "related to the efficiency sought to be achieved." 792 F.2d at 224. And, in *Polk Bros.*, 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. Nowhere in any of those three opinions does Judge Posner, Judge Bork or Judge Easterbrook suggest that a restraint must be "necessary" or "essential" to the creation or overall efficiency of a joint venture for it to be subject to the rule of reason.

The Initial Decision misreads *Polk Bros.* as holding that the restraint at issue there – whereby the parties to a shopping facility joint venture agreed not to sell certain products in their respective stores – was subject to the rule of reason because it was an "integral part" of the agreement to form the venture. The words "integral part" appear in *Polk Bros.* only as part of a discussion of the *erroneous* (and rather absurd) conclusion by the district court that the agreement was *not* ancillary, but instead was illegal *per se*, because it *was* an "integral part" of the venture – *i.e.,* that it was "so important" to the joint venture that it could not be considered merely ancillary. 776 F.2d at 190. Nothing in the opinion suggests that an agreement must be an "integral part" of a joint venture for it to be ancillary to the venture. To the contrary, *Polk Bros.* holds that, when an agreement even "arguably" "promoted enterprise and productivity at the time it was adopted," "the court must apply the Rule of Reason to make a more discriminating assessment." 776 F.2d at 189.

Indeed, *Polk Bros.* did not involve a challenge to any provision of the *initial* agreement to form the joint venture; rather, ten years after the venture was formed, and five years after the parties renewed the alleged restraint as a 50-year covenant, one party sought to invalidate the agreement on the theory that it was illegal *per se*. *Id.* at 187-191. Even though this challenge was brought long after the venture was formed, and even though there was no

argument that the agreement then continued to be "necessary" or "essential," the court *upheld* the agreement under the rule of reason. *Id.* Obviously, the agreement in *Polk Bros.* was no more "necessary" or "essential" to the continued operation of the facility than the moratorium was to the release and marketing of 3T3; it was, however, "ancillary" to the joint venture because, like the moratorium, it eliminated the potential for "free riding" by one venturer on the promotional efforts of the other. *Id.*

The Commission's decision in *Brunswick*, likewise provides no support for the Initial Decision's view of ancillary restraints. The Initial Decision cites *Brunswick*, which addressed a series of restraints adopted as part of a joint venture between Brunswick and Yamaha for the production and distribution of outboard motors, for the proposition that ancillary restraints are limited to agreements that "inevitably aris[e]" out of the joint venture or are "necessary (and of no broader scope than necessary) to make the joint venture work." 94 F.T.C. at 1275. Although the Commission's *Brunswick* opinion includes that language, it proceeded to invalidate the agreement whereby Yamaha's affiliate Sanshin agreed it would not sell its products in the United States because the agreement "ha[d] *no relation* to the *efficient functioning* of Sanshin, and *only serves* the anticompetitive goal of insulating Brunswick from Yamaha in the United States." *Id.* at 1276 (emphasis added). Likewise, the Commission invalidated another restraint whereby the parties agreed not to compete against one another in unrelated markets because it went "beyond anything that might *reasonably* be required to further *a legitimate objective* of the joint venture." *Id.* (emphasis added). Finally, the Commission invalidated a restraint on Brunswick's entry into the motorcycle market because it "impermissibly extend[ed] the product coverage of the agreement *without any offsetting procompetitive effect on the joint venture itself.*" *Id.* (emphasis added). This analysis – which was accompanied by an extensive discussion of actual anticompetitive effects – was plainly a rule of reason analysis. Although the Commission's decision invalidated the restraints at issue – a straightforward conclusion in light of the evidence of actual anticompetitive effects and the

absence of any procompetitive justifications – nowhere does the decision suggest that any of the restraints were illegal *per se*.

Likewise, the Eighth Circuit's *Brunswick* decision (which the Initial Decision does not mention) never suggested that any of the agreements at issue in that case were illegal *per se*. The Eighth Circuit characterized the Commission's decision as having found the agreements "unreasonable" (*i.e.* unlawful under the rule of reason) and affirmed that portion of the Commission's decision on the ground that the agreements were not "reasonably necessary to the purpose of the joint venture," "serve[d] only to insulate Brunswick from Yamaha in the United States market," and constituted an "unreasonable extension of the joint venture agreement." *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 981 (8th Cir. 1981). This, again, was a rule of reason analysis.

Any doubt on this issue should be laid to rest by the fact that *the Commission itself* has expressly recognized that the word "necessary," when used by courts to describe the relationship that must exist between a horizontal restraint and a legitimate joint venture for the agreement to be considered ancillary, means "reasonably related to," *not* "absolutely necessary." Brief of the United States as Amicus Curiae in *NCAA*, Attachment A to CCPTB at 13 (criticizing the petitioner for "tak[ing] the word 'necessary' out of the legal context in which it was used by the lower courts, *i.e.*, to mean 'reasonably related to,' and ascrib[ing] to it a meaning – 'absolutely necessary,' *i.e.*, there being no less restrictive alternative – not fairly attributable to those courts"); *id.* (framing "requirement that a defendant show that an anticompetitive restraint is 'necessary' to foster (*i.e.*, 'reasonably related to') a legitimate business or statutory purpose").[8] Here, PolyGram has amply demonstrated that the moratorium was reasonably related to the joint venture and to enhancing the efficiency of that venture. RPF 51-104. Thus, under the standard

[8] In that brief, the Commission also emphasized "that plaintiffs and courts can [not] merely second-guess those participating in an otherwise legitimate enterprise, and invalidate any restraint that is not the 'least restrictive' imaginable or practicable." *Id.* at 6.

that the Commission correctly advocated in *NCAA*, the moratorium unquestionably must be analyzed under the rule of reason.

**2. The fact that the moratorium applied to products that were not created or marketed by the joint venture does not mean that it was not ancillary.**

The Initial Decision also erred in concluding that the moratorium was not subject to the rule of reason because 3T1 and 3T2 "were not placed into the joint venture." ID at 52. As a factual matter, 3T1 and 3T2 were *not* "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 28, 35. PolyGram and Warner obviously had a legitimate interest in maximizing the long-term output of all Three Tenors products. The relevant PolyGram and Warner witnesses, as well as Complaint Counsel's marketing expert, testified that an artist's catalog products typically are considered in developing the marketing plans for a new album. RPF 51. 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 129; Tr. (Stockum) at 693:23-694:23, 703:2-8.

Moreover, there is no authority for the proposition that a restraint that is reasonably related to a joint venture is illegal *per se* simply because it applies to products that are "outside" the joint venture. *Brunswick* is the only case the Initial Decision cites for that novel proposition and, as discussed above, *Brunswick* was a rule of reason case and only confirms that *per se* analysis does not apply here. Other rule of reason cases arising in the joint venture context likewise involved agreements pertaining to products that were not "placed into" the joint venture. Thus, in *Polk Bros.*, two retail firms – one that sold appliances and home furnishings and another that sold building materials 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 did *not* integrate their assets in any other respect: they did not agree jointly to produce, distribute, sell, advertise, or promote any product. In connection with that limited integration, the firms agreed

that neither would sell certain types of products sold by the other – products that were "outside" the scope of the integration. The Seventh Circuit nevertheless held that the agreement was subject to the rule of reason, not the *per se* rule. *Id.* at 188-191.[9]

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 (emphasis added). Obviously, the competing cards were not "inside" the integration of Visa/MasterCard assets; they (like 3T1 and 3T2) were unquestionably "non-venture products." The Initial Decision's conclusion that the *per se* rule applies in this case is squarely at odds with that of the United States and the district court in the *Visa* case.

The Initial Decision also is inconsistent with the Commission's own *Antitrust Guidelines for Collaborations Among Competitors* (2000) ("Guidelines") in this regard. In Example 10 of those Guidelines, the Commission hypothesizes a collaboration between two computer firms to develop and market new word-processing software. Both firms have pre-existing word processing software, but that software is not integrated into the 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.* Even though the agreement involves "non-venture products," the Guidelines expressly provide that the agreement may be subject to the rule of reason.[10]

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[9] As explained below, the moratorium was *more* closely related to the parties' integration of assets than the restraint in *Polk Bros.* Here, the free-riding concern that motivated the 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.

[10] Dr. Stockum testified that the non-competition agreement posited in Example 10 would be substantially more restrictive than the moratorium 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 124.

### 3. The fact that the moratorium was adopted after the formation of the joint venture is irrelevant to whether it was an ancillary restraint.

The Initial Decision is similarly misguided in concluding that the moratorium was not "necessary for the creation of 3T3" and thus was not an ancillary agreement – because it was "created months after the creation of the joint venture agreement." ID at 52-53. First, the record does not support the factual predicate for that conclusion but instead shows that the moratorium was first discussed *before* the February 5, 1998 date that the parties executed the joint venture agreement and that the moratorium was adopted four and one-half weeks later at the first meeting held after the venture was formed. RPF 57.

Moreover, the mere fact that an agreement is adopted after the formation of a joint venture is irrelevant to whether it is procompetitive. In considering alleged restraints adopted in the joint venture context, courts consistently have allowed the parties substantial leeway to adopt measures to ensure the success of the venture even after a venture has been formed. Thus, the restraint in *Polk Bros.*, which barred each party to a shopping center joint venture from competing in certain product lines, and which formalized a prior arrangement that had been adopted at the outset of the venture, 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 that the restraint was adopted well after the joint venture was formed, 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. *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 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); *Visa*, 163 F. Supp.2d at 343-406 (concluding that same by-law was subject to rule of reason analysis).

Again, 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 procompetitive. *See* Tr. (Stockum) at 703:21-705:2;

JX104, Stockum Dep. at 142-43. A legal rule recognizing that agreements are subject to the rule of reason so long as they serve the procompetitive purposes of a joint venture and regardless of whether they are adopted before or after the formation of the joint venture would "make[ ] it easier for people to cooperate productively in the first place." *Polk Bros.*, 776 F.2d at 185. By contrast, the novel and unsupported rule suggested by the Initial Decision under which the mere fact that a restraint was adopted after the formation of a joint venture automatically would trigger *per se* analysis – would create a substantial disincentive to entering into joint ventures in the first place. JX104, Stockum Dep. at 142-43.

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

The lack of any judicial experience with similar restraints adopted in similar circumstances provides yet another reason for applying the rule of reason. Courts have repeatedly frowned upon efforts to pigeonhole novel situations into the few well-defined *per se* categories, holding that any abbreviated form of antitrust analysis must be deferred until after courts have had extensive experience demonstrating that the agreements at issue are virtually always anticompetitive. *See, e.g., BMI*, 441 U.S. at 7-8 (*per se* rule applies only to practices "so plainly anticompetitive" and so "lack[ing] . . . any redeeming virtue" that they can be "conclusively presumed" to violate the antitrust laws).

Courts have no experience with alleged restraints like the moratorium. Indeed, the Three Tenors joint venture is itself unique. PolyGram's witnesses – with decades of collective 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 risks of the venture. RPF 150. As the relevant PolyGram and Warner witnesses explained, the moratorium was motivated by the unique circumstances of the Three Tenors 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 but which threatened the success of the joint venture itself if not managed properly. RPF 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 102-03. Dr. Stockum testified that he was unaware of any prior judicial or academic analysis of any restraint like the moratorium, RPF 125; Stockum Dep. at 193-94, and Professor Moore was unable to identify any similarly structured joint venture in the music industry, RPF 104.

Moreover, in the few cases involving alleged restraints from other industries that are analogous to the moratorium, courts consistently have applied the rule of reason even when the restraints were far broader in scope and duration. *See Polk Bros.*, 776 F.2d at 189 (applying rule of reason to 50-year ban on competition against venture partner); *Rothery Storage*, 792 F.2d at 214 (applying rule of reason to indefinite ban on competition against van line venture); *Visa*, 163 F. Supp.2d at 343-406 (applying rule of reason to outright prohibition against members' issuance of competing cards). Thus, the mostly closely relevant judicial experience suggests the rule of reason must apply here.

In short, there is no history of judicial decisions or economic analyses concluding that similar restraints adopted in similar circumstances are virtually always anticompetitive: rather, the record evidence showed that this was a novel joint venture and a novel agreement. Accordingly, the moratorium must be evaluated under the rule of reason.

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

To establish that the moratorium was unlawful under the rule of reason, it was Complaint Counsel's burden to show (1) that the agreement had some actual anticompetitive effect and, (2) if the procompetitive justifications offered by PolyGram were plausible, that the *net* effect was anticompetitive. *CDA*, 526 U.S. at 771-81. Complaint Counsel utterly failed to meet their burden on both counts.

The Initial Decision erroneously concluded that Complaint Counsel could prevail under the rule of reason without presenting any evidence anticompetitive effect. Instead,

Complaint Counsel were permitted to rely exclusively on a supposed "presumption" of anticompetitive effect under which there was no need to show any evidence of anticompetitive effects in the first instance. ID at 55-58. Under this presumption, it was supposedly *PolyGram's* burden not only to identify plausible procompetitive justifications for the moratorium but also to establish the "validity" of those justifications by showing the moratorium actually was procompetitive before Complaint Counsel had any obligation to show any anticompetitive effect. This should elicit a sense of *déjà vu* for most members of the Commission, because this is precisely the burden-shifting approach that was rejected by the Supreme Court in *CDA*. 526 U.S. at 779.

The Initial Decision is contrary to the requirements of *CDA* at each stage of its burden-shifting analysis. First, it was Complaint Counsel's burden to show that the moratorium had some anticompetitive effect (or, as a surrogate, the presence of market power) *before* PolyGram had any burden to identify any procompetitive justification for the agreement. *CDA* squarely rejects the notion that there can be any "presumption" of anticompetitive effects in these circumstances; indeed, even under the pre-*CDA* cases like *Mass. Board* that recognized the existence of "presumptively anticompetitive" or "inherently suspect" restraints, there is no authority for applying any such presumption to a novel and ancillary restraint like the moratorium. Second, PolyGram clearly satisfied the burden it would have had *if* Complaint Counsel had offered actual evidence of anticompetitive effects by identifying plausible procompetitive justifications for the moratorium; indeed, Complaint Counsel's own expert *admitted* it was "plausible" that the moratorium was procompetitive. Third, PolyGram was not required to establish the "validity" of the moratorium – *i.e.*, to "show the moratorium was *necessary* in order to promote competition and benefit consumers" (ID at 58-59) – after identifying its procompetitive justifications. Rather, the identification of plausible procompetitive justifications triggered a need for a determination of the agreement's actual, net competitive effects (if any); because of Complaint Counsel's failure to offer anything to place on the "anticompetitive" side of the scale, this again must result in a decision in PolyGram's favor.

### 1. Complaint Counsel Were Required Under The Rule Of Reason To Present Evidence Of Actual Anticompetitive Effect.

The first stage in any rule of reason inquiry requires the plaintiff to show that the challenged conduct resulted in some actual anticompetitive effect. Complaint Counsel's decision not to attempt to present 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 *CDA*:

> [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.

That proof of actual anticompetitive effect (or of market power as its surrogate) is required in *any* rule of reason case is confirmed by other Supreme Court decisions as well. In *IFD*, 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." *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986). As the Court stated, "'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.* Similarly, in *NCAA*, the Supreme Court emphasized that "[b]oth lower courts found not only that NCAA has power over the market for intercollegiate sports, but also that in the market for television programming – no matter how broadly or narrowly the market is defined – the NCAA 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.

It is only *after* the plaintiff provides evidence of actual anticompetitive effect that the burden then shifts to the defendant to identify a procompetitive justification. *CDA*, 526 U.S. at 775 n.12. Complaint Counsel here offered no evidence that the moratorium had any actual anticompetitive effect. 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 123. Complaint Counsel's decision not to conduct such analyses undoubtedly was based on the recognition that any such analysis would indicate the moratorium had no anticompetitive effect. The 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 price or output.

