THREE RECENT COMPETITION ISSUES AT THE FTC

by

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I would like to thank Larry for organizing this session and more generally for his on-going efforts to provide opportunities to get the word out to the academic community about what is going on at the agencies. Last spring, I spoke at a session like this one at the Industrial Organization Society meetings in Boston.[1] As I devoted most of my remarks then to the consumer protection activities in the Bureau of Economics, I will use my time today to talk about competition matters. As was the case for what I said about consumer protection matters last spring, what I say today about any matter – competition-related or otherwise – reflects my views. It does not necessarily reflect the views of the Federal Trade Commission or any of the individual Commissioners.

In the brief time allotted me, I'll talk about three issues. I have chosen two because they are substantively two of the most important that the Commission has been dealing with since I arrived. The other one just struck me as being a case that some of you would find interesting to use with your students.

Issue 1 concerns standard setting organizations, or SSOs. These can create a kind of Scylla and Charybdis for participating firms. One of the risks concerns the obligations to disclose patented technology. The Commission has, in recent years, brought monopolization claims against two companies for failing to disclose patents incorporated into industry standards. It brought a case against Unocal for failing to disclose its patents incorporated into the standards for the summer-spec gasoline adopted by the California Air Resources Board.[2] That case was settled as part of the Commission's review of the Chevron-Unocal merger.[3] The other case involved Rambus's behavior in the JEDEC's setting of standards for SDRAM. The Commission ruled last August that Rambus's behavior violated Section 5 of the FTC Act.[4] As the Commission has not yet ruled on penalties, I must limit what I say in public about it and refer those of you who are interested to the Commission's decision, which is available along with additional information at the FTC web site. The other major antitrust issue raised by SSOs is what a patent-holder can say or negotiate about the licensing terms it will impose if the SSO incorporates the patents it does disclose into a standard. SSOs have historically been very cautious about having any pricing discussions, as their antitrust counsels have tended to advise them that such discussions can be viewed as price fixing. In many cases, companies have simply committed to license on so-called "reasonable and non-discriminatory," or RAND, terms. It is interesting to consider what the economic meaning of RAND is. I suppose it represents a commitment not to behave opportunistically. Exactly how one is supposed to determine what that means is not a

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[1] Michael A. Salinger, "Consumer Protection Economics at the FTC," Prepared remarks for the Chief Economist Roundtable at the International Industrial Organization Conference, Boston, MA, April 8, 2006. Speech can be accessed at http://www.ftc.gov/speeches/salinger/060408ConsumerProtectionEconomicsattheFTC.pdf.

[2] *U.S. v. Union Oil Company of California*, Civil Action No. CV 96-3980-WMB (RMCx) (C.D. Cal.). Documents relating to the case can be found at: http://www.ftc.gov/os/caselist/d9305.htm.

[3] *U.S. v. Union Oil Company of California*, Civil Action No. CV 96-3980-WMB (RMCx) (C.D. Cal.). Merger settlement can be accessed at: http://www.ftc.gov/os/adjpro/d9305/050802do.pdf.

[4] Docket No. 9302 *In the Matter of Rambus Incorporated*. Documents relating to the case can be found at: http://www.ftc.gov/os/adjpro/d9302/index.htm.

trivial problem, to put it mildly. In September of 2005, Chairman Majoras gave a speech in which she said that the Commission would not view discussions of licensing terms in SSOs as per se violations of the antitrust laws but would, instead, evaluate them under a rule of reason.[5] More recently, the Department of Justice issued a business letter in which it said it would not challenge the unilateral disclosure of the maximum license fees a patent holder would charge.[6]

