FEDERAL TRADE COMMISSION

I N D E X

JUNE 30, 1997

FEDERAL TRADE COMMISSION

In the Matter of:)
HEARINGS ON THE)
JOINT VENTURE PROJECT)
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Monday, June 30, 1997

Room 432
Federal Trade Commission
6th and Pennsylvania Ave., NW
Washington, D.C. 20580

The above-entitled matter came on for hearing, pursuant to notice, at 10:00 a.m.

BEFORE:

ROBERT PITOFSKY, Chairman
MARY L. AZCUENAGA, Commissioner
ROSCOE B. STAREK, III, Commissioner
Federal Trade Commission
6th Street and Pennsylvania Avenue, N.W.
Washington, D.C. 20580-0000

ALSO PRESENT:

SUSAN S. DeSANTI, Director, Policy Planning

WILLIAM E. COHEN, Deputy Director, Policy Planning

LOU SILVIA, Bureau of Economics

ELIZABETH HILDER, Bureau of Competition

STEPHEN CALKINS, General Counsel

JONATHAN B. BAKER, Bureau of Economics

SPEAKERS:

LLOYD CONSTANTINE

HARVEY BOCK

EARNEST GELLHORN

STEVE SALOP

CAL GOLDMAN

P R O C E E D I N G S

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CHAIRMAN PITOFSKY: Good morning, everyone. I'd like to open our third session of public hearings on the question of joint ventures and joint venture guidelines. We have had two outstanding sessions before, and given the roster of witnesses that we have this morning, I expect an equally fine session today.

We do have five different witnesses, and therefore, since the Commissioners and Staff almost always have questions, it would be useful if you could summarize your prepared statements, which I have read and I must say are outstanding, if you could summarize your prepared statements in about ten minutes and give us a chance for a useful give and take with all of you. With that, let's get started.

Our first witness is Lloyd Constantine, managing partner of Constantine and Partners where he concentrates on antitrust counseling and litigation. Mr. Constantine is a previous Assistant Attorney General for Antitrust Enforcement for the State of New York. In addition, he served as chair of the Antitrust Task Force for the National Association of Attorneys General from '85 to '89 and has been very active in the ABA section of antitrust law and serves on the advisory board of the

BNA Antitrust and Trade Regulation Report.

He was an adjunct professor of antitrust law at Fordham University School of Law from 1989 through 1996 and a frequent lecturer and author on competition law and policy in the United States, Canada and Europe.

Lloyd, it's a great pleasure to welcome you to the FTC and to these hearings.

MR. CONSTANTINE: Thank you, Mr. Chairman. Thanks for the opportunity to testify at these hearings which are being held in conjunction with the Joint Venture Project.

The public notice for the Joint Venture Project advises that the business community is seeking guidance and clarification on how antitrust law applies to the increasing number of joint ventures, business alliances and other forms of collaborative behavior frequently involving actual or potential competitors, which often are configured in new and exotic ways.

An implicit premise is that the law in the agencies dealt well with joint ventures in the past but that new forms of collaboration, the prevalence of technology markets, may call for new antitrust standards. I think this implicit premise is false. Neither the law nor the federal agencies have done a good job in this area.

The agencies must study the significant rhetoric of their failure and learn from it before they can hope to engage in the kind of line drawing through investigation and litigation which can meaningfully address the challenge which the agencies -- which face the agencies in an era of severely diminished resources, which you have talked about a lot.

A prime and ongoing example of the failure of antitrust law and the agencies to effectively diagnose and remedy the competitive problems of large joint ventures among competitors is the treatment of Visa and Mastercard. Visa and Mastercard, as you know, are two payment system companies whose owner members are virtually identical and include every significant bank in the United States, some 6000 in number. This construct of nearly identical owner membership is called duality in the industry.

Today, these associations and their dual members exercise and abuse their market power in the market for credit cards and in the market for charge cards, a market which includes revolving credit cards and travel and entertainment cards, such as American Express cards, Diners Club cards and Carte Blanche cards.

The associations now also dominate the point of sale debit card market, having gone from a minority share to a majority share and a position of dominant market power in just three years. They have done so with products that are markedly inferior to and priced at 7 to 20 times the price of superior online point of sale debit card products such as NYCE, MAC, I think you have MOST around here, Honor, Shazam, STAR, Avail, Cash Station, et cetera.

Visa and Mastercard openly fix prices. They tie the sale of new products to dominant products. They engage in a cornucopia of blatant predatory and exclusionary acts against their competitors, and Visa in particular, setting its sights on replacing the use of currency with its so-called check cards and cash cards, proclaims that its manifest destiny is that, "Visa will be the system consumers will use for virtually every purchase and payment that they make."

This statement is from a 1990 document called Evolution of a Full-Service Consumer Payment System. It sounded hyperbolic to me seven years ago when I read it, but it's becoming a reality while the agencies become more deeply mired in the regulatory practice, guideline writing and rampant empiricism which have supplanted law enforcement through the adversarial process of litigation.

The associations were formed in the late 1960s and since at their conception there were already four widely issued and accepted national charge cards, it is questionable why so many large potential entrants were allowed to enter the market as a network joint venture, especially when Visa's predecessor had successfully entered the market under the unitary ownership of the Bank of America. In 1976, the Antitrust Division acquiesced in and effectively encouraged the system of duality by refusing to support Visa's rule, which then precluded Visa members from issuing Mastercard. This moment is generally recognized as the beginning of the end of competition in the credit card market.

By 1985, Visa and Mastercard dual members dominated the credit card market, but the agencies sat on the sidelines while the Eleventh Circuit in the NaBanco case condoned the fixing of credit card interchange fees which comprised the bulk of the discount fees charged to every retailer that accepts Visa and Mastercard credit cards. The Eleventh Circuit held that price fixing was a lawful restraint ancillary to the procompetitive joint venture of 6000 banks to issue a national general purpose credit card.

The Court reasoned that without price-fixed interchange fees, banks in the United States might not have the incentive to issue credit cards, and this came at a time when credit cards were perhaps the bank's only profitable line of business in the mid-eighties, and that was because of the annual fees and the annual percentage rates and the late fees, et cetera, that were being collected from a consuming public which was already badly addicted to revolving credit.

This judicial observation by the Eleventh Circuit was perhaps the most contemporaneously ignorant statement of fact and of the reality of the marketplace that I have ever encountered. I mean, a close second might be the Supreme Court's 1986 observation of Matsushita that the Japanese consumer electronic industry conspiracy to destroy the American industry had met with no success in 1986, a position also urged upon it by the Antitrust Division, that comes to mind, but it still fails to match NaBanco.

And when NaBanco's lawyer, Sandy Litvak, sought the support of the agencies for a cert petition, he was rebuffed. The Division then, as now, was conducting a multi-year investigation into what it termed the creeping merger of Visa and Mastercard. Back then, the Division did nothing. It still has the opportunity to act now in its current inquiry into Visa and Mastercard practices.