Despite the absence of any evidence of anticompetitive effect, the Initial Decision concluded that the moratorium was unlawful based on what it referred to as its "presumptively anticompetitive effect" and its "obviously anticompetitive potential." ID at 54-60; *see also* F. 236 ("potential adverse effect"), F. 237, 248, 249 ("very likely to be anticompetitive").[11]

[11] The Initial Decision includes several findings that suggest that, absent the moratorium, "Warner" planned to advertise and discount 3T2. F. 255-256. However, as noted in PolyGram's objections to those findings, the underlying evidence for those findings relates *exclusively* to *WMI's* plans to promote 3T2 in territories *outside the United States*. Similarly, the Initial Decision improperly overruled PolyGram's objections to F.257-259, all of which are based on evidence that relates exclusively to the plans of certain PolyGram operating companies *outside the United* States to promote 3T1 prior to the moratorium period. In any event, the Initial Decision does not suggest that any of those findings show the moratorium had any actual anticompetitive effect in the United States, and Complaint Counsel's expert economist admitted that he was unaware of any discounting or promotion that would have occurred in the United States if the moratorium had not been adopted. RPF 122.

Although the Initial Decision concluded that the *potential* anticompetitive effects of the moratorium were "obvious," this case contrasts sharply with those cases in which actual anticompetitive effects have been found sufficiently "obvious" to permit the application of a "quick look" version of the rule of reason. In every "quick look" case, the conclusion of "obvious" anticompetitive effects was based on *record evidence* that demonstrated the particular restraint at issue actually had a substantial adverse effect on price or output in the relevant industry. *See Law v. NCAA*, 134 F.3d 1010, 1020 (10th Cir. 1998) (applying "quick look" to agreement that actually fixed price for assistant coach salaries); *Chicago Prof'l Sports*, 961 F.2d 667 (applying "quick look" to restriction that had actual effect of specifically limiting the number Chicago Bulls telecasts in Chicago); *NCAA*, 468 U.S. 85 (applying "quick look" to restriction that had actual effect of limiting broadcasts of college football games); *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 entered agreements that were found to actually limit sales of toys to club stores). Here, there is *no* record evidence of any actual anticompetitive effect, and *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.

The Initial Decision does not include any analysis of the effects of the moratorium in the context of the Three Tenors joint venture to conclude that the agreement had any "obvious" competitive effect. Instead, it relied solely on Dr. Stockum's theoretical observations that an "agreement to forgo discounting" or an "agreement not to advertise or promote catalogue Three Tenors products" has "obvious anticompetitive potential" because such naked agreements have had such effects in *other* industries, *outside* the context of any joint venture, and when they were *broader* in scope and/or duration than the moratorium. *Id.* at 56-58. These theoretical observations based on inapposite circumstances provide no basis for concluding that the actual competitive effects of the moratorium are comparably obvious to those present in *Law*, *Chicago Prof'l Sports, NCAA* or *Toys 'R Us*, particularly in view of Dr. Stockum's admission that he was

unaware of any evidence that the moratorium would have had any effect on price or output in the United States. RPF 122.

As now-Chairman Muris has observed, the Commission's decision in *CDA* was later reversed by the Supreme Court because it suffered from a "lack of serious empirical scrutiny of the economic issues . . . ." Timothy J. Muris, *California Dental Association v. Federal Trade Commission: The Revenge of Footnote 17*, 8 Sup. Ct. Econ. Rev. 265, 309 (2000). But even the limited empirical scrutiny that supported the Commission's *CDA* decision is not possible here. The Commission's decision in *CDA* was supported by record evidence regarding the competitive effects of advertising restrictions on dental services in California and was based on the Commission's precedents involving advertising restrictions adopted by other professional associations. *Id.* at 270. By contrast, Complaint Counsel here did not present *any* empirical evidence regarding the effect of the moratorium in the United States. The only empirical evidence cited in the Initial Decision relates to marketing practices outside the United States, the discounting and advertising of recorded music products generally, and academic studies of naked advertising restrictions adopted outside the context of any joint venture. F. 238-261. Dr. Stockum admitted and that he was unaware of any evidence regarding the advertising of catalog classical music products (*i.e.*, the only types of products subject to the moratorium) in the United States, and that he was unaware of any evidence that the moratorium actually (or even likely) had any effect on discounting or advertising in the United States. RPF Nos. 120, 122. Moreover, Dr. Stockum did not even mention the existence of the joint venture in his report, and his trial testimony regarding the theoretically likely effects of "agreements not to discount" and "agreements not to advertise" was completely divorced from any conceivable application to an agreement that was reasonably related to a procompetitive joint venture in the music industry. In light of the Supreme Court's conclusion that the relatively extensive record in *CDA* was insufficient, it is inconceivable that the record here could support any finding of anticompetitive effect.

Nor is there any legal basis for applying the "presumption" of anticompetitive effects urged by Complaint Counsel and adopted by the Initial Decision. The Initial Decision cites *CDA* for the propositions that "[w]here anticompetitive effects are presumed, the burden shifts to the respondents to demonstrate a countervailing efficiency sufficient to overcome the presumption," and that "[p]resumptively anticompetitive restraints may be condemned without assessing market power or examining actual anticompetitive effects." ID at 55 (citing *CDA*, 526 U.S. at 771, 779). However, Page 771 of the *CDA* opinion contains only one clause that even references this crucial part of the Initial Decision: "Even on *Justice Breyer's view [in dissent]* that bars on truthful and verifiable price and quality advertising are prima facie anticompetitive . . . and place the burden of procompetitive justification on those who agree to adopt them . . . ." 526 U.S. at 771 (emphasis added). Later, the majority opinion expressly *rejects* that mode of analysis, holding that "*before* a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of procompetitive effects . . . the court . . . [must have] considered whether the effects *actually* are anticompetitive." *Id.* at 775 n.12. And Page 779 discusses the fact that there were insufficient "factual underpinnings" for the "obvious anticompetitive effect" needed to justify any abbreviated analysis. *Id.* at 779 (citing *NCAA*, 468 U.S. at 10). Thus, the Initial Decision reads *CDA* to support the application of a presumption of anticompetitive effects in this case based upon (1) the Supreme Court's characterization of a *dissenting* view that the Court expressly *rejects* in the same opinion, and (2) the Supreme Court's conclusion that any finding of "obvious anticompetitive effect" must in any event be predicated on sufficient "factual underpinnings" regarding the restraint at issue. That language plainly does not support the application of any presumption here, where there are no "factual underpinnings" whatsoever for the Initial Decision's presumption that this moratorium, adopted in the context of this joint venture and in this industry, was likely to have anticompetitive effects.

*NCAA* also does not support the use of any presumption. The Initial Decision cites to Page 113 of *NCAA*. There, the Court wrote:

> [T]he NCAA television plan on its face constitutes a restraint upon the operation of a free market, *and the findings of the District Court establish that it has operated to raise prices and reduce output*. Under the Rule of Reason, *these hallmarks of anticompetitive behavior* place upon petitioner a heavy burden of establishing an affirmative defense which competitively justifies [the restraint].

468 U.S. at 113 (emphasis added). Earlier in the opinion, the Court detailed the district court's findings of actual anticompetitive effect. 468 U.S. at 104-06 ("[T]he NCAA's television restriction has a significant potential for anticompetitive effects. *The findings of the District Court* indicate that this potential has been realized. *The District Court found* . . . that the NCAA's output restriction *has the effect of raising the price* the networks pay for television rights.") (emphasis added). Thus, the page from *NCAA* upon which the Initial Decision relies establishes nothing more than that, *where the plaintiff has proven actual anticompetitive effects on price and output*, the burden shifts to the defendant to prove a procompetitive justification. That, of course, is entirely consistent with the Court's later holding in *CDA* and fundamentally inconsistent with the Initial Decision here.

The Initial Decision also quotes, out of context, the *NCAA* Court's statements that "the absence of proof of market power does not justify a naked restriction on price or output," and that "competitive justification" may be required "even in the absence of a detailed market analysis." 468 U.S. at 109-10; *see* ID at 55-56. What the Initial Decision omits are the crucial sentences that appear *between* these statements: "Petitioner does not quarrel with *the District Court's finding that price and output are not responsive to demand [i.e., findings of actual anticompetitive effects]*. Thus the plan is inconsistent with the Sherman Act's command that price and supply be responsive to consumer preference. We have never required proof of market power *in such a case*." 468 U.S. at 109-10 (emphasis added). In other words, *NCAA* holds merely that, *where there is proof of actual anticompetitive effect*, proof of market power and

"detailed market analysis" are unnecessary. Here, of course, Complaint Counsel offered no evidence whatsoever of actual anticompetitive effect, market power, or market analysis.

The Initial Decision also relies extensively on *United States v. Brown University*, 5 F.3d 658 (3d Cir. 1993), for the proposition that evidence of actual anticompetitive effect is not required. *Brown* was decided six years before *CDA*, in which the Supreme Court clearly repudiated the notion that a plaintiff in a rule of reason case may shift the burden to a defendant without any showing whatsoever of actual anticompetitive effect. Moreover, in *Brown*, the Third Circuit mistakenly relied on *NCAA* and *IFD* in support of its assertion that, under an abbreviated rule of reason analysis, competitive harm may be presumed without any showing of actual effect or market power. 5 F.3d at 669. As shown above, *NCAA* held that the burden was shifted to the defendant, not by a presumption of anticompetitive effect, but by the District Court's extensive factual findings of *actual* anticompetitive effect. *See* 468 U.S. at 104-06, 113. Similarly, in *IFD*, the Court held that "the Commission's failure to engage in detailed market analysis [was] not fatal [under an abbreviated rule of reason]" because "the [District Court's] finding of *actual, sustained adverse effects on competition* . . . [was] legally sufficient . . . ." 476 U.S. at 460-61 (emphasis added).[12]

Finally, the Initial Decision cites two Commission decisions, *In re Mass. Board*, 110 F.T.C. 549, 603-04 (1988) and *In re Detroit Auto Dealers Ass'n*, 111 F.T.C. 417 (1987). In those two cases, the Commission applied a version of the rule of reason under which the burden was shifted to the defendant to prove procompetitive effects if the challenged restraint was "inherently suspect." *Mass. Board*, 110 F.T.C. at 604; *Detroit Auto Dealers Ass'n*, 111 F.T.C. at 498. In *Detroit Auto Dealers*, however, the Sixth Circuit disapproved the Commission's "inherently suspect" methodology, concluding that it reflected improper use of a "per se

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

approach" without any "demonstrated effect" on competition. *In re Detroit Auto Dealers Ass'n*, 955 F.2d 457, 470-71 (6th Cir. 1992). Subsequently, the Commission itself recognized that the *Mass. Board* approach was rejected by the Sixth Circuit and is not appropriate under the rule of reason. *In re Cal. Dental Ass'n*, 121 F.T.C. 190, 1996 FTC LEXIS 81, at *93 (1996) (acknowledging that "the Sixth Circuit indeed rejected the Commission's use of the 'inherently suspect' approach"). In *CDA*, the Commission undertook a three-step analysis: *First*, the Commission considered evidence of the likely and actual anticompetitive effect of the challenged restraints and affirmed the ALJ's finding that "the suppression of advertising '*has injured* those consumers who rely on advertising to choose dentists.'" *Id.* at *64-*71. *Second*, the Commission determined that the CDA had sufficient market power to harm competition through the restraints. In doing so, the Commission interpreted *NCAA* and *IFD* in precisely the same manner as PolyGram: "The Supreme Court has indicated that *when a court finds actual anticompetitive effects*, no detailed examination of market power is necessary to judge the practice unlawful." *Id.* at *71 n.19 (citing *NCAA* and *IFD*) (emphasis added). Only after having found actual anticompetitive effect and market power did the Commission turn to "*the third step in our quick look*" – examination of the efficiency justifications offered by the CDA. *Id.* at * 80 (emphasis added). That is precisely the three-step methodology advocated here by PolyGram. Complaint Counsel having chosen to ignore the first two steps, there is no need to reach the third in order to rule for PolyGram.[13]

[13] Any doubt about the Commission's methodology in *CDA* is resolved by the Commission's Supreme Court brief, which emphasized that the Commission "*began* its rule of reason analysis by assessing the anticompetitive effects of the restrictions," that it "amassed an extensive record" regarding the actual effect of the rules and "reached its finding of a violation of Section 5 only after a careful assessment of [that] record," and that it "found the *actual* effect [of the rules] was to suppress a vast range of truthful and nondeceptive advertising," which was "harmful to consumers." *CDA* Brief at 6, 20, 21. The Commission made clear that its consideration of procompetitive justifications came only *after* it had "determined that [the challenged rules] had an anticompetitive effect." *Id.* at 23.

**2. The Moratorium Would Not Be Presumptively Anticompetitive Even If That Were The Applicable Standard.**

Even if *Mass. Board* supplied the relevant legal standard there would be no basis for applying any presumption to a novel restraint like the moratorium that was adopted in the context of a procompetitive joint venture. As now-Chairman Muris has cautioned, "most horizontal agreements will not fall into the inherently suspect class." Timothy J. Muris, *The Federal Trade Commission and the Rule of Reason: In Defense of Mass. Board*, 66 Antitrust L.J. 773, 798 (1998). Rather, under the *Mass. Board* framework, "[a]n agreement by competitors is inherently suspect if it eliminates or limits *significant* aspects of their competitive rivalry or otherwise acts to deny consumers the ability to choose among alternatives." *Id.* (emphasis added). Of particular importance here, the "inherently suspect" formulation would not apply until "economists and courts develop[] empirical evidence" to support the "theoretical" claims of anticompetitive effects. *Id.* The presumption thus would be applicable in cases that do not involve "the integration of productive facilities and accompanying efficiencies that occur in mergers and joint ventures . . . ." *Id.* However, "[r]estraints that are novel in form or industry application will not be reviewed as suspicious on their face." *Id.* Rather, "horizontal combinations that *involve integration of productive facilities* – in particular . . . many joint ventures – should be analyzed under a full review of market conditions." *Id.* (emphasis added).

Based on Chairman Muris' explanation of *Mass. Board*, it is impossible to see how any "presumption" of anticompetitive effect could apply here. First, the moratorium, unlike all of the "naked" restraints involved in the price-fixing and advertising-ban cases cited by the Initial Decision and invoked by Complaint Counsel, was adopted in the context of, and was designed to contribute to the efficiency and success of, a legitimate joint venture. RPF 51-104. Indeed, that is why the agreement is not illegal *per se*. Having determined that an agreement is subject to the rule of reason because it is ancillary to a joint venture, it would be inconsistent (indeed, irrational) then to rule that the agreement, although it may contribute to the efficiency of a procompetitive collaboration, is "presumptively anticompetitive." In short, once a court

determines that, as here, an agreement is ancillary to a procompetitive joint venture, that agreement cannot be deemed "presumptively anticompetitive."

Second, the only competition even potentially restricted by the moratorium was discounting and advertising that would not have occurred absent the joint venture. The Paris concert and the release of 3T3 created an opportunity for promoting 3T1 and 3T2 that would not otherwise have existed. There is no evidence that, had the joint venture not been formed, either PolyGram or Warner would have had any incentive to promote the prior albums in any manner that was prohibited by the moratorium. Complaint Counsel was unable to point to any efforts that PolyGram or Warner made to promote 3T1 or 3T2 in, for example, 1997 that were prohibited by the moratorium, and there is no evidence that, but for the joint venture, there would have been any additional discounting or promotional activities with respect to 3T1 or 3T2 in the United States. Tr. (Stockum) at 667:16-668:25.

Thus, the conclusion that a presumption of anticompetitive effects applies can be sustained only if it is "presumptively anticompetitive" for two companies to agree that, having formed a procompetitive joint venture, they will not undermine the efficiency and success of that venture by capitalizing on the new circumstances created by the venture itself to do things *they would not otherwise have done*. That cannot be the law. It may be that, in some circumstances, a court will determine that the actual anticompetitive effect of the parties' agreement not to do those new things outweighs the procompetitive, efficiency enhancing effects of the agreement, and that the agreement is therefore unlawful. But such an analysis would be appropriate only when, unlike here, there is some evidence of actual anticompetitive effect.