Issue 2 concerns the behavior of pharmaceutical companies faced with generic entry. The legislative background for understanding the issues is incentives provided by the Hatch-Waxman Act[7] for a generic to challenge the patent on a drug before it expires. When a generic company files a so-called "paragraph IV ANDA," it starts a 45-day clock during which the incumbent can challenge the implicit challenge to its patent. If the incumbent begins its suit during this period, the FDA is prevented from approving the generic drug for 30 months. Provided its product survives the incumbent's challenge and it receives FDA approval, the first generic firm to file a Paragraph IV ANDA receives a 180-day period of marketing exclusivity, during which no other generic versions of the drug at issue can be approved by the FDA. This provision of the Hatch-Waxman Act has given rise to two forms of controversial behavior. One is the terms of settlement of the patent litigation, which were at issue in the Commission's case against Schering.[8] At issue in the case was Schering's patent on an extended-release potassium supplement. Upsher Smith was the first generic firm to file a Paragraph IV ANDA, and Schering sued for infringement. Schering and Upsher Smith settled the suit with Schering paying $60 million and Upsher Smith agreeing to delay its entry into the market. Schering also received various rights to unrelated Upsher Smith products. The Commission brought suit against Schering, alleging that the combination of the payment from Schering and the agreement by Upsher Smith not to enter constituted an illegal payment not to compete. The Eleventh Circuit Court of Appeals ruled against the Commission, on the grounds that patent settlements are to be encouraged. The Supreme Court's denial of the Commission's petition for review ended that specific case, but may not have been the final word on the broader issue of the legality of patent settlements with reverse payments and restrictions on entry dates.[9] The other controversial strategy with respect to generic

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[5] Deborah Platt Majoras, "Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting," Stanford University, Stanford, California, September 23, 2005. A copy of the speech can be accessed at: http://www.ftc.gov/speeches/majoras/050923stanford.pdf

[6] Letter from the Department of Justice, Antitrust Division, Thomas O. Barnett, Assistant Attorney General to Robert A. Skitol, Esq. at Drinker, Biddle & Reath, LLP, Washington DC. Copy of the letter can be found at: http://www.usdoj.gov/atr/public/busreview/219380.htm

[7] Drug Price Competition and Patent Term Restoration Act of 1984, Pub. L. No. 98-417, 98 Stat. 1585 (codified at 15 U.S.C. §§ 68b-68c, 70b (1994); 21 U.S.C. §§ 301 note, 355, 360cc (1994); 28 U.S.C. § 2201 (1994); 35 U.S.C. §§ 156, 271, 282 (1994)). A copy of the act can be accessed at: http://thomas.loc.gov/cgi-bin/bdquery/z?d098:SN01538:@@@D&summ2=m&%7CTOM:/bss/d098query.html%7c

[8] *FTC v Schering-Plough Corporation*, No. 04-10688, and *Schering-Plough v FTC* (11th Cir. 2005) Case documents can be found at: http://www.ftc.gov/os/adjpro/d9297/index.htm.

[9] Prepared Statement of the Federal Trade Commission, "On Anticompetitive Patent Settlements in the Pharmaceutical Industry: The Benefits of A Legislative Solution," Presented by Commissioner Jon Leibowitz Before the Committee on the Judiciary of the United States Senate (January 17, 2007).

entry has been the phenomenon of authorized generics. The 180-day exclusivity period granted under Hatch-Waxman does not in any way prevent the patent holder from bringing out its own generic or granting to another generic producer a license to market a generic version of the drug. While this strategy has been available to pharmaceutical companies since passage of the Hatch-Waxman Act in 1984, it has become a more common strategy in recent years. In response to a Congressional mandate, the Commission is currently doing a study of the effects of this strategy.[10]

The last issue I will mention concerns invitations to collude. If you are looking for an interesting case to discuss with your classes, I recommend to you the Commission's complaint against Valassis.[11] The product at issue in the case was free-standing inserts – the booklets of coupons that come in Sunday newspapers. Historically, two companies each had about half the market – Valassis and News America Marketing, a subsidiary of NewsCorp. According to the complaint, in June 2001, Valassis raised its prices by 5%. When News America did not follow suit, it gained market share. With News America sticking to its old prices, Valassis decided in February 2002 to abandon its attempts to raise prices and instead to try to regain its lost market share. From February 2002 until the middle of 2004, a price war ensued, with prices dropping more than 15% from those that prevailed in June 2001. At that point, the complaint alleges, Valassis decided to give up on recovering its market share and instead decided to raise prices. It did not, however, want to repeat the experience of raising prices without having News America follow suit. As a result (again, according to the complaint), Valassis decided to communicate its plans during a stock analyst conference call. In that call, the CEO announced 1) that it was raising its prices, 2) that it would not cut prices in order to attract News America's customers, 3) that it would cut prices to whatever it had to in order to retain its existing customers, and 4) it would only stick with its strategy if News America made it clear that it was not going to try to take Valassis's existing customers. It even provided details about specific outstanding pricing offers. The text of the conference call is available as Exhibit A to the Commission's complaint in the case. I suggest you take a look at it and consider using it as case material in your courses.