In the period 1986 and 1987, three major events occurred. Visa and Mastercard announced the formation of ENTREE, a joint venture designed to preempt, retard the growth and eventually dominate the then massive point of sale debit card industry, an industry already well developed in Europe and Asia but retarded in the United States because Visa and Mastercard dual members erroneously feared that plastic debit cards would cannibalize the demand for their super-competitive and super-profitable credit cards.

In 1986 and 1987, Dean Witter and American Express entered the market with Discover and with the Optima revolving credit cards, and they were subjected to several overt boycotts by Visa and Mastercard members, and the agencies just watched. When the president of Visa sent a telegram to 5500 member banks of Visa and Mastercard calling for a boycott of American Express travelers' checks, gold cards, money orders, et cetera, I said enough.

Within a week, a multi-state investigation was underway and within a month the boycott ended, but the state investigation continued, and I convened the states' Payment Systems Working Group. The states found a shocking pattern of predatory and exclusionary action by the associations and also found that the five most likely entrants into the point of sale debit card market, Cirrus, Punch List, Interlink and Visa and Mastercard themselves had all been converged into one.

In 1989, 13 states sued to enjoin the operation of ENTREE, which was abandoned by Visa and Mastercard in 1990 as part of a decree which also precluded duality in the association's point of sale debit card networks, Interlink and Maestro. Duality was precluded, that is, until May 8th, 1997, when the states unfortunately allowed the decree to expire. I commend to you a two-part article by your advisor and your colleague, David Balto, which appeared in The American Banker last month marking the sunsetting of the ENTREE decree.

Mr. Balto chronicled the wisdom of the states, the failures of federal enforcement in the article and pointed to the challenges which Visa and Mastercard dominance posed for antitrust in the future. Notably, Mr. Balto singled out the current lawsuit by a group of retailers, led by Wal-Mart, Sears, Circuit City, Safeway and The Limited, against Visa and Mastercard for tying their debit cards to their dominant credit cards as the best hope for halting the anticompetitive advance of the associations.

Mr. Balto said, and I quote, "How that litigation is resolved will have a substantial impact on whether efficiency and competition will triumph in the point of sale debit card market." An article in -- recently in Business Week struck precisely the same tone. I'm lead counsel in that case for the plaintiffs.

How do we get to this sorry state where the outcome of one private lawsuit may be the last best hope to halt the association's avowed plan to dominate every form of consumer payment in the United States? Part of the fault obviously lies with the federal antitrust agencies' policy in the 1980s, but an equal or greater part of this problem was the flawed judicial and agency view of the proper role of antitrust law relative to joint ventures.

In general and more specifically in relation to Visa and Mastercard, the courts and agencies made the following mistakes, which should not be repeated in dealing with other large joint ventures, especially network joint ventures:

They allowed and indeed encouraged these joint ventures to be over-inclusive in their membership and simply too large. While it was questionable under a proper reading of Section 7 to allow each association to form from groups of large banks, many of which were potential single-firm entrants, it was inexcusable for the Division to hasten the functional merger of Visa and

Mastercard through its inaction on duality, which has ushered in two decades of high, rigid and uniform rates.

The second mistake was to allow price fixing among the members of the associations in this case, explicit price fixing of credit card and debit card interchange fees, which functionally fixes merchant discount fees by collectively raising and stabilizing them. Joint venturers who collectively produce inputs should never be allowed to fix the price of outputs in which they compete, never. It is never justified. Calling such price fixing an ancillary restraint highlights the speciousness of the ancillary restraints doctrine and why it is, no less, a sea of doubt than the reasonable fixed price doctrine which Judge Taft intended it to supplant.

Joint venturers who are competitors in output markets should never be allowed to fix price, nor to allocate markets, nor to tie new products to dominant products, nor to collectively boycott competitors outside the joint venture when they have attained market power.

Stated another way, joint venturers should not be free of per se rules. I am aware of the Commission's antipathy to per se rules and, in particular, the Bureau of Economics' antipathy to per se rules. You need to have per se rules. You especially need per se rules in relation to your very, very diminished resources to deal with anything other than mergers.

Per se rules, application of the general per se rule to group boycotts by joint venturers that possess market power, suggest very strict scrutiny of access rules to dominant joint ventures, but more importantly suggests that antitrust should be applied to prevent the acquisition by joint ventures of dominant market power in the first place. Well, that sounds nice, but how do you accomplish that goal?

One way is to avoid the trap of perversely suspending per se rules for joint ventures under the fallacious ancillary restraints doctrine. Joint ventures need stricter rules and more careful scrutiny, not less enforcement, as Visa's general counsel, Paul Allen, recently told you at these hearings.

Another way to subject a joint venturer to a search -- another way is to subject a joint venturer to searching re-examination when it goes beyond its original purpose. Visa and Mastercard were each established to form a national general purpose credit card network, a task supposedly beyond the reach of individual members, such as Citibank, which is about to buy American Express, Chase, Wells Fargo and the Bank of America. That was an obviously and contemporaneously false assertion, but why allow the same 6000 banks to joint venture in producing point of sale debit card networks, when these are more -- when there are more than a score of examples of cheaper, superior and more efficient but less inclusive point of sale networks?

Visa and Mastercard are by no means the only example of joint venturers that have been allowed to form to engage in per se restraints, to produce products beyond their original reason for being and to leverage dominant positions from one product into another without meaningful antitrust intervention, but Visa and Mastercard are certainly the most successful at these strategies because of the failure of the agencies and the courts to apply appropriate rules to their joint activities.

The best way the Commission and the Division can give guidance to the business community about the proper application of antitrust rules to the numerous new collaborations which are regularly conceived is to draw some real lines, not by writing guidelines but through litigation involving a joint venture which has attained, maintained and sought to extend its market power through anticompetitive conduct.

The decision to litigate always says more profoundly than any other action what an agency thinks about the law and what it will do to enforce it. I am thinking, as I'm sure you are, Mr. Chairman, about the Staples case, and that is the kind of line-drawing I am talking about.

Thank you, I will be submitting a much more extensive written statement for the record.

CHAIRMAN PITOFSKY: Well, thank you very much.

Let me just say that some of the comments you made relate to matters that are now under investigation by the Department of Justice, and while it's very helpful to have some concrete examples to illuminate this discussion of joint venture guidelines, we're not here, of course, to second-guess the Department of Justice, and I just want to make that clear for the record.

Well, you have said some very provocative things here. Any questions? Who would like to start?

Commissioner?

MR. STAREK: No.

CHAIRMAN PITOFSKY: Anyone?

MS. DeSANTI: Yes, I have a question.

I'm wondering, Lloyd, if ironically there may be one point, at least, where you agree with the general counsel of Visa USA who was in here the other day speaking to us also about network joint ventures and the very difficult issues that they can raise.