Third, the moratorium is totally unlike any of the agreements involved in the cases and articles the Initial Decision cites as support for its presumption. It restricted the discounting and advertising of *two* among thousands of compact discs for a period of *ten weeks*, leaving PolyGram and Warner free to discount and advertise those two products aggressively at all other times and to do whatever they chose with all their other products. Complaint Counsel's expert, Dr. Stockum, opined that restrictions on advertising have the "*potential* to harm

consumers and competition," and "*may* raise consumer search costs." JX104, Stockum Report (emphasis added). However, Dr. Stockum acknowledged that a similar agreement to ban advertising of two cereal products (for an unlimited period of time) would probably have "*no effect whatsoever" on price and therefore no effect on output.* Stockum Dep. at 124:11-125:5; Tr. at 653:22-655:6. Dr. Stockum also acknowledged that, in order to determine what, if any, competitive effect the moratorium would have, he would need to do a detailed market analysis. Stockum Dep. at 135:24-136:16; *see also* Tr. at 661:18-662:13. Dr. Stockum testified that he was unaware of any study regarding a restriction on advertising of "two relatively old products in a market in which there are hundreds of new products every year," *Id.* at 655:12-16, that the academic literature addressed advertising bans that were broader in scope and/or duration than the moratorium, *Id.* at 655:12-657:15, and that there are circumstances in which restricting advertising can be procompetitive. *Id.* at 662:20-665:7. Dr. Stockum testified that the actual competitive effects of the moratorium would depend on, *inter alia*, the extent to which the products previously had been advertised, the presence of other advertising for products with the same brand (*i.e.*, 3T3), and the extent to which the relevant consumers' decisions would be influenced by additional advertising. Tr. at 660:4-662:17. In these circumstances, even a version of the antitrust laws that included the *Mass. Board* approach to "inherently suspect" restraints would not provide any basis for invoking any presumption here.

**3. PolyGram's Procompetitive Justifications Preclude Any Finding Of Liability Under The Rule Of Reason.**

Had Complaint Counsel offered some evidence of anticompetitive effect – or if some presumption of anticompetitive effect applied – it would then be necessary for PolyGram to identify procompetitive justifications for the moratorium. In *CDA*, the Supreme Court recognized that it is enough at this stage of the rule of reason analysis for the defendant to identify a "plausible" procompetitive justification and that, once such a justification is identified, the net effect of the restraint must be anticompetitive for there to be any violation. 526 U.S. at 771 (holding that actual, net competitive effects must be considered where restraint "might

plausibly be thought to have a net competitive effect, or possibly no effect at all"). The procompetitive justifications here plainly are plausible – as Complaint Counsel's expert economist admitted, RPF 117 – and, under *CDA*, require a decision in PolyGram's favor because there is no evidence of any actual anticompetitive effect.

Before addressing PolyGram's procompetitive justifications, two points regarding the evidentiary record on those justifications are merited. First, Dr. Stockum was forthright in admitting that PolyGram's procompetitive justifications for the moratorium *are* plausible and that the only reason he did not believed a more detailed analysis was not required under the rule of reason was because he had not seen any "ambiguity" in the documentary record. Tr. at 640:2-13, 643:7-644:9. However, the record – including the relevant documents, the deposition testimony of PolyGram's witnesses, and the live testimony of Messrs. Hoffman and O'Brian – clearly demonstrates that the moratorium was adopted for the procompetitive reasons identified by PolyGram. RPF 51-104.

Second, the deposition testimony and expert reports of Professors Wind and Ordover strongly support PolyGram's procompetitive justifications, but the Initial Decision wrongly concluded that the opinions of PolyGram's experts were entitled to "little weight." ID at 58 n.25 & F. 294-299, 325-327, 329-30. The testimony and reports provided by Professors Wind and Ordover properly analyzed the moratorium and PolyGram's procompetitive justifications for adopting the moratorium as part of their joint venture, and properly concluded that the moratorium cannot be considered anticompetitive based on the limited analysis conducted by Dr. Stockum and Professor Moore. Complaint Counsel deposed Professors Ordover and Wind at length concerning their expert reports and moved the entirety of their deposition testimony into evidence during their case-in-chief. Tr. at 12. The deposition testimony of Professors Ordover and Wind thus must be considered "as though the witness[es] were then present and testifying." *See* 16 C.F.R. § 3.33(c)(1). Accordingly, the expert reports



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and deposition testimony of Professors Wind and Ordover merited the same consideration as all the other properly admitted evidence in this case.[14]

The record evidence and the relevant case law make clear that the procompetitive justifications for the moratorium are sufficient to require further analysis of actual effects under the rule of reason.

**a. The Moratorium Plausibly Was Procompetitive In Preventing Free Riding And Opportunistic Behavior.**

The moratorium served a plausibly procompetitive interest by preventing the PolyGram and Warner op-cos from using the promotional opportunity created by the Paris concert and the release of the new album, as well as the confidential marketing plans developed by the joint venture partners, to "free ride" on the joint venture. PolyGram and Warner believed that the op-cos' potential for opportunistic behavior posed a serious threat to 3T3 during the initial release period that could undermine the long-term success of the Three Tenors brand. RPF 83. In particular, the parties believed that any short-term increase in sales associated with aggressive promotion of 3T1 or 3T2 during the release period would be more than offset by decreased sales of Three Tenors products 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 55, 72. Complaint Counsel's expert economist, Dr. Stockum,

[14] The legal discussion of this issue set forth in footnote 25 of the Initial Decision – which is largely copied from Complaint Counsel's papers – has nothing to with the situation here. In the cases cited by the Initial Decision, the opposing party *objected to the admissibility of the expert report during trial*. *Tokio Marine & Fire Ins. Co., Ltd. v. Norfolk & Western Ry. Co.*, 1999 U.S.App. LEXIS 476, *5 (4th Cir. 1999); *Engebretsen v. Hartford Ins. Co.*, 21 F.3d 721, 727 (6th Cir. 1994); *EPIS, Inc. v. Fidelity and Guaranty Life Ins. Co.*, 156 F.Supp.2d 1116, 1123-24 (N.D. Cal. 2001). Here, Complaint Counsel themselves moved the depositions into evidence, Tr. at 12, and expressly confirmed that they *had no objection* to the admissibility of the expert reports. Tr. at 496. None of these cases, nor any other of which PolyGram is aware, remotely supports the assertion that expert reports should be given "little weight" where, as here, (1) the reports have been prepared by eminently qualified experts in the relevant disciplines, (2) those experts have been subjected to lengthy and unrestricted cross-examination in deposition, (3) the opposing party has introduced into evidence the entirety of that deposition testimony, including testimony that requires reference to the expert reports to be intelligible, and (4) the other side has expressly confirmed in court that it has no objection whatsoever to their admission.

acknowledged that this sort of "asymmetrical" effect from free-riding activities would be a legitimate concern for the joint venture partners. RPF 141. And, contrary to the Initial Decision, Dr. Stockum conceded that any analysis of the effects of the moratorium must consider its overall effect on competition, not just its effect during the ten-week period. RPF 105.

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

Contrary to the findings in the Initial Decision, Mr. O'Brien's testimony demonstrated that free riding by the PolyGram and Warner op-cos 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 WMI's threat to exploit the promotional opportunity surrounding the Paris concert and the release of the new album by running a European discount campaign from May – December 1998. RPF 94. Mr. O'Brien first became aware of WMI's threatened free-riding activities before entering into the joint venture agreement, and he entered into the joint venture believing that WMI would not be discounting 3T2 during the release period. *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 gone forward with the joint venture had either side believed the other would aggressively

discount and promote its prior Three Tenors album during the initial release period. RPF 95. The moratorium ultimately enabled Mr. O'Brien to persuade WMI not to proceed with its proposed campaign. RPF 100. Mr. O'Brien also made clear that the parties' total promotional expenditures for 3T3 depended on its initial sales – and that aggressive discounting and promotion of the prior albums during the release period thus could have led to lower promotional spending for 3T3. RPF 101.[15]

The Initial Decision's suggestion that PolyGram and Warner could have asked their op-cos to pay for their proposed free-riding activities by entering into a "joint advertising agreement" or some other form of compensation scheme simply misses the point. Unlike the defendants in *Toys 'R Us*, *General Leaseways*, or *Chicago Prof'l Sports*, PolyGram and Warner did *not* adopt the moratorium as part of an effort to internalize some third-parties' benefits from their promotional activities. The concern here was not the uncompensated "positive spillover" to the op-cos that could have resulted from promoting and discounting the prior albums during the release period; rather, the concern was that the "negative spillover" from promoting the prior albums would cause *asymmetrical* long-term harm to the various Three Tenors products that would not be offset by any benefits from promoting the prior albums. RPF 86-101. PolyGram and Warner spent more than $18 million ensuring that the Paris concert would take place and that the new album would exist, and they sought to ensure that their op-cos were focused on the new album so that the investment would not be wasted on short-term efforts to increase the sales of older catalog albums that had limited future marketing potential. RPF 54-56, 68. Dr. Stockum recognized this distinction between "positive spillover" effects and "negative spillover" effects, and he admitted that he was unaware of any alternative to the moratorium that would have done anything to address the "negative spillover" concern that gave rise to the moratorium. RPF 86, 141. The Initial Decision simply ignores the distinction between "positive spillovers"

[15] Professor Moore likewise confirmed that a record company typically would spend more money promoting a product if it was successful during its initial release. PF 108.

and "negative spillovers" effects, and further ignores Dr. Stockum's concession that aggressive promotion of the prior albums during the launch period for the new album could have had an "asymmetrical effect" upon sales of the new album.

Moreover, as Dr. Stockum acknowledged, this case is fundamentally different from *Chicago Prof'l Sports* and *General Leaseways* because *both* parties here had the ability and incentive to free ride. 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 op-cos would, collectively, have had the same incentive to free ride regardless of how Warner and PolyGram allocated their financial responsibility. Indeed, Dr. Stockum 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 Dep. at 72-73, 78-79. With that concession, Dr. Stockum eliminated the sole reason he offered why, in his opinion, there was no free-riding problem in the United States. *Id.* at 61-63.[16]

**b. The Moratorium Cannot Be Assessed Apart From The Procompetitive Effects of The Overall Venture.**

The moratorium allowed PolyGram and Warner to adopt a commercially sound marketing strategy for 3T3 a strategy that 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.[17] Under this marketing strategy, PolyGram and Warner allowed their op-cos to

[16] 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 op-cos 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, Dr. Stockum admitted that that there were plausible efficiencies associated with adopting a single, uniform marketing plan for the worldwide release of 3T3. RPF 130. Moreover, even assuming that the moratorium had *no effect* on competition in the United States because the parties would not have promoted or discounted the prior albums here in any event, RPF 111, 120, there is no authority for holding that the moratorium was unlawful *because* it had no effect.

[17] The fact that a single firm owning all three albums might have adopted the same marketing strategy strongly suggests that the moratorium was viewed as a reasonably necessary part of the joint venture, and

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 witnesses testified, promoting and discounting the prior albums rather than the new albums during the release period could have jeopardized the long-term output of all Three Tenors products. *See* RPF 55 (Cloeckaert Dep. at 68-70; *see also* O'Brien Tr. at 99; Saintilan Dep. at 78-84; Stainer Dep. at 57-58). Respondents' marketing expert, Professor Wind, opined that this was a sound strategy for maximizing the long-term success of the Three Tenors brand. RPF 112 (Wind Report at 16-17). This marketing strategy maximized the chance the new album would succeed and thereby likely increased the aggregate output of all Three Tenors products and increased the likelihood that the parties ultimately would release the greatest hits and box-set albums. Indeed, the only competition that arguably was adversely 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.[18]

The Initial Decision's conclusion that it was proper to ignore the procompetitive effects of the overall 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. The moratorium was inextricably intertwined with the Three Tenors joint venture, and consequently cannot be analyzed apart from the overall venture. *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

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not as a stand-alone measure designed to restrict sales of the prior albums. *See* RX717, Ordover Report at 17-19.

[18] On this point, an article by the Antitrust Division's Director of Research for Economic Analysis 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 authorities 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 moratorium – discounting and promoting 3T1 and 3T2 during the release period– existed only because of the joint venture.

they cannot meaningfully be isolated and attributed to any individual agreement."). The Initial Decision ignored this provision of the Commission's enforcement guidelines. Moreover, as discussed above, there is no support 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. *See, e.g., Polk Bros.*, 776 F.2d at 187-88 (holding restraint adopted six years after formation of joint venture lawful under rule of reason). As Mr. Hoffman and Mr. O'Brien testified, PolyGram and Warner entered into the joint venture as "full partners" and they saw no need to specify all the 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 venture was formed. RPF 50.

The artificial rule adopted by the Initial Decision -- under which the mere fact that a restraint was adopted after the formation of a joint venture would render it unlawful – would create a substantial disincentive to entering into joint ventures in the first place. RPF 127. As 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.* (RX716, Ordover Report at 9-10).

#### 4. PolyGram Was Not Required to Show the Moratorium Was "Necessary" to Further its Procompetitive Objectives.

The Initial Decision erroneously concluded that, to trigger a need for a more detailed analysis of the actual effects under the rule of reason, PolyGram was required to establish the "validity" of its procompetitive justifications by showing that the moratorium was "*necessary* in order to promote competition and benefit consumers." ID at 58-59. In support of that proposition, the Initial Decision again cited *BMI*, in which the Supreme Court upheld the challenged agreement not because it was "necessary," but because it provided a "substantial lowering of costs" and was "potentially beneficial" as compared with the available alternatives, 441 U.S. at 20-21; and *NCAA*, in which the Supreme Court did not ask whether the challenged agreement was "necessary," but rather concluded that it was unlawful under the rule of reason because the evidence showed that it had actual anticompetitive effects and no procompetitive justification, 468 U.S. at 100-01, 114.

The Initial Decision compounded its error by ignoring the fact that, even when the term "necessary" is used in the antitrust laws, the term means "reasonably necessary," "reasonably related to" or "potentially procompetitive," and is intended to suggest that courts should defer to, rather than second-guess, the reasonable decisions of business people. *See* Brief of the United States as Amicus Curiae in *NCAA*, Attachment A to CCPTB at 13 (arguing that "necessary" means "'reasonably related to'"). *CDA* makes clear that a procompetitive justification need only be plausible to foreclose any finding of liability without some consideration of actual, net competitive effects. 526 U.S. at 771. There is no additional requirement of proving that the agreement is "valid" in the sense that it actually is procompetitive. To hold otherwise effectively would reverse *CDA*.

### C. Complaint Counsel Failed To Demonstrate Any "Cognizable Danger" Of Recurrent Violation.

A cease and desist order may be entered only if there is a "real threat" that similar conduct will recur. *United States v. Oregon State Med. Soc'y*, 343 U.S. 326, 333 (1952); *TRW, Inc. v. FTC*, 647 F.2d 942, 954-55 (9th Cir. 1981). The order in this case is not supported by any

evidence that conceivably could support any such finding. The only "evidence" proffered to show that there is some threat that conduct similar to the moratorium is likely to recur was: (1) testimony regarding the fact that artists sometimes switch from one label to another, F. 331-33; and (2) a press release describing a joint venture for distributing music over the Internet. F. 334.[19] There is no evidence that the concerns that gave rise to the moratorium exist in either of those circumstances, or that either of those circumstances involved the degree of integration and shared risk that was present here. Rather, the record evidence unambiguously shows that the parties adopted the moratorium for reasons that were closely tied to the unique features of the Three Tenors venture. RPF 103-104, 149. The record evidence showed that PolyGram has not seen a need for a similar agreement in any other context. *Id.* There is no basis whatsoever for concluding that there is any threat of recurrence.