The issue raised by the case is similar to the one raised by the famous telephone call by then American Airlines chairman Robert Crandall to the chairman of Braniff suggesting that they both raise prices at their Dallas hub. As the Braniff chairman did not agree, there was no Section 1 violation. Such invitations to collude have, however, been challenged under Section 2, as attempts to monopolize, as well as under Section 5 of the FTC Act.[12] Past invitation to collude cases have, however, generally involved private

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See also, Federal Trade Commission, Bureau of Competition, "Agreements Filed With the Federal Trade Commission Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003: Summary of Agreements Filed in Fiscal Year 2006: A Report by the Bureau of Competition," (January 2007). Speech and written report can be accessed at: http://www.ftc.gov/ftc/news.htm.

[10] FTC, "FTC Proposes Study of Competitive Impacts of Authorized Generic Drugs," press release, March 29, 2006, available at http://www.ftc.gov/opa/2006/03/authgenerics.htm.

[11] *In the Matter of Valassis Communications*, Inc.File No. 051 0008 Docket No. C-4160. Case documents can be found at: http://www.ftc.gov/os/caselist/0510008/0510008.htm

[12] *United States v. American Airlines, Inc.* 743 F.2d 1114 (5th Cir. 1984).

communication. The Valassis case is the first of which I am aware in which there was an allegation that a public statement was an invitation to collude.

One can debate whether public statements in general and analyst calls in particular should be treated any differently from private communication for the purposes of invitations to collude. On the one hand, discussions of pricing strategy can provide analysts with information they need to place proper valuations on stocks and thereby improve the efficiency of the capital markets. That said, if statements made in analyst calls were deemed legal provided they contained information that investors might deem relevant for valuation, then analyst conference calls would become the new "instant messenger" for invitations to collude. Indeed, as the Commission's aid to public comment pointed out, economic analysis suggests that analyst conference calls could be particularly effective media for communicating invitations to collude if doing so were legal. In private conversation, an executive might promise to raise prices and have no intention of following through. Doing so in an analyst conference call would create the risk of willfully misleading investors.

As this session is occurring at the hiring meetings, let me just close by saying what a fabulous place the Federal Trade Commission is to work. It is a place where ideas and truth really matter. I worded that last sentence carefully. I said both "ideas and truth," because the academic journals contain far too many ideas and far too many results that are not true, or at least not reliable. It is not such a big problem when the published result is an article in the *Journal of Public Policy and Marketing* suggesting that the Do Not Call List lowered economic welfare.[13] But the problem exists in even the very top journals, and the apparent authority presumed for articles in those journals makes the problem much harder to deal with. And I qualified "matter" with "really," because ideas of course matter within the university. At the agencies, though, they matter for reasons beyond tenure decisions. The FTC can be a great place for newly-minted Ph.D.s as well as for people who, for whatever, reason, have decided to leave academia. For faculty on sabbatical, we can arrange visits for a semester or a year. And there are potentially opportunities even for the most senior people. If you or your students might have some interest, let me know.

As I know Larry wanted to leave time for discussion, I'll end my comments with that. Thank you.

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[13] T. Randolph Beard and Avery M. Abernethy, "Consumer Prices and the Federal Trade Commission's 'Do-Not-Call' Program, 24 JOURNAL OF PUBLIC POLICY & MARKETING 253 (2005). For a comment, see Keith B. Anderson, "The Costs and Benefits of Do-Not-Call: A Comment on 'Consumer Prices and the Federal Trade Commission's "Do Not Call" Program' by T. Randolph Beard and Avery M Abernethy," 27 JOURNAL OF PUBLIC POLICY & MARKETING, (forthcoming, 2007).