His point was -- his argument was that to deter the types of over-inclusion that you raised as -- in your list of points, of problems about network joint ventures, and your first point was that the -- you felt that the antitrust policy that had been defined so far had encouraged over-inclusion, okay? His suggestion to deter that type of over-inclusion was that there should be rules for large joint ventures, dominant joint ventures, that should be the same as those for single-firm entities with respect to excluding their competitors or potential competitors.

In other words, that you would simply -- you would treat that as single-firm activity, under which it is less likely that in this example a network joint venture would be required to admit competitors or potential competitors, and thus this problem of over-inclusion that you noted might not occur.

I'm wondering what your reaction is to that proposal as a possible treatment, and if you don't agree with that, why not.

MR. CONSTANTINE: Well, obviously the Visa general counsel's comments are also -- are also directed at the current Justice Department investigation, which --

MS. DeSANTI: Well, let me -- then let me take that off the table. I don't want to talk about the current investigation.

MR. CONSTANTINE: All right.

MS. DeSANTI: But I do want to talk about the possibility that antitrust should be -- should not be hospitable to claims from would-be entrants into a network joint venture, that they should be permitted to enter.

MR. CONSTANTINE: My belief -- and I think as I tried to convey in my testimony -- is that when a joint venture has attained market power, then it is the role of antitrust and the antitrust agencies to carefully scrutinize their access rules, and I would say that at that point, when they have attained market power, probably through some failure of antitrust up until that point, that at that point, those access rules have to be carefully scrutinized, and I would think that those access rules have to be made to be open or as open as possible at that point in time.

The time to give a joint venture the ability to exclude and to treat it more like a single firm is well shorter, well earlier, than the time when the -- than the joint venture has attained a dominant market power position in the market.

CHAIRMAN PITOFSKY: Could I -- the line that attracted my attention is competitors in output markets should not be allowed to fix price. Would you say that BMI was wrongly decided?

MR. CONSTANTINE: Yes, I would, Mr. Chairman. I think that if you think about BMI, think about what the court said in BMI, the Court said, well, this might be the only way -- price fixing, and I think you and I would probably agree that it's always hard to think about what was going on there as actually price fixing, unlike the conduct -- the fixing of interchange fees, which is clearly naked price fixing, but assuming that the conduct involved in BMI sort of fits into the price-fixing box, the Court said, well, maybe that's the only way that owners of intellectual property composers can collect their fees, then we sort of should allow that to happen.

Now, that musing was rendered obsolete within a moment of time by the progress of computer technology and, indeed -- I think it was 1979 -- it was probably obsolete when uttered. It borders on being as ludicrous at the time as the statement from NaBanco which I averted to or the statement from Matsushita which I averted to. Already by 1979, computers had reached the point where -- where clearly there was a possibility of individual owners of intellectual property to negotiate on a bilateral basis their royalty fees.

But I am very, very protective of certain rules, price-fixing rules, market allocation rules, and I think it is hardly ever the case -- it is never the case, as I've stated -- it is never the case that you should allow price fixing among competitors, and I think the Commission, and with all due respect, you, will rue the day that you helped to open the Pandora's box on price fixing with the position that the Commission has taken in the Kahn amicus curiae brief. It will come back to haunt the Commission, and it will further deter the Commission in its mission.

MR. CALKINS: Lloyd, it's always good to have a little vigor and enthusiastic presentation of views. I actually researched this question over the weekend when my kid and a neighborhood kid whipped up a batch of lemonade and went out and sold it.

Now, assume that if instead of selling it at the same stand, my kid had taken this street and given the other side of the street to the neighborhood kid with an agreement that they jointly made the lemonade, and they each would go out and sell it, and they agreed that each would charge a nickel a cup and keep whatever they earned.

I assume you would not say that those producers could not agree on the price of an output, and I suspect that when you think through a variety of hypos, you wouldn't really say that it is always supposed to be per se illegal any time two producers do something that could affect price where there are a whole variety of things that make it an integrated sort of thing.

So, although I think that vigor and strong presentation of views is helpful, I suspect that at the end of the day, there probably are situations where you would be hesitant to apply a per se rule where there has been a certain amount of integration, and it would probably be helpful if one would think through a variety of those situations in the event that calmly thinking through it wouldn't say it is always per se anytime there is an output and there is an agreement that has an effect on price.

MR. CONSTANTINE: No, I did not say that there is an agreement that has an effect on price. What I said was price fixing, and we know, obviously, you and I both know the difference between price fixing, which has a particular meaning in the law, and other restraints of trade which have an effect on price. There are many restraints of trade and, indeed, all restraints of trade have an effect on price and are intended to have an effect on price, but price fixing is a particular form of restraint of trade involving fixing, stabilizing, raising, maintaining, lowering price at least until the fall -- the October term of the Court, and that is -- and that was what I was talking about.

The hypothetical conduct of your son and his friend to me is even less sympathetic than the conduct of my own alma mater, Williams College, when it entered into a specie of price fixing arrangement a number of years ago. So, I have no sympathy for that whatsoever. I have great respect in the rule against price fixing, and in all cases -- and especially -- especially in cases where the law has tolerated the formation of a joint venture to produce inputs with the expectation that that will increase competition in the market for outputs, to then allow those outputs to be fixed in price or to be subject to a market allocation scheme seems to be a perversion of the law, and it has gotten us into the trouble that I have chronicled in my remarks today but I think is generally applicable to the treatment of other large joint ventures. I have never seen a case where it is justified, never.

CHAIRMAN PITOFSKY: Well, I thought, just -- I thought I heard you say that if the product wouldn't exist but for the joint venture, as Chicago Board of Trade, that kind of case, you would accept that a joint venture that fixes output prices would be okay there, not even -- or not even there?

MR. CONSTANTINE: Well, Mr. Chairman, what I see in reading and studying cases is that the -- those would not -- would not exist but for the price fixing, would not exist but for the market allocation, generally speaking has been incorrect, you know, retro -- you know, given retrospective analysis of those cases, they -- those kinds of -- of statements have been incorrect and I think was incorrect in the BMI case.

CHAIRMAN PITOFSKY: So, you would be skeptical of the claim that --

MR. CONSTANTINE: Yes, I think right now, for example, to get into another matter which is at the -- at the Division, the Division is taking its regular chronic relook at the decrees, at the ASCAP and BMI decrees, and I think one of the things that they are asking themselves now, is this price fixing necessary or justified anymore.

My feeling is it was not justified in '79 when the Court rendered the decision. Unfortunately, what the Court did at that time was knock a hole in the previously impenetrable wall of the per se rule against price fixing and opened a Pandora's box, which led to such decisions as NaBanco, which has really been a lot more harmful in its effect, and also the Eleventh Circuit decision in Bar Review Group, Palmer v. BRG of Georgia, which the Supreme Court was forced to summarily reverse back I think in around 1990 or 1991.

So, I think that I have -- while I would hold out the theoretical possibility of the situation which you conjure up as existing, I've never seen that case yet.