Moreover, the breadth of the order cannot be justified by the supposed threat. The order has a 20-year term; the restraint at issue applied to two classical music products for ten weeks. Paragraph VII requires that all of Respondents' officers, directors and employees be provided with a copy of the order and that they each provide a signed acknowledgment that they have read the order; the administrative burdens associated with providing the order to hundreds of employees (and their successors for the next 20 years) cannot possibly be justified in a case involving conduct that lasted for ten weeks and took place within a single classical music label four years and two major mergers ago. Paragraph VI would allow the Commission's staff unfettered access to any Respondent employee on five days notice; none of the evidence in this case justifies imposing that burden. And Paragraphs II and III of the order would allow the Commission to charge PolyGram with contempt and to require PolyGram to prove that it has *not*

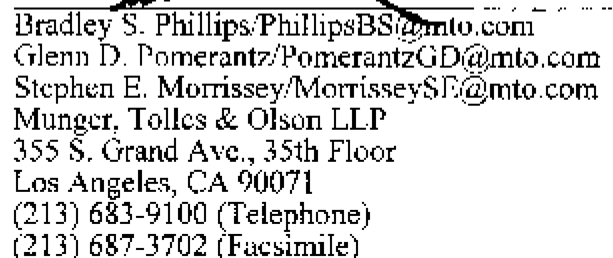
[19] The Initial Decision also found supposed support for the order in Respondents' refusal to "acknowledge their past lawlessness." ID at 71 (citing *Wilk v. AMA*, 895 F.2d 352 (7th Cir. 1990)). In *Wilk*, the court concluded that injunctive relief was appropriate based in part on the fact that the AMA "never acknowledged the lawlessness" of its long-term boycott of chiropractors. *Id.* at 366. However, the injunction there also was supported by the AMA's "systematic, long-term wrong-doing and long-term intent to destroy chiropractic," and the "lingering effects" of the AMA's conduct. *Id.* There are no such additional facts to support the order here.

entered into an agreement to restrict prices or advertising that was not reasonably related to and reasonably necessary to a lawful joint venture. Those provisions reverse the substantive and procedural burdens under the antitrust laws, and cannot properly be imposed.

## V. CONCLUSION

For all of the foregoing reasons, the Commission should reverse the Initial Decision and adopt PolyGram's proposed findings, conclusions and 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: August 9, 2002

**Exhibit A**

THIS TYPESCRIPT VERSION
MAY NOT BE IDENTICAL TO THE PRINTED BRIEF

97-1625

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

CALIFORNIA DENTAL ASSOCIATION, PETITIONER

v.

FEDERAL TRADE COMMISSION

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT


DEBRA A. VALENTINE
*General Counsel*

JOHN F. DALY
*Assistant General Counsel*

JOANNE L. LEVINE
ELIZABETH R. HILDER
Attorneys
Federal Trade Commission
Washington, D.C. 20580

SETH P. WAXMAN
*Solicitor General*

JOEL I. KLEIN
*Assistant Attorney General*

LAWRENCE G. WALLACE
*Deputy Solicitor General*

PAUL R.Q. WOLFSON
*Assistant to the Solicitor General*

Department of Justice
Washington, D.C. 20530
(202) 514-2217

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## QUESTIONS PRESENTED

1. Whether petitioner is subject to the jurisdiction of the Federal Trade Commission as an association "organized to carry on business for * * * [the] profit * * * of its members," within the meaning of Section 4 of the Federal Trade Commission Act, 15 U.S.C. 44.

2. Whether the Federal Trade Commission conducted a sufficient analysis to determine, under the antitrust rule of reason, that petitioner's restrictions on its members' advertising of prices, discounts, and quality violated Section 5 of the FTC Act, 15 U.S.C. 45.

## STATEMENT

1. This case involves advertising restrictions imposed as a condition of membership by petitioner California Dental Association (CDA). Petitioner's members include 75% of the dentists actively practicing in California. Pet. App. 161a-162a. Petitioner has 32 local component dental societies, and membership in a local association is mandatory for membership in petitioner. Id. at 162a. In addition, membership in petitioner is mandatory for California dentists who wish to be members of the American Dental Association. Id. at 46a. Although membership in petitioner is legally voluntary and is not required for a license to practice dentistry, membership is highly valued by California dentists for its "real economic benefit," and "no one gives up membership" in petitioner to avoid its restrictions on advertising. Id. at 84a; see also id. at 232a-234a (detailing importance of CDA membership to dentists).

Petitioner is organized under California law as a nonprofit corporation. Pet. App. 161a. It is exempt from federal income tax under 26 U.S.C. 501 (c)(6), the tax category for "[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, [and] professional football leagues." It does not qualify for exemption as a charitable institution under Section 501(c)(3). See Pet. App. 50a-51a, 174a.

Although petitioner's stated purposes include improvement of public health, it also describes itself as "represent[ing] dentists in all matters that affect the profession" and "offer[ing] far more services to its members than any other state [dental] association." Pet. App. 51a.[1]

Petitioner offers broad assistance to its members to increase their revenues and decrease their costs. As its promotional literature describes (J.A. 20-23), petitioner provides its members with services such as job placement, recruitment of dental assistants, review of proposed contracts with third-party payers (vaunted as affording a substantial savings over hiring a private attorney), and financial planning seminars. Pet. App. 51a-52a, 172a-188a. Through a for-profit subsidiary, petitioner offers low-cost malpractice insurance, which saves members at least $1,000 annually over other insurance plans; this insurance is available in California only to CDA members. Id. at 166a, 173a, 184a-185a. Other for-profit subsidiaries offer, exclusively to members, financing for dental equipment, financing assistance for patients, and a home mortgage program. Id. at 166a-168a, 185a-186a; see also id. at 181a-183a (seminars, training sessions, and publications offered to members at steeply discounted rates).

Petitioner engages in lobbying and litigation concerning laws and regulations that affect dentists' businesses; its lobbying successes "mean money" to members, or so it claims, and have saved members thousands of dollars each year. Pet. App. 176a, 177a-179a; see J.A. 20. [2] Petitioner also conducts marketing and public relations initiatives to enhance the image of its members; these activities have brought members, on average, an additional $6,000 of annual income from new patients, equaling a "20-to-1 return on investment." Pet. App. 179a-180a. In sum, petitioner estimates that the potential value to members who take advantage of a selection of its services is $22,000 to $65,000, and that the value to members of its benefits far exceeds their membership dues. Id. at 175a.

2. Section 10 of petitioner's Code of Ethics, on its face, prohibits advertising that is "false or misleading in any material respect." Pet. App. 9a; J.A. 33. The record in this case demonstrates, however, that petitioner has broadly interpreted and enforced that prohibition in a way that effectively prohibits (a) most advertising about relative prices, (b) all advertising of across-the-board price discounts, and (c) virtually all advertising claims, whether relative or absolute, about the quality of a member's dentistry or service. Pet. App. 55a. These prohibitions cover even advertising claims that "are not false or misleading in a material respect." Id. at 260a; see id. at 56a-57a n.6.

Thus, petitioner has prohibited its members from using terms such as "low," "reasonable," or "affordable" in their advertising, whether or not they truthfully describe the dentist's fees, Pet. App. 65a-66a, 198a-199a, under the reasoning that members' statements about their fees must be "exact" and must "fully and specifically disclos[e] all variables and other relevant factors" to avoid being branded misleading, id. at 9a-10a, 64a;

J.A. 34-35. Under similar reasoning, petitioner has disallowed such phrases as "affordable, quality dental care," "making teeth cleaning * * * inexpensive," Pet. App. 65a, "affordable family dentistry," id. at 199a, "reasonable fees quoted in advance," id. at 227a, and "Fees that Fit a Family Budget," id. at 237a.

As for advertising about discounted fees, petitioner has required that such advertising contain at least five disclosures: (1) the dollar amount of the nondiscounted fee; (2) either the dollar amount of the discounted fee or the percentage of the discount for the specific service; (3) the length of time, if any, that the discount will be offered; (4) a list of verifiable fees; and (5) specific groups qualifying for the discount and any other terms or conditions for the discount. Pet. App. 64a-65a, 200a. The practical effect of those requirements is "nearly prohibitive" of advertising of any broadly applicable discounts. Id. at 201a.[3] Indeed, petitioner has disapproved a broad array of discounting offers because they were not accompanied by the required disclosures.[4]

Finally, petitioner has made clear that virtually all advertising about quality of services (including the word "quality" itself) is deemed "likely to be false or misleading" because it is not "susceptible to measurement or verification." Pet. App. 74a-75a, 202a-203a; see J.A. 35. Petitioner has also disapproved any advertising that, in its view, implies that a dentist is superior to other dentists. Pet. App. 206a. Such quality claims have been prohibited without regard to whether they are in fact false or misleading. Id. at 203a-204a, 207a, 209a. Petitioner and its components have therefore required that members and would-be members eliminate any advertising phrases that refer to the quality of dental care that patients will receive, or indeed to the quality of service ancillary to the actual dentistry, such as punctuality.[5]

Petitioner enforces its advertising restrictions by requiring applicants for membership to submit copies of all of their own advertising, plus advertisements by their employers and referral services, to the ethics committee of their local dental society. Pet. App. 193a, 237a-239a. Petitioner's local components also publish notices in their newsletters soliciting members to report possible Ethics Code violations by the applicant. Id. at 194a. Applicants are denied membership in petitioner if they do not agree to withdraw or revise advertisements that petitioner deems objectionable. Id. at 195a-198a. Petitioner also urges its local components to review local Yellow Pages directories for nonconforming advertisements by current members. Id. at 194a, 234a-235a. Members who do not agree to revise offending advertisements may be subject to a hearing before petitioner's Judicial Council, and thereafter to censure, suspension, or expulsion. Id. at 11a; see id. at 56a n.6.

The record in this case compiles actions taken by petitioner and its local societies against nearly 400 dentists, in which petitioner or a component disapproved particular advertising claims by members and applicants for membership, without regard to the truth of such claims. Pet. App. 56a-57a n.6, 89a-90a n.25, 199a-212a, 214a-218a, 235a.(6) Petitioner's efforts to suppress truthful and nondeceptive advertising have been successful; when forced to choose between a challenged advertisement and membership in petitioner, dentists almost always give up the advertisement. Id. at 80a, 235a-237a. Petitioner's restrictions have also had a substantial deterrent effect. Some local societies reported that 90-100% of their members' advertisements complied with petitioner's restraints. Id. at 234a-235a.

3. a. On July 9, 1993, the Federal Trade Commission (FTC or Commission) issued an administrative complaint (J.A. 5-16) charging that petitioner had restrained competition among dentists in California by restricting truthful, nondeceptive advertising regarding price and quality of dental services. The complaint alleged that these restraints were "unfair methods of competition" in violation of Section 5 of the Federal Trade Commission Act (FTC Act or Act), 15 U.S.C. 45. After discovery and trial, an Administrative Law Judge (ALJ) concluded that petitioner had violated Section 5. Pet. App. 159a-265a.(7)

The ALJ determined, upon extensive factual findings (Pet. App. 161a-247a), that petitioner had "successfully withheld from the public information about prices, discounts, quality, superiority of service, guarantees, and the use of procedures to allay patient anxiety." Id. at 259a-260a (record citations omitted). He also found that petitioner's "illegal[] conspir[acy]" had "injured those consumers who rely on advertising to choose dentists." Id. at 261a-263a.(8) The ALJ did rule that petitioner lacked "market power," id. at 261a, but that conclusion was based on the legal premise (later rejected by the Commission, id. at 83a) that such power exists only in the presence of "insurmountable" barriers to entry, id. at 262a. And the ALJ rejected petitioner's arguments of "procompetitive" effects flowing from its restrictions. He found that petitioner's ethics code, as actually enforced, "unjustifiably banned whole categories of advertisements which are not false or misleading in a material respect," and reflected "a hostility toward advertising by its members even if it is truthful and nondeceptive." Id. at 259a-260a.

b. On plenary review of the ALJ's initial decision (see 16 C.F.R. 3.54(a)-(b)), the Commission affirmed the ALJ's finding of a violation of Section 5. Pet. App. 43a-158a. The Commission first found (id. at 47a-52a) that petitioner was subject to the FTC Act as a corporation "organized to carry on business for its own profit or that of its members," within the

meaning of Section 4 of the Act, 15 U.S.C. 44. Noting that it had previously rejected the argument that the term "profit" in this context should be limited to "direct gains distributed to * * * members," the Commission held that it had jurisdiction in this case because a substantial portion of petitioner's activities consists of practice management, marketing, public relations, lobbying, and other business-related services that confer "pecuniary benefits" on its members. Id. at 49a, 51a-52a.

On the merits, the Commission concluded that petitioner's advertising restrictions, both price-related and quality-related, constituted unlawful restraints of trade. Pet. App. 58a-92a. The Commission found, upon its review of the record, that "advertising is important to consumers of dental services and plays a significant role in the market for dental services." Id. at 60a; see id. at 76a-77a. As for the price advertising restrictions specifically, the Commission upheld the ALJ's findings that petitioner had barred its members from advertising "low" or "reasonable" fees, and had effectively precluded truthful across-the-board discount offers. Id. at 63a-67a. The Commission also found that these restrictions on price advertising "constitute[d] a naked attempt to eliminate price competition," accomplished through the "indirect means of suppressing advertising" about prices. Ibid. Based on that finding, the Commission held that petitioner's price-related restraints were unlawful per se. Ibid.; see id. at 60a-63a, 67a-73a.

The Commission also applied the antitrust rule of reason to all the advertising restrictions at issue in this case. Pet. App. 73a-92a. After observing that this Court "has made clear that the rule of reason contemplates a flexible enquiry, examining a challenged restraint in the detail necessary to understand its competitive effect," id. at 74a (citing NCAA v. Board of Regents, 468 U.S. 85, 103-110 (1984)), the Commission found (ibid.) that application in this case of the rule of reason could be "simple and short," because "[t]he anticompetitive effects of CDA's advertising restrictions are sufficiently clear, and the claimed efficiencies sufficiently tenuous, that a detailed analysis of market power is unnecessary to reaching a sound conclusion." But, the Commission added (ibid.), "in any event, CDA clearly had sufficient power to inflict competitive harm."

The Commission began its rule of reason analysis by assessing the anticompetitive effects of the restrictions. Pet. App. 74a-78a. Supplementing its earlier findings (under the per se rule analysis) of the effects of petitioner's restrictions on price advertising, id. at 73a-74a, the Commission found that petitioner had also proscribed a "vast" range of nonprice advertising, barring virtually all claims regarding quality, regardless of the truthfulness of such claims. Id. at 74a-76a. It found

"substantial evidence" that the challenged advertising restraints "prevented the dissemination of information important to consumers," regarding both price and nonprice aspects of the dental services offered. Id. at 76a-77a. And it found that the restraints "hamper dentists in their ability to attract patients," particularly dentists new to an area. Id. at 78a. The Commission therefore concluded that, because of the importance of advertising to consumers in choosing dentists (id. at 60a, 77a), petitioner's broad bans would "deprive consumers of information they value and of healthy competition for their patronage." Id. at 78a. Although it did not "quantify[] the increase in price or reduction in output occasioned by these restraints," the Commission found their "anticompetitive nature" to be "plain." Ibid.

The Commission also found that petitioner had the "power to cause harm to consumers" by inducing its members to withhold information. Pet. App. 80a. It had "little doubt" that petitioner had "the ability to police, and entice its members to adhere to, the restrictions on advertising." Ibid. Moreover, it found that "the services offered by licensed dentists have few close substitutes," that "the market for such services is a local one," and that petitioner's members command "more than a substantial share of these markets" -- 75% of practicing dentists statewide, and more than 90% in one region. Id. at 82a. Contrary to the ALJ's conclusion (id. at 261a), the Commission found that there are "significant barriers to entry" into those markets, id. at 82a-84a, even if they are not "insurmountable," id. at 83a. Accordingly, the Commission found that petitioner "possesses the necessary market power to impose the costs of its anticompetitive restrictions on California consumers of dental services." Id. at 84a.

Like the ALJ, the Commission rejected petitioner's contention that its restraints were either harmless or pro-competitive. Pet. App. 84a-89a. The Commission acknowledged that the prevention of false and misleading advertising is a "laudable purpose," but it concluded that "the record will not support the claim that CDA's actions [were] limited to advancing that goal." Id. at 84a. It found, rather, that petitioner's "broad categorical prohibitions" (id. at 87a) were enforced "without any enquiry as to how [prohibited claims] might be construed by consumers and whether, as construed, they are true of the particular practitioner making the claim" (id. at 86a). And it perceived "no convincing argument, let alone evidence" that "consumers of dental services have been, or are likely to be, harmed by the broad categories of advertising" that petitioner restricts. Id. at 89a.