CHAIRMAN PITOFSKY: Okay, but going beyond that possible case, I hear what you're saying is that no level of efficiency and no -- no matter how small the market power of the joint venture is, they ought not to have an opportunity to get together and set -- and set the market price, set the output price.

MR. CONSTANTINE: Not if the purpose of the joint venture was to -- to join together for -- to produce -- to establish and produce inputs, which were then supposed to allow them to compete more vigorously in an output market. No, I do not believe so, Mr. Chairman.

CHAIRMAN PITOFSKY: Other questions?

All right, thank you very much.

MR. CONSTANTINE: Thank you.

CHAIRMAN PITOFSKY: Our next participant is Harvey Bock, senior vice president of Morgan Stanley, Dean Witter, Discover, and general counsel of its credit services business. Before joining the company in 1990, Mr. Bock was a partner in the national law firm based in Boston with -- a national law firm based in Boston where he specialized in financial services law.

He is past chairman of the American Bar Association Subcommittee on Interstate Delivery of Consumer Financial Services and is a charter member of the American College of Consumer Financial Services Lawyers. He was lead in-house lawyer in the Mountain West investigation -- litigation between Visa and Dean Witter.

Mr. Bock, welcome to these hearings.

MR. BOCK: Thank you, Mr. Chairman. Thank you for the opportunity to speak to you this morning.

I was going to start by saying something disclaiming any coordination between my remarks and Lloyd Constantine's. Given the extent of their overlap, I think it will be obvious that two people coordinating would have taken much greater efforts to disguise the similarity of their remarks than we have.

As the Chairman indicated, I am general counsel for the credit services businesses of Morgan Stanley, Dean Witter, Discover and company. Those businesses include the Discover card, with which you are probably most familiar, which the company launched in 1985, but less familiar, perhaps, but equally important to us is our NOVUS network, which is the network that we built on the network that we had originally created for acceptance of the Discover card and announced in 1995. The NOVUS network is designed to accommodate the acceptance of multiple brands of credit cards, both cards that we issue and cards issued by third parties.

In addition to the Discover card, we currently issue four credit card brands of our own over the NOVUS network with others in the wings, but you will -- you will probably be aware that no other companies, despite our expression of interest in obtaining other issuers on our network, currently use the NOVUS network, and that fact is a direct result of the issues that I would like to discuss with you this morning concerning dominant network joint ventures.

There are many examples of dominant network joint ventures in the financial services industry. In addition to Visa and Mastercard, they include, for example, other ventures that operate automated teller machine networks, such as the MOST network in this area. They are also found in other industries, for example, local real estate associations that operate multiple listing services, but what these joint ventures have in common is that they operate networks that facilitate transactions among most of the firms in a given market. And this morning, I'd like to discuss some of the very significant antitrust issues that they present.

When I accepted the Staff's invitation to testify this morning, I didn't anticipate that I would be responding to the testimony of Visa last week, but having attended that testimony, I think you will find that my remarks respond to much of what Mr. Allen said. In particular, I take very strong issue with his assertion that a joint venture like Visa should be entitled to relaxed treatment under the antitrust law and treated for most purposes no differently than a unitary firm.

I think antitrust law very properly premises its treatment of joint ventures on the fact that they represent coordinated activity among competitors, which has the potential for harm. It is tolerated; it is, in fact, encouraged to the extent that it produces efficiencies; but it is a very different animal than a single firm, and it would be a mistake for the antitrust law not to recognize that.

With all due respect, I believe that Mr. Allen's position that antitrust scrutiny of Visa and other dominant network joint ventures needs to be relaxed has it exactly backwards. I'd like to say why this is true. I want to explain why network joint ventures present competitive issues that are different than those of other joint ventures, why network joint ventures are more likely than other joint ventures to become dominant, and why they as a result deserve special antitrust scrutiny, and what some of the types of anticompetitive conduct by dominant joint ventures are that antitrust enforcement should focus on.

Antitrust law has long recognized that joint ventures of actual or potential competitors have the potential for abusive conduct, but when those joint ventures are formed to operate networks, they deserve special scrutiny. Joint ventures can, of course, create efficiencies that enhance competition, but network joint ventures are among a small class of joint ventures that are capable of producing the special efficiencies that economists call positive externalities, and their competitive impact complicates the picture.

Positive externalities in the case of a network are the efficiencies that accrue as participation in a network grows simply as a result of the growth of the number of participants in the network. The telephone system is a standard example. A network with one telephone customer is useless; a network with a hundred customers is of some value, but its value is quite limited because of the relatively small number of connections that can be made; a network that connects all of the -- all of the households that own telephones has exponentially greater value to the participants.

These positive externalities of network joint ventures have direct implications for competition and antitrust policy, because as joint -- network joint ventures grow, these positive externalities add to their incumbency advantages and help to entrench them competitively. A prospective challenger must not only offer superior price or quality, it must in addition compete with the advantage that the incumbent enjoys simply by virtue of the number of participants that it has, and it has to overcome the reluctance that customers will have to use a network that has fewer participants.

Let me illustrate with an example from my own industry. If a firm wants to compete as a national issuer of credit cards on one of the existing networks, such as Visa or Mastercard, it can recruit customers by offering a product that is superior in price or quality, but the cards that it offers will not differ in value because of the number of people who carry them. The first card will be as useful to a cardholder as the thousandth.

Contrast that with the same firm if it wishes to enter as a network competitor in the credit card industry. Even if it offers a network service at a lower price or with improvements in quality, it has to overcome the enormous barrier to entry that arises from the fact that it starts out with none or few participants. Card issuers, merchants, cardholders will all find that network initially considerably less -- less utility-intense interests than the incumbent networks, and, of course, the larger the gap between the incumbent networks and the start-up, the higher the obstacle that it needs to overcome.

What this means is that the market mechanisms that antitrust policy typically depends upon to correct distortions in the marketplace are -- can be counted on less in the case of network joint ventures, because of the -- the barriers to entry created by these network -- positive network externalities.

These network externalities also give rise to what you might call positive feedback effect in the growth of the joint ventures, and as a result, it is not at all unusual for one network joint venturer to become dominant in a particular market. ATM networks very commonly are characterized by one dominant network in a given region.

While the side-by-side existence of the Visa and networks may at first appear to be a counter-example, it is more a case of the exception that proves the rule, because Visa and Mastercard, for the historical reasons that Lloyd Constantine just described, share nearly identical memberships, and I think one of the few points about this industry on which Visa and my company see eye to eye is that the degree of competition between Visa and Mastercard is extremely limited.

When a network is operated by a joint venture of its participants, the network is likely also to become dominant in another sense. Its owners may come to include competitors who have a dominant collective position in their own markets. This is clearly the case with respect to Visa and Mastercard. They are dominant in both senses. Visa and Mastercard collectively currently have approximately 75 percent of the market for network services, and that percentage has been growing steadily over the years, and the percentage of the card-issuing market represented by their collective memberships is actually even higher by both -- as measured both in number of cards and receivables generated from their credit card activities.

A joint venture with market dominance that is sustained by positive network externalities has enormous potential to abuse competition. For the reasons that I've mentioned, it is relatively invulnerable to competition from other networks, and in addition, its structure puts at its disposal the collective market power of its members in its efforts to limit competition.

It can marshal that resource either through informal persuasion or through explicit rulemaking, and these means can be used to the detriment of competition both in the venture's own market for network services and in its members' related markets.

Let me illustrate three ways in which this can occur. First, a dominant joint venture can restrain member-against-member competition. For example, in response to the launch and runaway success of the AT&T Universal card, I believe it was in June of 1990, Visa adopted rules that prohibited the very features that had made that card so attractive to consumers; that is, the linkage of the Visa card to their credit -- to their credit calling -- their calling card privileges with

AT&T. These rules had the effect of directly restraining competition within Visa's membership by excluding improvements in quality.

Second, a dominant network joint venture can restrain competition by nonmembers against its members. Visa did this several years ago when it responded to the launch of the Discover card by attempting to orchestrate a merchant boycott against Discover. I believe in 1995, in the course of our general counsel, Chris Edwards' testimony, she played a video in which the then head of marketing for Visa described these efforts and urged Visa's members on to go out to their merchants and to encourage them not to accept Discover. Impeding Discover card's ability to compete had the effect of directly restraining competition against Visa's members by a lower-priced nonmember.

Third, a dominant network joint venture can restrain competition in its own market by hindering competition from other networks, and in the balance of my testimony this morning, it's this type of restraint that I would like to focus on, but note that a single practice will often have effects on competition at more than one level at the same time.

Take the example of the 1986-era Visa boycott. Visa orchestrated a merchant boycott of Discover card.

It was, as I said, a restraint against competition by Discover card against Visa's members as card issuers, but it was also -- and this was expressly stated as its intent in the video clip that I referred to -- intended to send a very powerful signal to others who might be contemplating issuing cards outside of the Visa and Mastercard networks not to do so. So, it was also directed at competition at the network level.

In my remaining time this morning, I'd like to focus on two ways that dominant network joint venturers can protect themselves from competition against themselves. The first is the refusal to deal, and I refer you to the article that Dennis Carlton and Steve Salop wrote on this subject and published last year in the Harvard Journal of Law and Technology.

A dominant network joint venturer has a compelling interest in ensuring that a new entrant, particularly one that is a maverick, is unsuccessful, and it can pursue this goal by means of either of two forms of refusal to deal. It can orchestrate a group boycott by its members of the competing network or it can itself refuse to deal with the competing network.

Visa and Mastercard have done both vis-a-vis my company's NOVUS network, as well as against -- vis-a-vis American Express' network. The clearest example is the one that has already been alluded to this morning. It is the group boycott that they have -- they have organized through the rules that they have both adopted that prohibit any of their members from issuing cards on either of the NOVUS or American Express networks.

Because of the dominance of the Visa and Mastercard network joint ventures, banks cannot risk giving up Visa and Mastercard services and the price of also purchasing network services from us. So, the effect of the rules is to prevent NOVUS and American Express from offering network services to banks, that is, to the very class of customers who are in the current market, the only ones who would be in the market for the services, the network services that NOVUS and American Express would like to provide.

A dominant network joint venturer can also undermine competition by smaller networks by refusing to deal with them itself. This has also occurred. For example, Visa forbids our network and American Express' from contracting with merchants who handle Visa transactions, even though they permit Mastercard's affiliated processor to do exactly that.

Again, as -- I -- as I believe I did not mention but as is obvious, Visa and Mastercard do permit their members to issue each others' cards. In that instance and this one, the anticompetitive purpose of the restraint, that is, to restrain competition by the smaller networks, is apparent from the disparate treatment of the smaller networks in comparison with the dominant networks' treatment of one another.

The second form of potential abuse by dominant network joint venturers to the detriment of competition is the extension of their activities into new markets, a subject which Lloyd has just spoken about. It is striking that our antitrust enforcement mechanisms typically do not scrutinize changes in the scope of the activities of joint ventures. Even if the original formation of a joint venture was appropriate, there is no reason to assume that the network or other economies that justified its creation will also justify its encroachment into other markets.

Where the joint venturer has become dominant in its original area of activity, it is just as likely that its expansionism will leverage the venture's power into the new field and entrench its position in the original one. Only scrutiny of the facts of the particular case will tell, but such scrutiny simply generally does not occur.

Visa and Mastercard have expanded into a variety of new technologies and markets since their formation some 30 years ago. These include ATM networks, Visa now controls the Plus network, and Mastercard the Cirrus network, electronic transaction processing for merchants, debit card networks, as Lloyd describes, and stored value card systems.

As far as I know, with the limited exception of the state antitrust challenge that Lloyd described, which was based, as he said, not so much on the change and expansion of the network's activities as the fact that they were acting in a concerted way, there has been almost no review of that expansion.

Visa and Mastercard were created to enable a geographically fragmented banking industry to manage the clearing of credit card transactions in a paper-intensive world that as Paul Allen himself said last week bears little resemblance to today's emerging world of electronic commerce. In fact, I believe that in today's environment, networks owned by a much smaller number of companies would be more efficient and more competitive at providing these services, and they would certainly present less risk of abuse, but unless antitrust constraints are imposed, they simply cannot overcome the associations' ability to leverage their entrenched power into new markets.

In conclusion, anticompetitive conduct by dominant network joint ventures has far-reaching consequences not just for companies like mine that aspire to be effective and successful competitors but for tens of millions of affected consumers in a variety of industries. And it is my hope that these hearings will lead to more effective antitrust enforcement in this area, and we are prepared to work with the Commission and its Staff in pursuit of that goal.

Thank you.

CHAIRMAN PITOFSKY: Thank you very much.

Questions or comments?

MR. CALKINS: I hear your call for care and attention and consideration, and I was struck by the comparison with Lloyd's remark which blamed much of what he sees as a problem on the Antitrust Division, when they declined to give a lesson of nonantitrust concern with the exclusionary rules of the original Visa and Mastercard, as my recollection was that the Division was asked to give a clean bill of health on antitrust grounds, and the Division said no, we refuse to do that.

So, in a way one could say the intent was at that time, and I haven't read it and wasn't a part of it, but it sounds like the Division was at that time being concerned and being troubled, and yet Lloyd blames that inability, unwillingness to give a clean bill of health, as the source of much of the trouble.

So, if one says it's important for the antitrust agencies to be concerned, I have to hesitate, because that Antitrust Division concern led to much of what Lloyd sees as a problem. So, the question then becomes if you have these joint ventures and you have these networks, I take it that the agencies need not only to be concerned but also need some way of knowing when it is that they are supposed to be saying be more inclusive and when they are supposed to be saying be less inclusive, and I would be interested in whether you have suggestions that go beyond the concern to sort of specific guidelines as to when they should be concerned one way and when they should be concerned another way.