The Commission therefore held that petitioner's advertising restrictions violated Section 5 of the FTC Act. Pet. App. 90a-91a. The Commission's cease-and-desist order prohibits those restrictions (id. at 27a-31a), but

expressly provides that petitioner may "adopt[] * * * and enforc[e] reasonable ethical guidelines governing the conduct of its members with respect to representations that respondent reasonably believes would be false or deceptive within the meaning of Section 5 of the Federal Trade Commission Act." Id. at 30a.

4. The court of appeals affirmed. Pet. App. 1a-24a. As to jurisdiction, the court agreed with the FTC and with other courts that Congress "did not intend to provide a blanket exclusion for nonprofit corporations" from the reach of the FTC Act, and it approved the Commission's approach of "looking at whether the organization provides tangible, pecuniary benefits to its members" in order to determine whether it is a "corporation" subject to the Commission's jurisdiction. Id. at 15a-16a. Under that standard, the court was "confident that the facts of this case support the FTC's jurisdiction." Id. at 16a.

As to the merits, although the court acknowledged "some support" in case law for the FTC's per se analysis of petitioner's restrictions on price advertising, it concluded that a rule of reason analysis is more appropriate for all aspects of petitioner's advertising restraints. Pet. App. 17a-18a. It then observed approvingly that the FTC had applied "an abbreviated, or 'quick look' rule of reason analysis" in this case because petitioner's restraints "are sufficiently anticompetitive on their face that they do not require a full-blown rule of reason inquiry." Id. at 18a (citing NCAA, supra).

The court first noted that "[r]estrictions on the ability to advertise prices normally make it more difficult for consumers to find a lower price and for dentists to compete on the basis of price." Pet. App. 19a. On the other hand, the court found no reason to give petitioner's proffered justifications for its disclosures more than a "quick look," because, "in practice," under petitioner's disclosure requirements, it was "simply infeasible to disclose all of the information that is required," and there was "no evidence that [petitioner's] rule has in fact led to increased disclosure and transparency of dental pricing." Ibid.

Second, the court concluded that petitioner's restrictions on non-price advertising restricted the supply of information available to consumers, thereby "prevent[ing] dentists from fully describing the package of services they offer, and thus limit[ing] their ability to compete." Pet. App. 19a-20a. The court further suggested that the restrictions "are in effect a form of output limitation, as they restrict the supply of information about individual dentists' services." Ibid. It rejected petitioner's contention that its restrictions were justified because of the potential for deception, for even that potential "does not justify banning all quality claims without regard to whether they are, in fact, false or

misleading." Id. at 20a.

Finally, the court rejected petitioner's contentions that the FTC's findings were not supported by substantial evidence. Pet. App. 20a-24a. In particular, the court ruled that substantial evidence supported the FTC's finding that petitioner had banned categories of advertising without regard to whether they were false or deceptive. Id. at 21a-23a. It also upheld the FTC's finding that petitioner "possesses enough market power to harm competition" through its restraints on advertising. Id. at 24a. The court accordingly affirmed the Commission's opinion and enforced its order that petitioner cease and desist from restricting "truthful and non-deceptive advertisements." Ibid.

## SUMMARY OF ARGUMENT

I. A. The Federal Trade Commission properly exercised jurisdiction over petitioner, even though it is formally a nonprofit corporation, because a substantial portion of its activities engenders economic benefits for its profit-seeking members. Section 4 of the Federal Trade Commission Act, 15 U.S.C. 44, which sets forth the entities subject to the Commission's jurisdiction, reaches not only conventional business enterprises but also any association "organized to carry on business for its own profit or that of its members." The FTC has consistently interpreted that statute, adhering to ordinary definitions of the term "profit," to reach trade associations that engage in activities for the economic benefit of their profit-making members, even where the association itself is organized as a nonprofit entity and the member benefits take forms other than cash disbursements. The legislative history of the FTC Act evinces Congress's intent to authorize FTC jurisdiction over such associations, and the FTC and the courts have long acted on the understanding that the Act does in fact reach such associations.

B. There is no basis in the statute for an implied, blanket exemption of associations representing profit-making professionals. Petitioner's arguments based on Congress's ostensible lack of attention to professionals when it enacted the FTC Act fail for the same reasons the Court rejected an implied exemption of professionals from the antitrust laws in Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975). Since that ruling, the FTC has enforced the Act to protect the public from anticompetitive and deceptive practices in which professional associations have engaged.

C. The FTC's interpretation of the statute's reach -- which is based on the provision of substantial economic benefits to an association's profit-seeking members -- is reasonable and merits judicial deference. The record amply supports the FTC's application of that standard to

petitioner, which generates significant economic benefits for its members through its provision of services to its members and its lobbying, public relations, and marketing activities designed to increase their profitability.

II. A. The FTC engaged in a proper and sufficient analysis of petitioner's advertising restraints under the antitrust rule of reason. This Court has repeatedly emphasized the flexibility of the rule of reason; it has instructed that the rule's application may be tailored to the circumstances of particular cases, and that elaborate industry analysis is not necessary in all cases to condemn a restraint of trade as unreasonable. The Commission carefully considered here all aspects of a rule of reason analysis and concluded, based on a substantial record, that petitioner's advertising restrictions harmed consumers.

B. The Commission found, based on a substantial evidentiary record, that petitioner's advertising restrictions deprive consumers of information they value and of healthy competition for their patronage. Petitioner's restrictions, as enforced, proscribe a vast range of truthful advertising claims regarding price and quality. The Commission's findings regarding the actual effects of the restrictions belie petitioner's assertion that its disclosure requirements would prompt dentists to provide more information to consumers. Recognizing the indispensable role of advertising in a free enterprise system, the Commission found that the price and quality advertising suppressed by petitioner would be important to consumers in choosing dental services. Although petitioner disparages the value of the information at issue, this Court made clear in FTC v. Indiana Federation of Dentists, 476 U.S. 447 (1986), that a private party is not entitled to preempt the working of the market by deciding for itself what information will be made available to consumers, and that the concerted withholding of information valued by consumers may be condemned even absent proof that it resulted in higher prices.

C. The Commission carefully considered petitioner's proffered "procompetitive" justifications for its restrictions, and properly found them lacking. The Commission found that petitioner's disclosure requirements do not, in fact, result in more information to consumers, and found no basis for petitioner's contention that a ban on quality claims was necessary to avoid deception. Unlike the carefully tailored state restrictions that this Court has accepted in the context of First Amendment challenges, petitioner banned broad categories of advertising without regard to whether the banned claims were truthful or nondeceptive. The Commission properly rejected such a blanket restriction on information that consumers desire as an unreasonable restraint of trade.

D. Given the Commission's findings concerning the actual anticompetitive

effects of petitioner's restraint, it was not required to engage in a further analysis of market power. It nevertheless did so, concluding first that petitioner has the ability to require members to adhere to its advertising restrictions (due to the high value placed on membership), and second that petitioner has the power to inflict the anticompetitive effects of those restrictions on California consumers. It also pointed to the substantial percentage of California dentists who comply with petitioner's restrictions, as well as substantial barriers to sufficient entry of new dentists. Those findings were sufficient for this case; the Commission was not required to engage in elaborate industry analysis that may be required in other contexts, such as merger cases.

## ARGUMENT

### I. THE COMMISSION PROPERLY EXERCISED JURISDICTION OVER PETITIONER BECAUSE ITS ACTIVITIES, IN SUBSTANTIAL PART, PROVIDE PECUNIARY BENEFITS FOR ITS MEMBERS

Congress has empowered the FTC to prevent "persons, partnerships, or corporations" from engaging in unfair methods of competition and unfair or deceptive acts and practices in or affecting commerce. 15 U.S.C. 45 (a)(2). The FTC Act defines "corporation" broadly, in Section 4, to include not only companies with capital stock, but also "any company, trust, so-called Massachusetts trust, or association, incorporated or unincorporated, without shares of capital or capital stock or certificates of interest, * * * which is organized to carry on business for its own profit or that of its members." 15 U.S.C. 44. In this case, the FTC, applying its longstanding administrative interpretation of Section 4, properly concluded that petitioner is subject to the FTC Act's reach as an association "organized to carry on business for [the] profit * * * of its members" because a substantial part of its activities "engender a pecuniary benefit" for its profit-seeking members. Pet. App. 49a, 51a-52a.

#### A. The Text, Legislative History, and Enforcement History of the FTC Act Support the Commission's Exercise of Jurisdiction Over Nonprofit Associations That Engender Pecuniary Benefits For Their Members

The text of the FTC Act shows a congressional purpose to grant the FTC broad authority over companies and associations. The language of Section 4 is expansive. Section 4 extends the ordinary meaning of "corporation" to include "any" association "organized to carry on business for its own profit or that of its members," even if unincorporated and lacking such hallmarks of a profit-making enterprise as "shares of capital or capital stock or certificates of interest." As long

as the association carries on business "for [the] profit * * * of its members," it is subject to the Act's prohibition against unfair methods of competition. 15 U.S.C. 44.

The pivotal question in this case is whether an association may be said to work for the "profit" of its members, even if it does not distribute earnings to them. Petitioner argues (Br. 19-21) that Section 4 uses the term "profit" in the limited sense of the "excess of revenues over investment or expenses." Thus, it contends, to be within the reach of the FTC Act, an association must itself earn and pay such "profits" (i.e., the excess of its own revenues over expenses) to its members.

Even if the Act did use the term "profit" in the limited sense of the excess of revenues over expenses, that would not advance petitioner's jurisdictional argument. Petitioner's activities are intended to, and do, increase the revenues and decrease the expenses of its members, who are "independent competing entrepreneurs" (Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 357 (1982)). Petitioner's activities help its members achieve profitability. Thus, petitioner carries on business for its members' "profit," even if it does not distribute its own earnings to them. Nothing in logic or the text of Section 4 suggests that the only way an organization may carry on business to help its members achieve profits is to distribute its own earnings to the members.

Moreover, "profit" is, and long has been, commonly used to refer more broadly to economic benefit. When the FTC Act was passed in 1914, a standard dictionary defined "profit" to include "[a]ccession of good; valuable results; useful consequences; avail; gain; as, an office of profit." Webster's International Dictionary 1713 (def. 2) (1913); see also 2 S. Rapalje & R. Lawrence, A Dictionary of American and English Law 1020 (1883) ("In its primary sense, profit signifies advantage or gain in money or in money's worth."). Modern definitions are similar. See Webster's Third New International Dictionary 1811 (def. 2) (1986). And Congress has frequently used "profit" and "for profit" in statutes to refer to pecuniary benefit generally, rather than in the limited sense of the excess of earnings over expenses and investment.(9) The language of Section 4 thus comfortably reaches associations that work for their profit-seeking members' economic benefit, even if they do not distribute earnings to the members.

Petitioner submits (Br. 21 n.5) that any "genuine nonprofit entity" should be outside the reach of the Act. A "genuine nonprofit entity," however, may well conduct activities that are intended to be, and are, for the economic benefit of its members. Trade associations, for example, frequently work to advance their members' economic interests and provide them with benefits of substantial value, even though such

associations are genuinely nonprofit in that their revenues are not distributed to their members, and even though such entities (like petitioner) may be entitled to exemption from federal income tax under 26 U.S.C. 501(c)(6).[(10)]

The legislative history of the FTC Act demonstrates, moreover, that Congress considered the coverage of nonprofit associations (especially, nonprofit associations of entrepreneurs) and decided to include such entities within the Act's reach. When Congress was considering legislation to replace the Bureau of Corporations with the Federal Trade Commission, both the House and the Senate initially passed bills that would have defined "corporation" to refer only to incorporated, joint-stock, and share-capital companies organized to carry on business for profit. See H.R. Conf. Rep. No. 1142, 63d Cong., 2d Sess. 11, 14 (1914). Two days after the Senate passed its version of the legislation, Bureau of Corporations Commissioner Davies wrote to Senator Newlands, the bill's sponsor and a member of the Conference Committee, expressing concern about its definition of "corporation." Davies explained that the bill would prevent the new Commission from acting against trade associations that "purport to be organized not for profit," and that, although "[a]s to some of the things done by these associations, no question as to their propriety can be raised," such associations nonetheless "furnish convenient vehicles for common understandings looking to the limitation of output and the fixing of prices contrary to the law."[(11)] The Conference Committee subsequently revised the definition of "corporation" in Section 4 specifically to include associations lacking capital stock that are organized to carry on business for their own profit or that of their members. Id. at 3. That alteration of the statutory text shows that Congress intended the Act to reach nonprofit entities, including trade associations, if they work to advance their members' economic interests.

The FTC and the courts have consistently read the FTC Act in conformity with Congress's intent to cover trade associations advancing the economic interests of their members. From its earliest days, the FTC has exercised its jurisdiction over anticompetitive practices by nonprofit associations whose activities provided substantial economic benefits to their for-profit members' businesses, even though the associations did not themselves engage in manufacturing or retailing, and did not distribute earnings to members.[(12)] The courts soon confirmed that "[t]he language of the act affords no support for the thought that individuals, partnerships, and corporations can escape restraint, under the act, from combining in the use of unfair methods of competition, merely because they employ as a medium therefor an unincorporated voluntary association, without capital and not itself engaged in commercial business." National Harness Mfrs. Ass'n v. FTC, 268 F. 705,

709 (6th Cir. 1920); see also Chamber of Commerce v. FTC, 13 F.2d 673, 684 (8th Cir. 1926). Following these decisive early rulings, the FTC and reviewing courts (including this Court) have consistently acted on the understanding that nonprofit trade associations are within the FTC's jurisdiction.(13) More recently, when the FTC took action against a nonprofit association for misrepresenting that no scientific evidence linked cholesterol in eggs to increased risk of cardiovascular disease, the Seventh Circuit held that the group, which was "formed to promote the general interests of the egg industry," came within the definition of "corporation" in Section 4 because it "was organized for the profit of the egg industry, even though it pursues that profit indirectly." FTC v. National Comm'n on Egg Nutrition, 517 F.2d 485, 487-488 (1975) (internal quotation marks omitted), cert. denied, 426 U.S. 919 (1976). (14)

Despite that lengthy history of FTC enforcement actions (upheld by the courts) against nonprofit organizations, petitioner argues (Br. 24-25) that Congress's failure to act on a proposed amendment to the FTC Act in 1977 demonstrates that Congress did not intend, in 1914, to bring such organizations within the reach of the Act. This Court has frequently characterized such reliance on congressional inaction as "a particularly dangerous ground on which to rest an interpretation of a prior statute." Central Bank v. First Interstate Bank, 511 U.S. 164, 187 (1994); see FTC v. Dean Foods Co., 384 U.S. 597, 608-611 (1966). Congress's failure to take action on the 1977 proposal in fact reveals little about the matter at hand, because that proposal would have given the FTC jurisdiction even over wholly charitable institutions; the Act, as amended, would not have been limited to nonprofit institutions that advance their members' pecuniary interests.(15) Congress may have declined to amend the Act because it was satisfied with the existing state of the case law, which (then as now) allowed the FTC to exercise jurisdiction over nonprofit associations such as petitioner that advance their members' pecuniary interests (even if they do not distribute earnings to members), but not over wholly charitable institutions.(16) Accordingly, no reliable guidance can be gleaned from Congress's failure to enact legislation in 1977. Cf. Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 116-120 (1980); United States v. Southwestern Cable Co., 392 U.S. 157, 170 (1968).

**B. There Is No Basis In The Statute For A "Professional Association" Exemption**

Petitioner argues (Br. 16) that, even if some nonprofit entities advancing members' economic interests (such as associations of automobile dealers or retail grocers) fall within the reach of the FTC Act, professional

associations like itself nonetheless do not. The text of the statute, however, will not support any implied, blanket "professional association" exception. A voluntary nonprofit association of professionals may be organized (and legitimately so) to advance its members' economic interests even if it also engages in public service activities and monitoring of its members' ethics. Many associations of professionals (as well as other entrepreneurs) engage in both kinds of activities. See, e.g., National Soc'y of Prof. Eng'rs v. United States, 435 U.S. 679, 682 (1978). As the Court explained in Goldfarb v. Virginia State Bar, 421 U.S. 773, 788 (1975), it is "no disparagement of * * * a profession to acknowledge that it has [a] business aspect." Dentists no less than industrialists may come together in a voluntary nonprofit association to advance their economic interests as a group. It is also difficult to see how any clear line could be drawn between classes of "professionals" and "non-professionals" for the purpose of defining the FTC's jurisdiction.