MR. BOCK: Let me say a couple of things. First, my recollection of the history of the Antitrust Division's response to the request from Visa is slightly different; that is, I recall -- what I recall is they objected to the rule insofar as it would prohibit members from acting as acquirers of both Visa and Mastercard transactions, but on the issue of card issuance, my recollection is that they explicitly said that that -- restrictions on duality of card issuance troubled them -- troubled them less. The focus was very much on the acquiring side.

But let me -- let me talk about this issue of inclusiveness. I am not prepared to say that the inclusiveness of network joint ventures in industries like this is necessarily inappropriate; that is, that there are clearly network efficiencies and other efficiencies which accrue from -- from these joint venturers and which drive -- drive economically towards greater inclusiveness.

It is not the -- it is not and I did not this morning intend to say that it is the scope of these joint ventures that is in itself a problem and ought to be -- ought to be blocked; rather, it is the fact that the very economic logic -- the economic logic that leads to the inclusiveness of these joint ventures creates a set of facts in which you now have entities which by virtue of their market power and the market power of their members have the capacity to do considerable harm.

They -- that power needs to be actively policed, and that is the thrust of my comments this morning, not that the inclusiveness is necessarily an issue. Certainly there will be cases where it is. I'm not sure that credit card networks are such a case, but where such networks arise through the logic of -- of the market, there is a need for -- for close antitrust oversight to ensure that they don't abuse the power that they have at their disposal.

MR. CONSTANTINE: Dave, can I take a shot since you -- since you -- since you were contrasting our testimonies?

I think the line which is one which is certainly familiar to you and to antitrust is the line of market power. A lot of rules depend upon whether or not a party has market power or does not, and I think I -- what I tried to say, but probably did not say very clearly so I will say it again, is that it seemed to me that the agencies and the law should be vigilant to -- to come down on the side of less inclusiveness, not to say under-inclusiveness, but less inclusiveness, well short of the point where a network joint venture has attained market power, but at the point of time when the network joint venture has attained market power, and that point came a long time ago with respect to these associations, mostly because of what the Antitrust Division did.

Then, it would seem to me that just as other rules depend upon whether or not an entity has market power, it would seem to me at that point the law should encourage or discourage access rules which disadvantage competitors through exclusion from the joint venture -- from the network joint venture which already has attained and exercises its market power. So, I think that's a -- that's a fairly easy line. It's well recognized, and it's utilized throughout antitrust law.

CHAIRMAN PITOFSKY: Susan?

MS. DeSANTI: Yes, I wanted to follow up on Steve Calkins' question to you, Mr. Bock.

I hear what you're saying with regard to the network externalities that you maintain make a situation more likely that network joint ventures will acquire market power and those entities therefore will require more antitrust scrutiny once they have market power, but I'm looking for more information on what your views are when network joint ventures are being formed, and I think part of Steve's question went to this, in terms of what should the guidelines be for a network joint venture as it is being formed in terms of its access rules? What -- are you in agreement with Lloyd Constantine and what he's articulated or do you have any other guidelines that you would suggest?

MR. BOCK: I don't have specific guidelines to suggest, and I would be reluctant to suggest guidelines that were not fairly specific to the -- because I think these -- the question will be somewhat fact-specific.

Lloyd -- Lloyd was raising the question of whether as a factual matter at the time of its creation it was necessary, given even the technology and other constraints at the time, for the Visa joint venture to be as inclusive as it was.

I think the -- the outcome in that case, that is, of antitrust policy as to how inclusive the joint venture should be turns very much on that type of factual question. I -- I think that the law should tolerate joint venture, encourage a joint venture to the extent that it creates efficiencies that outweigh the -- any diminution in competition as a result of the formation of the joint venture, but what that size is and where one draws that line I think can only be determined based on an examination of the facts that pertain to that particular market and the particular activities that joint venture wishes to engage in.

CHAIRMAN PITOFSKY: Other questions?

MR. COHEN: Yes, I'm interested in some of your comments on -- concern of moving from one market to another in a joint venture. If you have a situation like that, are you suggesting that we look at it as a Section 2 issue or rather as a re-assessment under Section 1 of the agreement in the context of the new market?

MR. BOCK: No, I was saying as a Section 1 issue, it strikes me that, in effect, you have got a turning point, a development from an antitrust perspective that is no different than the formation of the new joint venture. The historical fact that this same group of players has acted jointly in an existing market doesn't -- should not create a presumption that the new activity is justified in the same way that the old activity was.

CHAIRMAN PITOFSKY: Good, thank you very much.

Our next participant is an old friend and frequent participant in our -- in our hearings here at the FTC. Earnest Gellhorn is professor of law at George Mason University, teaching administrative law, government and antitrust law. Between 1966 and 1985, he taught in the law schools at Duke and the University of Virginia and served as dean at Arizona State, Case Western and University of Washington.

From 1962 to '66 and '86 to '94, Professor Gellhorn practiced law at Jones, Day, Reavis & Pogue. He is a past member of the Administrative Conference and former chair of its committee on rulemaking and past chairman of the ABA section on administrative law and regulatory practice. He is also co-editor of the Supreme Court Economic Review and author of approximately 100 articles and four books.

It's a great pleasure to welcome you here.

MR. GELLHORN: Thank you very much, Mr. Chairman.

I feel like I'm sort of out of water here, at least in terms of listening to what seems to me like the popular views of the 1960s. As one who receives constant pitches for new credit cards and owns, I think, half a dozen of them, I wasn't frankly of the view that this was a market that was badly constrained in terms of entry or in terms of competitive activity. So -- but I'm not a special pleader. I don't have a particular case in this race in terms of credit cards. I'd like to focus really more on the idea of the structure and approach of joint venture or competitor collaboration guidelines.

My written statement covers both joint ventures in the standard setting, and I thought the remarks I might make today focus really on joint ventures, and what I propose to do is comment on four things. First, the process by which joint ventures are reviewed initially. Second, the legal rules applicable to joint ventures at the time of formation. Third, the antitrust framework that would be applied to joint ventures in operation, if they are to be at all different. And then finally, to comment briefly on the transparency of the process by which this Commission adopts these rules.

I start from a really -- really basically a different premise than that which I have heard today, and that is, reading the Commission's or the Staff's policy -- competition policy report on its earlier hearings, I start from the assumption that most joint ventures serve a very valuable purpose, ought to be encouraged, as long as they operate within constraints recognized generally in antitrust. I don't start from the opposition basically to joint ventures, as much of the law does, as cases like Sealy and Topco and Timken do, and I think erroneously.

With that background, let me talk about the first issue, the issue that I would pose of the process for reviewing joint ventures. I would urge that they be reviewed in the same fashion as mergers, because what you are doing is you are creating a new entity, maybe not a formal legal entity, may not be an acquisition of assets, may not be in a corporate form, it's generally by contract, but nonetheless, creating one in which if the parties don't get substantial guidance in cases where something tends to discourage their use and may also lead to situations where the agency should be aware of what they did but were not informed, may not be reported in The Wall Street Journal, often or always, or may not be given the prominence normally required.