Petitioner suggests (Br. 24) that Congress must have intended to exclude professional associations from the FTC Act's reach because the professions were not regarded as subject to the antitrust laws when the Act was passed. This Court in Goldfarb rejected the similar argument that the business activities of "learned professions" were beyond the Sherman Act's reach because such professions were not regarded as "trade or commerce" when that Act was enacted. 421 U.S. at 787-788. Given the broad language of coverage used in Section 4 of the FTC Act, its reach cannot be frozen by assumptions in 1914 any more than the Sherman Act has been confined by assumptions extant in 1890. And whether or not Congress contemplated at its enactment that the FTC Act (or the Sherman Act) would be used against organizations of professionals such as dentists and lawyers, this Court "frequently has observed that a statute is not to be confined to the particular applications contemplated by the legislators." Diamond v. Chakrabarty, 447 U.S. 303, 315 (1980) (internal quotation marks, brackets, and ellipsis omitted).

Since this Court made clear in Goldfarb that combinations of professionals in restraint of trade are indeed subject to the antitrust laws, the FTC has consistently acted to protect the public from anticompetitive practices of professional associations. It has brought enforcement actions against organizations that were fixing or stabilizing prices,[17] thwarting cost containment programs,[18] and blocking the development of health maintenance organizations.[19] It has also acted against deceptive advertising and promotion by professional associations, such as misrepresentation of their members' expertise.[20] Petitioner's submission that such organizations are exempt from the FTC Act would deprive the public of the important consumer protection provided by Section 5 against such unfair competition and deceptive

practices.[21]

**C. The Commission's Construction Of Its Jurisdiction Under The FTC Act Is Entitled To Deference, And Its Application Of That Construction In This Case Was Proper**

For the reasons we have stated, the text of the FTC Act does not support a construction exempting all nonprofit (or professional) associations. At a minimum, the text does not compel such a construction. Since the word "profit" is capable of the construction that the FTC has placed on it - encompassing the situation in which a nonprofit organization works to advance its members' economic interests, even if it does not distribute earnings to them - that construction is entitled to deference. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-844 (1984); Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354, 380-382 (1988) (Scalia, J., concurring) (Chevron deference applicable to agency's interpretation of its own statutory authority or jurisdiction); see, e.g., NLRB v. Town & Country Elec., Inc., 516 U.S. 85, 89 (1995) (deferring to NLRB's interpretation of who is "employee" covered by National Labor Relations Act). Deference is particularly appropriate because the FTC has consistently acted on the view that Section 5 reaches such nonprofit associations since shortly after the FTC Act was passed. See p. --, supra; Zenith Radio Corp. v. United States, 437 U.S. 443, 457-458 (1978).

It bears emphasis that the Commission does not read the FTC Act as reaching all nonprofit associations but (consistent with the Act's requirement of "profit") only those organizations "whose activities engender a pecuniary benefit to [their] members if [those] activit[ies are] a substantial part of the total activities of the organization, rather than merely incidental to some non-commercial activity." Pet. App. 49a (quoting American Med. Ass'n, 94 F.T.C. 701, 983 (1979), aff'd, 638 F.2d 443 (2d Cir. 1980), aff'd by an equally divided Court, 455 U.S. 676 (1982) (AMA));[22] see also College Football Ass'n, 117 F.T.C. 971, 1000-1008 (1994) (FTC's determination that it lacked jurisdiction over nonprofit organization engaged in commercial activity for its members' benefit because its members were not profit-seeking). There is no basis, therefore, for the suggestion that the FTC's reading of the Act will expand its jurisdiction beyond its proper reach, to the realm of eleemosynary institutions.[23] Rather, the Commission has sensibly read the Act as permitting it to intervene when a nonprofit entity advances its members' economic interests in the commercial world.

Petitioner's argument (Br. 19) that it falls outside the statute's reach because its "main purpose" is to promote dental health lacks textual support. The statute applies by its terms to entities that conduct

business for the profit of their members, and makes no exception for ones that also conduct activities for the benefit of the public. Furthermore, drawing a jurisdictional line based on an association's "primary" purpose would create serious difficulties as to the proper classification of an organization's activities (particularly those with both public and private benefits) as well as the weights to be assigned to them (e.g., weighing by amount of expenditure or by degree of pecuniary benefit conferred). Such a line could also allow an association to evade jurisdiction through creative accounting classifications of its expenditures. The FTC was therefore justified in construing the Act's reach to turn on the existence of a substantial pecuniary benefit to an organization's members, rather than on the nature of its primary activities.

The record also amply supports the FTC's application of that standard in this case. Given petitioner's emphasis on the economic benefits that it provides to its members (see pp. ---, supra), the services that it offers in competition with for-profit businesses (including training programs, job placement, legal services, and low-cost insurance through its for-profit subsidiaries) (see p. ---, supra; J.A. 20-23), and its lobbying on behalf of its members' pocketbook issues (ibid.), there is substantial evidence to support the FTC's conclusion that petitioner provides its members with substantial "pecuniary benefits." Accordingly, the FTC properly concluded that petitioner is subject to the Act.

## II. THE COMMISSION CORRECTLY CONCLUDED THAT PETITIONER'S ADVERTISING RESTRICTIONS CONSTITUTE AN UNREASONABLE RESTRAINT OF TRADE

Section 1 of the Sherman Act, 15 U.S.C. 1, prohibits unreasonable restraints of trade. See Standard Oil Co. v. United States, 221 U.S. 1, 65 (1911). Restraints that "always or almost always tend to restrict competition and decrease output" are deemed unreasonable per se. Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 289-290 (1985); see Northern Pacific R. v. United States, 356 U.S. 1, 5 (1958). Other restraints are subject to the "rule of reason," reason," which seeks to distinguish between a restraint that "merely regulates and perhaps thereby promotes competition" and one that "may suppress or even destroy competition." Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 49 n.15 (1977) (internal quotation marks omitted). In all cases, however, the purpose of the antitrust inquiry is "to form a judgment about the competitive significance of the restraint. NCAA v. Board of Regents, 468 U.S. 85, 103 (1984) (internal quotation marks omitted).

In this case, the Commission carefully examined petitioner's restraints in

light of their surrounding circumstances and an extensive factual record that had been compiled about their actual effect. Pet. App. 73a-92a. It found that petitioner applied its advertising rules to ban systematically a "vast" range of advertising valued by consumers, depriving them of truthful, nondeceptive information about the price and quality of dental services. Id. at 74a. It also concluded that the restraints significantly interfered with the proper functioning of the market and were therefore anticompetitive. Id. at 78a. Although the Commission found it unnecessary to quantify the precise consumer injury caused by these restrictions, it sufficiently considered pertinent factors under the rule of reason, including market impact power the ostensibly procompetitive justifications proffered by petitioner. Id. at 78a-92a; see id. at 20a-24a (consideration of same factors by court of appeals).(24)

Petitioner's primary complaint (Br. 38, 42) is that the Commission failed to make a detailed inquiry into market structure and into its market power. In fact, the Commission (and the court of appeals) did examine market power, and found that petitioner had the ability to withhold from consumers the valuable information that they seek about dentists' prices and services. See Pet. App. 23a-24a, 79a. The Commission's analysis in this case followed the Court's teachings that the rule of reason may properly be tailored to the circumstances of each case, and does not necessarily require a "detailed market analysis" in every instance. See FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460 (1986) (IFD). By insisting on what it terms a "full rule of reason" analysis in cases such as the present one -- including the detailed analysis of matters such as the structure of local geographic markets -- petitioner would interpose unjustified barriers to the adjudication of antitrust claims by the Commission and the federal courts. Although an informed judgment about an arrangement's likely competitive effects may in some cases require elaborate efforts to delineate market boundaries, no such detail was needed here to find a substantial restraint on competition. Petitioner's other objections to the FTC's analysis are all attacks on the Commission's factual determinations, which (as the court of appeals ruled, Pet. App. 20a-24a) are amply supported by the record.

### A. The Commission's Analysis In This Case Was Consistent With This Court's Decisions, Holding That The Rule Of Reason Requires A Careful Yet Flexible Inquiry Into Competitive Effects, Tailored To The Circumstances Of Each Case

Antitrust tribunals apply the rule of reason to evaluate the competitive significance of a wide variety of business and trade association practices, which can vary greatly in their complexity, purpose, and effect. For this reason -- and in keeping with its common law origins -- the rule of reason is "used to give the [antitrust laws] both flexibility and definition."

National Soc'y of Prof. Eng'rs v. United States, 435 U.S. 679, 688 (1978).[25] The Court has emphasized the flexibility of the rule of reason on several occasions, and has instructed that the requirements of analysis under the rule vary according to the circumstances presented. For example, in NCAA, supra, the Court declined to apply the per se rule, but invalidated without detailed market analysis the NCAA's restrictions on televising football games under the rule of reason. The Court rejected on both legal and factual grounds the NCAA's argument that its television plan could not be condemned under the rule of reason because it lacked market power:

> As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output. To the contrary, when there is an agreement not to compete in terms of price or output, "no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement."

468 U.S. at 109 (quoting Prof. Eng'rs, 435 U.S. at 692).

The Court took a similar approach to rule of reason analysis in IFD, supra, a case quite similar to the present one. There, a state association of dentists had agreed not to provide copies of dental x-rays to insurers, who sought to use them to assess the propriety of the dentists' services and charges. See 476 U.S. at 448-450. The Court rejected arguments in support of the agreement similar to the ones petitioner advances here -- namely, "that the Commission's findings were inadequate because of its failure both to offer a precise definition of the market in which the Federation was alleged to have restrained competition and to establish that the Federation had the power to restrain competition in that market." Id. at 453. Although the Court held that the refusal to provide x-rays did not amount to a per se illegal boycott, it nevertheless ruled that "[a]pplication of the Rule of Reason to these facts is not a matter of any great difficulty," in light of the nature of the restraint and the Commission's finding of actual effects on competition. Id. at 459.

In so ruling, the Court made two points about the role of market power evidence in rule of reason cases. First, some restraints are unlawful under the rule of reason without any proof of market power at all: "absence of proof of market power does not justify a naked restriction on price or output." IFD, 476 U.S. at 460 (quoting NCAA, 468 U.S. at 109). Second, other restraints may be shown to be unlawful without extensive market power analysis. As the Court explained, "even if the restriction imposed by the Federation [was] not sufficiently 'naked' to call this principle [condemnation without proof of market power] into play, the Commission's failure to engage in detailed market analysis [was] not

fatal to its finding of a violation of the Rule of Reason." Ibid. The Court reasoned that "Federation dentists constituted heavy majorities of the practicing dentists" and that insurers were actually unable to obtain x-rays, ibid., and, therefore, that the restraint "had adverse effects on competition," id. at 461. The Court further reasoned that, even if the purpose of obtaining x-rays was to minimize costs, the restraint was "likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned absent proof that it resulted in higher prices." Id. at 461-462.

In the present case, the Commission hewed closely to this analysis and to the Court's teachings "that the rule of reason contemplates a flexible enquiry, examining a challenged restraint in the detail necessary to understand its competitive effect." Pet. App. 74a (citing NCAA, 468 U.S. at 103-110) (emphasis added). The Commission referred to its rule of reason analysis as "simple and short" (ibid.), which it was, in comparison to the lengthier analysis that may be needed in (for example) a merger case, where it may be necessary to delineate numerous geographic markets. But the Commission - which has extensive experience with the effects of advertising restrictions -- reached its finding of a violation of Section 5 only after a careful assessment of the record regarding the actual and likely effects of petitioner's highly restrictive advertising rules on consumers of dental services in California. See id. at 74a-84a. Based on its finding that "the general proposition regarding the importance of advertising to competition carries over to the instant situation," ibid., the Commission reasonably concluded that petitioner's restrictions on advertising had adverse effects on competition, for an agreement that "limit[s] consumer choice by impeding the 'ordinary give and take of the marketplace' cannot be sustained under the Rule of Reason." IFD, 476 U.S. at 459 (quoting Prof. Eng'rs, 435 U.S. at 692).(26)

Petitioner (Br. 27, 45-46) and amicus NCAA (Br. 11-12) go far afield in urging the Court to establish the contours of the analysis required under the rule of reason for all possible cases. All that is at issue here is whether the restraints on advertising in this case required a more extensive analysis than the Commission afforded them. In asserting the need for a "full rule of reason analysis," petitioner would have the Court require an exhaustive market analysis whenever an antitrust tribunal applies the rule of reason (outside some ill-defined class of restraints in which it concedes that a "quick look" is sufficient, Br. 31). Such a rigid requirement is not required by this Court's precedents, however, and can stand only as an unnecessary roadblock to a measured and sensible application of the antitrust laws, especially in contexts like the present case, involving extensive suppression of information that consumers find highly useful.(27)

**B. The Commission Properly Found, Based On Substantial Evidence, That Petitioner's Advertising Restrictions Had Anticompetitive Effects.**

The Commission engaged in an extensive analysis of the effects of petitioner's advertising restrictions, and concluded that they harmed competition by "depriv[ing] consumers of information they value and of healthy competition for their patronage." Pet. App. 78a; see also id. at 55a-60a, 63a-67a, 74-77a. That conclusion was based on two intermediate findings. First, the Commission found that the actual effect of petitioner's restrictions was to suppress a vast range of truthful and nondeceptive advertising. Second, it found that the restraints were harmful to consumers of dental services, because the advertising that was suppressed would have been useful to them in making choices about dental services. Those conclusions are fully supported by the record.

1. As detailed above (pp. ---, supra), the Commission amassed an extensive record of the ways in which petitioner foreclosed its members from providing useful information about price and quality to consumers. Based on that record, the Commission concluded that petitioner had "effectively preclude[d] its members from making low fee or across-the-board discount claims." Pet. App. 63a. It also found that "[t]he nonprice advertising CDA prohibits is vast," and that petitioner had, in practice "prohibit[ed] all quality claims." Id. at 74a-75a.

These well-supported factual findings refute any notion that petitioner's onerous disclosure requirements, in particular, could have had the effect of "giv[ing] consumers more information, not less" (Pet. Br. 34). Although petitioner's policy concerning the advertising of discounts is superficially couched in terms of disclosure requirements, the Commission found that the actual effect of such requirements was "prohibitive" of across-the-board discount advertising. Pet. App. 66a-67a, 85a-86a. In reaching that factual finding, the Commission employed its expertise - developed in its dual function of protecting consumers against deceptive practices and preventing anticompetitive acts - in evaluating the practical effect of disclosure requirements. As petitioner points out (Br. 34-35), there are circumstances in which disclosure requirements are highly beneficial to consumers, and the FTC does in some cases mandate disclosures to prevent consumer deception. But the FTC is aware (as is this Court, see Morales v. Trans World Airlines, 504 U.S. 374, 389-390 (1992)), that excessively burdensome disclosure requirements can have the "paradoxical effect" of stifling information that might benefit consumers. See Pet. App. 66a. The FTC is often called upon to make practical judgments about the actual or likely effects of disclosure requirements, and it properly concluded in this case that petitioner's requirements were so onerous that they operated in actual

effect as a "broad ban" on discount advertising. Id. at 67a. Indeed, petitioner appears to concede (Br. 36) the unreasonableness of its requirement that across-the-board discounts on all dental procedures be accompanied by the full litany of mandated disclosures.(28)

2. The Commission also addressed at length the significance to consumers of petitioner's restraints. It was not just the fact that dissemination of truthful information was forbidden, but particularly the kind of advertising banned -- relating to the price and quality of service offered -- that concerned the Commission. As the Court has emphasized, advertising "performs an indispensable role in the allocation of resources in a free enterprise system." Bates v. State Bar of Arizona, 433 U.S. 350, 364 (1977); see also Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 765 (1976); AMA, 94 F.T.C. at 1004; Massachusetts Bd. of Registration in Optometry, 110 F.T.C. 549 (1988); American Dental Ass'n, 94 F.T.C. 403, 405-406 (1979), modified, 100 F.T.C. 448 (1982).