The current practice, I would suggest, is anomalous, as a cite borrowed from an earlier article by the Chairman, we tend to view joint ventures or review them several years into operation, whereas mergers are reviewed generally when they are formed and not very much thereafter.

Now, I want to be clear that this is not an endorsement of the merger review process necessarily as the way it is currently structured or the way it operates. I'm not addressing that issue. My point is there is, it seems to me, no good reason not to have the same process available to review both, and I would suggest that the Commission through its rulemaking could or by going to Congress expand its authority to extend the Hart-Scott-Rodino process to significant joint ventures in the same fashion as they do for the mergers.

The second point I would make, and that is that the antitrust policy or framework applied to joint ventures at the time of formation should similarly rely on the merger guidelines, subject to perhaps an adjustment for the joint venture status. I mean, the real question in the initial adoption of the joint venture is whether in those markets in which the venture is to operate this unduly concentrates it, or does this add entry, which is I think true in most cases, or does it foreclose entry from others as a consequence, which has been raised?

Generally it seems to me a bird in the hand is worth two in the bush and that therefore the presumption would be that the joint venture is beneficial, but it should, I believe, be subject to some scrutiny. The various tests under the merger guidelines, market concentration, likely adverse effects and justifications and benefits at the time and timely and likely entry, efficiencies, failure of either party and their assets to leave the industry, would seem to be all fully applicable.

Now, measurement of the market or identification of the market and measurement of market power in that situation may be difficult, but that's also often true in connection with mergers, and that there is one difference here. Joint ventures do not necessarily last as long as mergers, though mergers can be undone. It's much easier often to terminate a joint venture. They may have kick-out provisions in the contract. Its scope is not as large generally as the businesses of those who are applying. And it seeks -- and I obviously differ here slightly -- beneficial network effects.

The final point I would make under the suggestion of an antitrust framework is one in which I spent more pages in my statement than I should have, and that is I think the inadequacy -- I would urge, in fact, the inapplicability of testing the desirability of a joint venture and its legality on whether or not there is integration of operations, integration of risk-sharing or of financing. It seems to me if you look at the question of integration, it has occasionally been required in the cases and otherwise not.

I don't think there was real integration in either NCAA or in BMI, and the Court applied essentially rule of reason standards. We had very different language in Maricopa County, which I suppose would limit it to its facts, but it seems to me that whether or not there is integration doesn't really tell us anything about whether this is a cover for price fixing or a cartel or not, even though it's often been used for that.

What we have with integration, market -- or integration of the parties here is a view of the two firms, right or wrong or half dozen firms or whatever as to whether or not integration is likely to make them a more effective competitor in the marketplace, obtain cost savings or other efficiencies, or whether, in fact, it's not.

And I think at the earlier hearings I gave to the Commission an example of an unintegrated joint venture, in which I provided counsel to the participants, where what they did was they provided entry into the market and a chance to invigorate competition, but integration would have been an additional cost, which they were unwilling to pursue. It's not one, therefore, that we submitted for review by the Commission, because I thought this was a case where we would get an answer, no, followed by what was the question?

My third point, and that is that I would urge that anti -- the antitrust framework for the review of joint ventures in operation should always be under the rule of reason as long as it has passed review on formation, and that would involve -- well, there are differences obviously in how one approaches this.

First, I use the BMI framework, a facial review of the competitive merit of the conduct, a market power screen, which I would urge is always applicable, and which, in fact, I heard from the prior testimony some agreement that some might be appropriate. I like the 30 percent test in Jefferson Parish, because it's the highest number I can find among those of decisions approved by the Supreme Court. I think that's probably too low, but it seems to me one can live with that. That's at least an enormous advance. Then look at the competitive effects and other -- and efficiencies and other benefits.

It does seem to me, and I would re-emphasize this point, that the agency, if it draws up competitive collaboration guidelines, should move away, just as the merger guidelines did in the 1980s, from -- actually in the 1960s -- from cases which really no longer warrant support. Here I would start out with Sealy and Topco, which ignored market power issues, which ignored the likely benefits, which had trouble identifying actual competitive effects, as a first step.

The final point I would make is that the process by which the Commission adopts the joint venture or competitor collaboration guidelines should be an open one. You have certainly started very effectively with these hearings, hearing very disparate views today in which I guess I could say I agreed with virtually nothing that I have heard before, but I'm confident of one thing, that those who spoke before would agree with nothing with which I have said, but it seems to me that once you get to the next step and you adopt some drafts of guidelines, we ought to do something different and do, frankly, what most agencies do and what this agency does in other areas, and that is put the draft out for public comment and hear it.

It doesn't have to be a long and lengthy process, but it is a vehicle used by virtually every major administrative agency, an antitrust agency being somewhat separate in this sphere, by publishing their draft guidelines in the Federal Register and by at least allowing for notice -- for comment hearings, that is, written submissions.

I would also urge one other thing that I think is already built into the Commission's practice, and that is not only to issue draft guidelines but to issue a statement of basis and purpose which outlines the various issues that were considered, why particular lines were drawn, why particular results were to be achieved.

Well, thank you again for allowing me to use these hearings as a platform for ideas. Whether you agree or not with my testimony, I really do want to congratulate the Commission for its active pursuit of open hearings to discuss issues which frankly have not been reviewed so openly and so effectively by agencies and by willing to hear disparate views.

Thank you.

CHAIRMAN PITOFSKY: Thank you, Ernie. Let me open it up.

The -- in your testimony, the one thing that surprised me, given my knowledge of your previous writings and your statement today that joint ventures should certainly be reviewed under a rule of reason, is your proposal that the examiners, the enforcement agencies, drop the notion of less restrictive alternative. That's a staple of joint venture analysis for a long time, and it certainly is a staple of rule of reason.

Why would we do that?

MR. GELLHORN: I don't think it -- at least I don't view it as a staple of rule of reason. In other words, I view the approach being somewhat different, and that is, one looks at what is the competitive harm, the likely adverse effects that will occur from the particular conduct, what are the justifications or benefits identified.

Now, do they have to pick the best route? I think there are lots of routes usually available to competitive enterprises or to joint ventures, and I think they ought not to be put in the position of having to identify that which is the best. I think the best or the better ought not to be the enemy of the good.

The test here is, rather, have they passed the threshold of where the likely benefits and efficiencies outweigh the likely adverse effects, as either occurred in the past or will occur in the future. I think that's a tough enough decision to make. Put ourselves, however, in the position -- and this is where I guess I would suggest past decisions are often erroneous -- to say this is the best way of filling the pot. I think it's wrong, and I don't think the Supreme Court required that in BMI. It just said that this particular approach would work, and it is going to be acceptable.

MR. SALOP: That's not what they said.