On the facts of this case, the Commission found fully applicable the well-established importance of price and quality advertising to consumers. Advertising, it found, "is important to consumers of dental services and plays a significant role in the market for dental services." Pet. App. 60a; see id. at 78a. Those findings by the Commission echo those of the ALJ, who concluded that petitioner's "conspiracy has injured those consumers who rely on advertising to choose dentists." Id. at 261a. The record showed that advertisements highlighting low or discount prices, comfort and gentleness in the provision of dental services, or both were effective in attracting consumers (and much more effective than "generic advertising without comparative quality or price claims"), demonstrating the importance of such information to consumers. Id. at 77a.(29) Accordingly, the Commission properly found that information about price as well as "quality and sensitivity to fears is important to consumers and determines, in part, a patient's selection of a particular dentist." Id. at 76a-77a.

Petitioner attempts to minimize the competitive significance of some of the banned ads. It argues, for example (Br. 36-37), that discount advertising conveys "negligible informational content." The short answer to such contentions is that, in a free-market economy, it is generally up to consumers to decide what information is useful and what is not. See generally N. Averitt & R. Lande, Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law, 65 Antitrust L.J., No. 3, at 713 (Spring 1997). The advertising of discounted prices and references to "affordable fees" can signal to the consumer the potential availability of cost savings, which can then be investigated further.(30) Similarly, claims about quality of service, although dismissed by petitioner as

"subjective" (Br. 40), may convey useful information concerning the attitudes and approach of the dentist -- such as commitment to punctuality, to understanding the patient's anxieties, or simply to providing high-quality care. As this Court has recognized, advertising can benefit consumers even if it requires further inquiry. See Morales, 504 U.S. at 388-389 (noting utility of advertisements for discounted air fares); Prof. Eng'rs, 435 U.S. at 692-693 (rejecting argument that "inherently imprecise" pricing information was of no value to consumers). Petitioner "is not entitled to pre-empt the working of the market by deciding for itself that its [members' patients] do not need that which they demand." IFD, 476 U.S. at 462.

3. The Commission's conclusions in this case are consistent with long-observed effects of advertising restrictions: they "increase the difficulty of discovering the lowest cost seller of acceptable ability[, and] * * * [reduce] the incentive to price competitively." Bates, 433 U.S. at 377-378. As the Commission also noted, the importance of advertising "attaches not only to price information, but to all material aspects of the transaction," including quality. Pet. App. 59a. Although the Commission found it unnecessary to "quantify[] the increase in price or reduction in output occasioned by these restraints" (id. at 78a), its conclusion that these results would ensue is supported by both the record and by "common sense and economic theory, upon both of which the FTC may reasonably rely." IFD, 476 U.S. at 456. Moreover, as this Court stressed in IFD, the market may be deemed harmed by concerted, artificial suppression of information even without direct proof of effects on prices:

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

Id. at 461-462.[31] Accordingly, the FTC's conclusion that petitioner's advertising restraints had anticompetitive effects is fully consistent with this Court's decisions and supported by the record.

### C. The Commission Properly Found That the Restraints Lack Any Plausible Procompetitive Justification

Contrary to petitioner's contention, the FTC did not end its rule of reason inquiry once it determined that petitioner's restraints on truthful, nondeceptive advertisements had an anticompetitive effect. Rather, consistent with this Court's instructions about rule of reason analysis (IFD, 476 U.S. at 459; Prof. Eng'rs, 435 U.S. at 693-695), the FTC

carefully considered petitioner's contentions that its advertising restrictions have procompetitive effects. See Pet. App. 84a-90a. The FTC fully recognizes that self-regulation by professional organizations "may serve to regulate and promote * * * competition" by preventing deceptive practices. See Prof. Eng'rs, 435 U.S. at 696. It also acknowledged in this case that "the prevention of false and misleading advertising is indeed a laudable purpose." Pet. App. 84a. It found, however, that petitioner's advertising bans were not tailored to that purpose, but instead "swept aside" price and quality advertising with "broad strokes," without regard to its potential for deception. Id. at 89a.

Before this Court, petitioner makes two principal arguments, neither of which has merit. With respect to price advertising, the sole procompetitive theory petitioner advances is that its disclosure requirements for advertising discounts will increase the amount of information provided to consumers. (Petitioner appears to make no argument in defense of its prohibition against comparative advertising claims such as "low fees" and "reasonable fees.") Because of that potential for increased information, petitioner maintains (Br. 34-36) that a more detailed analysis of its restrictions was required. Whatever might be the merits of such a contention where disclosure requirements really do have a procompetitive potential, it cannot be sustained in this case, where (as we have explained), the FTC, employing its expertise in such matters, found that the actual effect of petitioner's onerous disclosure requirements, as they have been interpreted and enforced, is to suppress all across-the-board discounting claims. See pp. -, supra. The FTC therefore rejected petitioner's asserted procompetitive justification for its restraint only after finding it factually unsupportable.(32)

With respect to its restrictions on quality claims, petitioner submits (Br. 38-39) that it may ban all such claims because they are "potentially misleading." This Court has suggested that some quality claims by professionals about performance may well be misleading and may therefore be restricted. See Bates, 433 U.S. at 366, 383-384. The Court has not held, however, that all quality claims by professionals -- even claims that do not relate directly to the quality of performance, such as promises of punctuality and offers of a comfortable environment, designed to dispel anxiety about visiting the dentist (p. --, supra) -- are necessarily misleading. Indeed, Bates warned of the potential of overbroad advertising restrictions used to "perpetuate the market position of established [market participants]." Id. at 377-378. The Court has also admonished, with respect to state regulation of marketing by professionals, that "the free flow of commercial information is valuable enough to justify imposing on would-be regulators the costs of distinguishing the truthful from the false, the helpful from the misleading, and the harmless from the harmful." Shapero v. Kentucky

Bar Ass'n, 486 U.S. 466, 478 (1988) (internal quotation marks omitted). That admonition is even more apt in the context of industry self-regulation, where the body imposing restrictions lacks full public accountability and may be subject to incentives to adopt approaches that restrict competition.

In the present case, drawing distinctions between deceptive and nondeceptive advertising is precisely what petitioner did not do. Instead, it imposed blanket bans on useful advertising claims without regard to whether they were truthful or deceptive. Furthermore, although it had every opportunity to do so, petitioner made no effort to show any basis on which a prophylactic restraint might be justified, such as a history of abuse or false and deceptive advertisements that could not be effectively prevented by a more narrowly tailored rule. Cf. Florida Bar v. Went For It, Inc., 515 U.S. 618, 626-628 (1995). The Commission also expressly allowed petitioner to enforce "reasonable ethical guidelines * * * with respect to representations that [petitioner] reasonably believes would be false or deceptive." Pet. App. 30a. Generalized arguments about the procompetitive benefits of suppressing false and deceptive advertising therefore cannot sustain petitioner's overbroad restrictions.

**D. The Commission's Market Power Analysis Of Petitioner's Restraints Was Appropriate**

In light of the Commission's conclusions regarding the anti-competitive effects of petitioner's advertising restrictions, it did not find it necessary to perform an elaborate structural analysis of the markets in which petitioner's members conduct business. Pet. App. 78a. As the Commission noted, this Court "has indicated that when a court finds actual anticompetitive effects, no detailed examination is necessary to judge the practice unlawful." Ibid. n.19 (citing NCAA and IFD). Nevertheless, the Commission did examine market power, and it had an ample basis on which to conclude that petitioner had the ability "to impose the costs of its anticompetitive restrictions on California consumers of dental services," id. at 84a, which was the relevant determination.

The facts supporting that determination are straightforward. Fully 75% of California's practicing dentists (and 90% in one region) are members of petitioner.[(33)] Pet. App. 82a. The Commission found substantial barriers to entry and few close substitutes for the services offered by petitioner's members. Id. at 82a-83a.[(34)] It also found that petitioner had the power to require members and aspiring members to comply with the restrictions, because of the importance placed on membership by California dentists. Id. at 80a-81a. Given those findings (which the court of appeals upheld and which petitioner does not challenge here), the

Commission properly concluded that conspiring members of petitioner had the power to impose their will on the market as a whole. See id. at 84a.

The FTC was not required to approach the issue of market power as if this were a merger case. Market power analysis is not an end in itself; it is a tool to help determine whether the challenged conduct is anticompetitive. See IFD, 476 U.S. at 460. Because the anticompetitive potential of different types of conduct varies, the appropriate market power analysis varies as well. See, e.g., NCAA, 468 U.S. at 109-110; IFD, 476 U.S. at 460. Certain kinds of agreements challenged under Section 1 of the Sherman Act require an extensive structural analysis because it is not possible to reach a reasoned conclusion about the competitive effects of such agreements without an understanding of the market context. See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. at 296 (buyer cooperatives); Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 334 (1961) (exclusive dealing arrangements). Similarly, in merger cases, the antitrust tribunal must predict the competitive effect of structural changes to the market, and so the inquiry ordinarily focuses on structural issues. By contrast, in cases involving conduct deemed unlawful per se, there is generally no need for market analysis because the conduct is conclusively presumed to be anticompetitive.

Other cases fall between these two poles. NCAA, for example, involved a restraint that the Court characterized as a naked restraint on output, which could be condemned without an "elaborate industry analysis." 469 U.S. at 109. In IFD, the Court suggested that the agreement was sufficiently anticompetitive on its face to fall within the NCAA analysis. 476 U.S. at 460. It also made clear, however, that even if that were not the case, a full structural analysis of the market was not required. Ibid. In this case, the Commission and court of appeals properly relied on this Court's teaching in IFD that "the finding of actual, sustained adverse effects on competition in those areas where [petitioner's] dentists predominated, viewed in light of the reality that markets for dental services tend to be relatively localized, is legally sufficient to support a finding that the challenged restraint was unreasonable even in the absence of elaborate market analysis." 476 U.S. at 461; see also Pet. App. 24a (court of appeals noting that advertising restrictions imposed by such "large scale professional organizations" have substantial anticompetitive effects that can properly be condemned "without careful market definition") (quoting 7 P. Areeda, Antitrust Law ¶ 1503, at 377). The advertising that petitioner bans informs consumers so that they may compare competing market participants. If, as the Commission found, a combination comprising three-quarters of the practicing dentists in the State adheres to strict policies banning such advertising, then consumers

will lack the information they desire, regardless of the actions of other market participants. Accordingly, once the Commission found that the restraint had anticompetitive effects and that petitioner could inflict those effects on the market as a whole, it was amply justified in concluding that petitioner "possesses the necessary market power to impose the costs of its anticompetitive restrictions on California consumers of dental services." Pet. App. 84a.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

DEBRA A. VALENTINE
*General Counsel*

JOHN F. DALY
*Assistant General Counsel*

ELIZABETH R. HILDER
JOANNE L. LEVINE
*Attorneys*
*Federal Trade Commission*

SETH P. WAXMAN
*Solicitor General*

JOEL I. KLEIN
*Assistant Attorney General*

LAWRENCE G. WALLACE
*Deputy Solicitor General*

PAUL R.Q. WOLFSON
*Assistant to the Solicitor General*

DECEMBER 1998

1. In the last year that petitioner explicitly reported its public service expenditures, they they accounted for 7% of its annual budget. J.A. 19; Pet. App. 52a. In the same year, expenses for "direct member services" were 65% of petitioner's budget, and administration and indirect member services accounted for an additional 20 percent. Ibid.

2. Although some of petitioner's lobbying has advocated measures to promote public health, much of its lobbying has been directed at protecting members' profitability. Thus, petitioner has opposed legislation regarding mandatory health insurance coverage for part-time employees and treatment of infectious and hazardous waste, and it has supported malpractice-liability and workers' compensation reforms. Pet. App. 177a-179a.

3. One dentist testified that, to advertise an across-the-board discount, a member would have to list his regular fees for 100-300 procedures. Pet. App. 201a. A member of petitioner's Judicial Council (which is responsible for enforcing its Code of Ethics, see id. at 9a) acknowledged that to advertise an across-the-board discount in compliance with these requirements "would probably take two pages in the telephone book," and that "[n]obody is going to really advertise in that fashion." Id. at 66a.

4. For example, petitioner disapproved advertisements that offer "20% off new patients

with this ad"; "25% discount for new patients on exam x-ray & cleaning/ 1 coupon per patient/ offer expires 1-30-94"; "20% senior citizen discount; 20% military discount"; and "Complete Consultation, Exam and X-rays (if needed) * * * [for only] a $1.00 charge to you and your entire family with this coupon" before a certain date. Id. at 66a-67a, 90a n.25, 200a-202a. Dentists new to an area who sought to attract patients by advertising a "Grand Opening Special $5 exam x-ray, $15 polishing and 40% off dental treatment," or a "get acquainted offer" that "an initial consultation, complete exam, any x-rays and tooth cleaning will be done for only $5 (applies to all members of your family)" also encountered petitioner's disapproval. Id. at 77a n.18.

5. Thus, petitioner has disapproved such phrases as "personal quality dental care"; "[W]e cater to those people that demand quality, personal attention, and punctuality" (Pet. App. 204a); "you shouldn't have to wait hours or days for dental care" (id. at 205a); "my number one concern is your care and comfort"; "You'll appreciate our warm personal attention"; "State of the art dental services" (id. at 208a); "dedicated to quality dental care at low cost"; "comfortable and personalized"; "latest equipment and gentle, caring, techniques" (id. at 214a); "fully modern . . . luxurious atmosphere" (id. at 236a); "all of our handpieces (drills) are individually autoclaved for each and every patient"; and "highest standards in sterilization" (id. at 75a). For several years, petitioner disallowed advertising that a dentist offers "gentle" care, or "special care for cowards," and many local components continue to proscribe such claims. Id. at 76a, 211a-212a.

6. The excerpts of the record filed by the FTC in the court of appeals include an extensive summary of petitioner's disciplinary actions as well as a long list of the words and phrases that petitioner and its components have proscribed. See FTC Supp. E.R., Vol. I, Tab 2, and Vol. II.

7. Although the present case arises under Section 5 of the FTC Act, 15 U.S.C. 45, practices that violate Section 1 of the Sherman Antitrust Act, 15 U.S.C. 1, are necessarily "unfair methods of competition" under Section 5, and the Commission relied on Sherman Act principles in addressing the merits of this case. See Pet. App. 53a n.5; FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 454-455 (1986).

8. Petitioner maintains that the ALJ found that its advertising restrictions had "no impact on competition." See Pet. Br. 2, 6-7, 13, 15, 27, 41-42; Pet. App. 246a. In context, however, it appears that the ALJ was quoting the testimony of petitioner's own expert witness, and was not adopting that testimony as his own factual finding. See ibid. Indeed, the ALJ noted that this witness "has no expertise in, nor has he made any study of, the economic aspects of the dental market or dental advertising." Id. at 244a. Even if the ALJ did credit that witness's testimony on the impact of competition (see id. at 83a n.22), the Commission rejected such a conclusion and found that competition was harmed by petitioner's restrictions, ibid.; see pp. --, infra, and the court of appeals upheld the Commission's finding as supported by substantial evidence, see pp. --, infra; Pet. App. 23a-24a.

9. See, e.g., 7 U.S.C. 1a(5)(A)(1) (defining "commodity trading advisor" as one who, "for compensation or profit," advises others on commodity trading); 7 U.S.C. 2132(f) (defining animal "dealer" as one who "for compensation or profit" delivers animals for sale); 8 U.S.C. 1375(e)(1)(A) (Supp. II 1992) (defining "international matchmaking organization" as one that offers matrimonial services "for profit"); 18 U.S.C. 1170(a) (punishing one who "uses for profit" any Native American human remains without the right of possession); 42 U.S.C. 3604(e) (punishing one who, "[f]or profit," induces another to sell or rent a dwelling based on changes in racial composition of neighborhood); see also 12 U.S.C. 2802(4); 18 U.S.C. 31; 18 U.S.C. 921(a)(21); 18

U.S.C. 1466(b); 42 U.S.C. 2205(b); 50 U.S.C. 217.

10. Petitioner (Br. 20 n.4) and amici (ASAE Br. 10, ADA Br. 15) argue that, to qualify as tax-exempt under Section 501(c)(6), they had to satisfy that Section's requirement that "no part of [their] net earnings * * * inure[] to the benefit of any private shareholder or individual," which (they contend) necessarily means that they do not operate for the profit of their members. Under Section 501(c)(6), however, it is generally permissible for a trade association's activities to "improve[] the business conditions" of the industry as a whole, including its members, as long as such benefits are not confined to the association's members. See National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 482-484 (1979); MIB, Inc. v. Commissioner, 734 F.2d 71, 76 & n.3 (1st Cir. 1984); 26 C.F.R. 1.501(c)(6)-1. Indeed, as Section 501(c)(6) is confined to entities with common business interests (as opposed to charities, which are covered elsewhere), that Section presupposes the promotion of an industry's economic interests. Furthermore, there are significant differences between the purposes and operation of the revenue laws and the FTC Act. Cf. FTC v. Bunte Bros., 312 U.S. 349, 353 (1941) ("Translation of an implication drawn from the special aspects of one statute to a totally different statute is treacherous business"). The fact that an entity might be considered nonprofit for tax purposes does not necessarily mean that it is outside the broad enforcement reach of the FTC Act.

11. Trade Commission Bill: Letter from the Commissioner of Corporations to the Chairman of the Senate Comm. on Interstate Commerce, Transmitting Certain Suggestions Relative to the Bill (H.R. 15613) to Create a Federal Trade Commission, 63d Cong., 2d Sess. 3 (1914).

12. See, e.g., FTC v. Association of Flag Mfrs., 1 F.T.C. 55 (1918); FTC v. United States Gold Leaf Mfrs. Ass'n, 1 F.T.C. 173 (1918); FTC v. Bureau of Statistics of the Book Paper Mfrs., 1 F.T.C. 38 (1917).

13. See, e.g., FTC v. Cement Inst., 333 U.S. 683 (1948); Millinery Creator's Guild, Inc. v. FTC, 312 U.S. 469 (1941); Fashion Originators' Guild v. FTC, 312 U.S. 457 (1941); FTC v. Pacific States Paper Trade Ass'n, 273 U.S. 52 (1927); Standard Container Mfrs. Ass'n v. FTC, 119 F.2d 262 (5th Cir. 1941); California Lumbermen's Council v. FTC, 115 F.2d 178 (9th Cir. 1940), cert. denied, 312 U.S. 709 (1941).

14. Petitioner relies heavily (Br. 16-19) on the Eighth Circuit's decision in Community Blood Bank v. FTC, 405 F.2d 1011 (1969), which, it contends, supports its narrow reading of the term "profit." That decision, however, is consistent with the approach to Section 4 explained above. There the court of appeals rejected the theory that a community blood bank -- which it found to be organized for "only charitable purposes" -- could be said to earn "profit" by virtue of its retention of earnings "for its own self-perpetuation or expansion." Id. at 1016, 1022. Nonetheless, the court recognized that Section 4 does not "provide a blanket exclusion of all nonprofit" entities. Id. at 1017. It acknowledged Congress's intent to confer on the Commission jurisdiction over "trade associations," and emphasized the need for an "ad hoc" inquiry focusing on the facts of the particular organization. Id. at 1017-1019. Most significantly, it had no occasion to address the status of an entity, like the present petitioner, that is organized as a nonprofit corporation but whose activities provide pecuniary benefits to profit-making members. See also FTC v. Freeman Hosp., 69 F.3d 260, 266 (8th Cir. 1995) (characterizing Community Blood Bank as holding that only genuine charitable organizations are outside Section 4).

15. The proposal would have amended the definition of "person, partnership, or

corporation" in Section 4 "to include any individual, partnership, corporation, or other organization or legal entity." See H.R. 3816, 95th Cong. (1977), reprinted in Federal Trade Commission Amendments of 1977 and Oversight: Hearings Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess. 4, 27-28 (1977) (1977 House Hearing). The proposal therefore would have overruled the Eighth Circuit's decision in Community Blood Bank, supra.

16. Compare Community Blood Bank, supra, with National Comm'n on Egg Nutrition, supra; see also 1977 House Hearing, supra, at 82 (testimony by FTC Chairman Collier that Community Blood Bank decision "affirmed the Commission's jurisdiction over nonprofit corporations whose activities redound to the economic benefit of their shareholders or members").

We also note that, in 1982, Congress failed to pass an amendment reported out of a Senate committee that would have terminated the FTC's jurisdiction over all state-licensed professionals and their associations. See S. Rep. No. 451, 97th Cong., 2d Sess. 5-7, 34-35 (1982). Under petitioner's logic, that refusal to take action could be taken as as evidence that Congress approved of the FTC's actions in this area, especially since the minority on the committee observed that "the long list of FTC actions in this area is clearly pro-consumer and pro-competitive." Id. at 49.

17. See, e.g., FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411 (1990); Empire State Pharm. Soc'y, 114 F.T.C. 152 (1991) (boycotts against third-party payers that attempted to obtain lower prices for prescriptions).

18. See, e.g., FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986); Michigan State Med. Soc'y, 101 F.T.C. 191 (1983); Indiana Dental Ass'n, 93 F.T.C. 392 (1979).

19. See, e.g., Forbes Health Sys. Med. Staff, 94 F.T.C. 1042 (1979); Medical Serv. Corp., 88 F.T.C. 906 (1976).

20. See FTC v. National Energy Specialist Ass'n, No. 92-4210, 1993 WL 183542 (D. Kan. Apr. 29, 1993).

21. Petitioner points out that, even if it is exempt from the FTC Act, it will still be subject to antitrust scrutiny by the Department of Justice under the Sherman and Clayton Acts. The same cannot be said, however, of the FTC's authority under Section 5 to prevent deceptive practices, for which there is no analogue in the antitrust laws. Petitioner's argument would leave the FTC without authority to proceed against nonprofit trade and professional associations that disseminate false information about their services or products. Cf. National Comm'n on Egg Nutrition, supra (FTC Act used to prevent dissemination of false information about health effects of cholesterol in eggs); American Dairy Ass'n, 83 F.T.C. 518 (1973) (consent order against misrepresenting fat content or caloric value of milk).

22. With respect to the Court's affirmance in the AMA case, we note that, when it reached this Court, that case presented not only the jurisdictional question, but also the propriety of the FTC's entry of a prospective cease-and-desist order in light of ethical-rule changes adopted by the AMA after the filing of the administrative complaint. See 80-1690 FTC Br. I, 46-59.

23. Amicus American College for Advancement in Medicine (ACAM) cites the FTC's investigation into its activities as evidence that the FTC has wrongly asserted

jurisdiction over a purely eleemosynary medical society (Br. 1, 3). (The IRS master list of exempt organizations reveals that ACAM is a Section 501(c)(6) business league, not a Section 501(c)(3) charity.) On December 8, 1998, ACAM agreed to settle the FTC's charges that it made false and unsubstantiated advertising claims regarding EDTA chelation therapy for treating coronary artery disease; ACAM has agreed not to make any representation about the efficacy of such chelation therapy unless supported by competent and reliable evidence. See http://www.ftc.gov (copies of complaint and proposed settlement); see also Quackery: A $10 Billion Scandal: Hearing Before the Subcomm. on Health and Long-Term Care of the House Select Comm. on Aging, 98th Cong., 2d Sess. 96-98 (1984); United States v. Evers, 643 F.2d 1043, 1045-1046 (5th Cir. 1981).

24. As we have noted (pp. --, supra), the Commission concluded that petitioner's bans on price advertising were unlawful per se. The Commission pointed (Pet. App. 67a-69a) to substantial support in the case law for such per se treatment of advertising restrictions. Although we submit the Commission's use of the per se rule was appropriate, especially given its accumulation of experience with advertising restrictions (see id. at 71a-72a) , the Court need not reach that issue if it agrees with our submission that the Commission's analysis under the rule of reason was sufficient.

25. This Court's decision in Professional Engineers itself displayed the flexibility of the rule of reason. The Court held that the Society's ban on competitive bidding, while not "price fixing as such," "impede[d] the ordinary give and take of the market place," and "deprive[d] the customer of the ability to utilize and compare prices in selecting engineering services." 435 U.S. at 692-693 (internal quotation marks omitted). Under those circumstances, the Court ruled that "no elaborate industry analysis is required" to condemn the bidding ban under the rule of reason. Id. at 692. Moreover, the Court did so without a finding of market power. See id. at 681-682 (Society had membership of 69,000 of 325,000 registered professional engineers).

26. Arguments advanced by petitioner (Br. 27, 31) regarding the supposed need to confine "quick look" analysis to a "limited class of cases" are therefore based on a misconception of the Commission's ruling. In giving what it called a "quick look" to petitioner's restraints, the FTC did not engage in a separate category of antitrust analysis. Rather, it applied the rule of reason in the particular context of advertising restrictions, in which it has considerable expertise. That context permitted it to take into account the well-established, fundamental role of advertising in the proper functioning of a free-market economy. See pp. --, infra. Furthermore, consistent with the requirements of rule of reason analysis, the Commission considered the procompetitive justifications offered by petitioner in support of its restraints. See pp. --, infra.

27. Petitioner and amicus NCAA elsewhere appear to suggest that virtually any proffer of an ostensible procompetitive effect has the effect of necessitating a "full rule of reason analysis." Pet. Br. 37-38; NCAA Br. 16-17. The cases on which they rely, however, dealt with restrictions far afield from those in the present case, which involves the well-understood effects of a suppression of advertising of discounts and comparative price and quality claims. In United States v. Brown University, 5 F.3d 658 (3d Cir. 1993), the court was presented with novel arguments about the distribution of financial aid to students based on need that had not been previously addressed, and concluded that such arguments required extensive analysis. See id. at 669, 678-679. Vogel v. American Soc'y of Appraisers, 744 F.2d 598 (7th Cir. 1984), was an antitrust challenge to an ethical rule against a percentage-based pricing system for appraisals. The court emphasized that the ethical rule appeared to promote, rather than restrict, competition, because "[t]he apparent tendency" of the outlawed pricing system was "to

raise, not lower, the absolute level of appraisal fees." Id. at 602. Neither case suggests that an exhaustive market analysis is required whenever a defendant asserts a procompetitive theory.

28. Petitioner nonetheless speculates (Br. 36) that its member dentists, even if effectively (and unreasonably) precluded from advertising across-the-board discounts by its restrictions, should be able to comply with a requirement that advertised discounts on individual services be accompanied by a litany of disclosures. The Commission, however, exercising its expertise in the effects of advertising claims, found found that "the truthful offer of a discount from the price ordinarily charged by a dentist for services is not deceptive." Pet. App. 85a. It also noted that petitioner's restrictions went far beyond any restriction that would be necessary to prevent dentists from engaging in "chicanery" such as selectively inflating the price from which the discount is computed. Ibid.

29. Studies show that anxiety about discomfort in dental procedures is one of the principal reasons that consumers do not obtain needed dental services. See J. Elter, et al., Assessing Dental Anxiety, Dental Care Use and Oral Status in Older Adults, 128 J. Amer. Dent. Ass'n 591 (May 1997); N. Corah, et al., The Dentist-Patient Relationship: Perceived Dentist Behaviors That Reduce Patient Anxiety and Increase Satisfaction, 116 J. Amer. Dent. Ass'n 73 (Jan. 1988); N. Corah, et al., Dentists' Management of Patients' Fear and Anxiety, 110 J. Amer. Dent. Ass'n 734 (May 1985). Along with allaying concerns about pain, lower fees and a "friendlier and more caring" dentist are three of the four top factors that adults reported would make them more likely to visit a dentist. See Influences on Dental Visits, 29 ADA News 4 (Nov. 2, 1998) (citing ADA Survey Center, 1997 Survey of Consumer Attitudes and Behaviors Regarding Dental Issues).

30. Petitioner's citation to an article written by FTC Chairman Pitofsky nearly two decades ago does not advance its argument. That article emphasized the risk to consumers and the competitive process from overregulation of discount price claims "because of the special proconsumer and procompetitive effects of aggressive price competition." R. Pitofsky, Advertising Regulation and the Consumer Movement, in Issues in Advertising: The Economics of Persuasion 27, 42 (D. Tuerck ed. 1978). Thus, while Chairman Pitofsky stated that a claim of "10 percent off" may be ambiguous and therefore ignored by consumers, he also stressed that regulation of such claims "entails considerable social and economic costs," id. at 39, a proposition entirely consistent with this Court's cases on advertising restrictions.

31. Restraints on advertising, such as those in the present case, can increase a consumer's search costs in finding a dentist. The FTC has observed that agreements that increase consumer search costs are harmful to consumer welfare and form a proper concern of the antitrust laws. See Detroit Auto Dealers Ass'n, 111 F.T.C. 417, 495-496 (1989), aff'd in part and remanded, 955 F.2d 457 (6th Cir.), cert. denied, 506 U.S. 973 (1992). Furthermore, as the court of appeals recognized (Pet. App. 19a-20a), the concerted withholding of information that is of value to consumers may be viewed as a form of restriction on output. While the advertising information at issue here is not the principal output of dentists, neither were the x-rays at issue in IFD. In both cases, the information was used by consumers (or insurers acting on their behalf) to make assessments regarding the purchase of dental services. Cf. IFD, 476 U.S. at 461-462.

32. Petitioner maintains (Br. 30-31, 33) that its disclosure requirements require more extensive analysis because they are not "facially" anticompetitive (since their literal terms prohibit only false and deceptive advertising). The FTC, however, did not base its analysis on the language of Section 10 of petitioner's Code of Ethics, but rather on the actual enforcement of the advertising restrictions. As Professor Areeda noted, the

phrase "facially unreasonable" as used in antitrust cases is "reminiscent of facially unconstitutional statutes" and thus "may seem to focus attention on the words on the face of an agreement." 7 P. Areeda, Antitrust Law ¶ 1508, at 405 (1986). In fact, as he pointed out, the phrase properly refers to a restraint about which a judgment can be made based on plausible arguments about anticompetitive effects without detailed proof. Ibid. Thus, the court of appeals correctly ruled that petitioner's advertising restrictions were "facially anticompetitive" (Pet. App. 24a), even though its understanding of the nature of petitioner's restraints required an examination of its conduct in enforcing those restraints, and not merely the language of its Code of Ethics.

33. Compare IFD, where the Court affirmed the FTC's finding of an unlawful restraint of trade where 67% of the dentists in one area participated in the restraint. 476 U.S. at 451. The 75% figure in this case may actually understate petitioner's influence because its advertising strictures apply as well to affiliated employers, employees, and referral services. Pet. App. 81a.

34. The ALJ found otherwise, Pet. App. 262a, but the Commission rejected that finding as predicated on an error of law, see id. at 83a. Contrary to the view of the ALJ, market power does not require a showing of "insurmountable" barriers to entry. Cf. U.S. Dep't of Justice & FTC, Horizontal Merger Guidelines, §§ 3.1-3.4, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1997). Furthermore, although petitioner relies heavily on the rejected findings of the ALJ, the courts review the findings of the Commission, not the ALJ, and sustain the Commission's findings if they are supported by substantial evidence. See Southwest Sunsites, Inc. v. FTC, 785 F.2d 1431, 1437 (9th Cir.), cert. denied, 479 U.S. 828 (1986); see generally FCC v. Allentown Broadcasting Corp., 349 U.S. 358, 364 (1955); Universal Camera Corp. v. NLRB, 340 U.S. 474, 493 (1951).

## CERTIFICATE OF SERVICE

I, Stephen E. Morrissey, hereby certify that on August 9, 2002, I caused a copy of **RESPONDENTS' OPENING BRIEF ON APPEAL FROM DECISION AND ORDER** 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 E. MORRISSEY