CHAIRMAN PITOFSKY: Suppose that our analysis accepts your premise and we never ask that the parties pick the best, but it asks whether or not if there were some benefits and some harms, but the benefits could be achieved easily, practically, promptly, in some other way that contributes no harms whatsoever, that -- would you take that into account?

MR. GELLHORN: Well, it's clearly an exceptional case, and maybe it's the exceptional case that proves the rule. Obviously if you get one very clear in that fashion, then the question becomes it seems to me a little different. Why is it they picked this one? And it seems to me --

CHAIRMAN PITOFSKY: Exactly.

MR. GELLHORN: -- it seems to me then if you started to dig into the more likely adverse effects where the benefit is no longer or the balance is no longer there, but if the balance is still there after looking with great scrutiny at the adverse effects, then it seems to me that this is not a regulatory agency in terms of antitrust, nor is the Antitrust Division. What it is to do is to say, no, you have crossed the threshold, you have gone beyond the line, but if you haven't gone beyond the line, I would leave it open.

And the reason I do it is we basically still know only very limited amounts about competition, about the best formation and structure of the firm and the economics of the structure of the firm, which a joint venture is, is not something which I put so much confidence in I can identify what's the way to go.

CHAIRMAN PITOFSKY: Thank you.

Other questions?

COMMISSIONER AZCUENAGA: Yes, thank you Mr. Chairman.

With respect to seeking public comment on any proposed guidelines the Commission might consider issuing, I agree with you that that's an excellent idea. It has been suggested, however, that before putting them together, it might be useful, in addition to these public hearings, which are an excellent idea, for people at the Commission who are working on the guidelines to meet in a less public fashion with some of the leaders of the antitrust bar on the theory that that would allow people to be less inhibited and identify serious problems.

Would you have any concern about that as long as we ultimately issued them for public comment?

MR. GELLHORN: Well, the only concern I would have is to be attentive to the requirements of the Federal Advisory Committee Act and whether it permits you to do that, and I'm not an expert in it. Indeed, I thought it was a move that went too far, but I just caution you on that.

Other than that, it seems to me that an agency is empowered to get its information from any source, and indeed, at that point, you still haven't technically even entered the formal rulemaking stage, so there wouldn't be any constraints on that under the ex parte rules. So that I don't see any legal constraint.

Is it a good idea? I think, sure, get your information from whatever source you can, as long as you follow it up with an open process.

CHAIRMAN PITOFSKY: Other questions? Steve?

MR. CALKINS: Just a quick follow-up. Do you really mean the Federal Register or would our Internet home page be enough?

MR. GELLHORN: No, I mean the Federal Register, because that -- actually, this would be -- the guideline would be what Peter Strauss calls a publication rule, and so technically he and I would both agree that the APA requires that you put it out in the Federal Register. I know it costs the agency some money, but you can keep the pages down.

CHAIRMAN PITOFSKY: Other questions?

Bill?

MR. COHEN: Yes, in order to make one of your points more concrete, could you give some specific examples of the types of arrangements that might involve financial or operational integration or risk-sharing that you still feel would warrant rule of reason treatment?

MR. GELLHORN: The example I would give is one I have dealt with before and therefore I'm comfortable with it, but let's say you have a market in a state involving the distribution of a product. It's a market that used to have dozens of competitors, and it's now down basically on a state-wide basis to two major firms who have over 80-90 percent of the business. There are a couple who have a relatively modest share of the business, one does downstate and one does upstate. They would like to market the products that they sell together under one price in order to compete effectively with the two large, essentially integrated wholesalers.

In that circumstance, it seems to me that there is absolutely no benefit to be achieved by integration or risk-sharing. Indeed, if this venture becomes successful -- and this is what I put in the contract -- either party would have a right to buy its way out and become a separate entity once it had reached that scale.

Now, that's a very -- that's a different situation from one where the venture becomes the dominant market member. These are situations where it is not, but the -- and this raises another question, and that is, it suggests or it has been suggested that network externalities inevitably leads to first-mover advantages and difficulties of entry, and it seems to me the history of that is just the opposite, that we have enormous change in terms of market leaders, that new joint ventures come up to work their way around old ones and that, if anything, markets are not blocked except by rules imposed, frankly, from government, by government regulation.

CHAIRMAN PITOFSKY: Thank you.

Other questions?

COMMISSIONER AZCUENAGA: Just one question. I noticed Steve Salop almost waving his hand in response to the Chairman's first question, and I was wondering if there was anything that he wanted to add.

MR. SALOP: Oh, no, I'll wait. Thank you.

COMMISSIONER AZCUENAGA: Okay.

CHAIRMAN PITOFSKY: Yes, Steve?

MR. CALKINS: Your suggestion and call for increased clarity and thresholds and things like that implies that under the current approach, there are a substantial number of procompetitive joint ventures out there that are not going forward because of fear about antitrust liability or that there is some other sort of social harm being caused by insufficient clarity.

And this is a question that's come up before in these hearings, and indeed, one of our earlier speakers said that the current approach is just about right, and nothing is being discouraged, and we asked the other speakers there if they could point to specific harms flowing from uncertainty or possible over-concern about antitrust liability.

Do you have any examples?

MR. GELLHORN: Well, you're asking a little bit about the dog that didn't bark. It seems to me, inevitably if the people are too constrained, people would utilize other mechanisms, so long as there is a market opportunity. They will either merge, which -- on a long-term basis, or they will seek to do it perhaps in more costly ways. The example I just gave you is one that we tried to work our way around, but it was clearly a more extensive process.

It seems to me that that's what's likely to occur here, but no, just as I've stayed away from specific credit card examples, I would stay away from any effort to try to say an individual has enough information to identify that which would have gone forward. I don't think a businessman could answer it either.

CHAIRMAN PITOFSKY: Susan?

MS. DeSANTI: I have a question about your statement that integration and financial risk-sharing are not criteria that should be looked to as evidence of likely efficiencies.

Given that that -- that you yourself advocate in deciding how to get from per se to rule of reason looking at whether there is a legitimate basis for concluding that the collaboration is likely to produce market benefits, do you have any particular indicia in mind for how to make that distinction? That's one part of my question.

And second, would you decide that issue solely on the basis of arguments at that point or would you be looking for specific evidence?

MR. GELLHORN: Answering the first, what I'm saying is that integration itself or the label of risk-sharing or integration of operations or integration of finances tells us nothing and ought not to be a label or an excuse or a justification for making a distinction, and here I think the best illustration is the health care guidelines and the health care decisions often which I find inexplicable or undesirable.

So that I would say one would look at what are the harms that are likely to occur, what are the benefits that are likely to occur, without regard to the label of whether or not the parties have thrown assets into the venture, given up some of their individual autonomy on price-making, et cetera.

Second, moving to your second question, would you rely solely on argument or would you look to evidence, it seems to me that generally we look to what evidence parties can submit, but that also involves argument about that evidence and its significance, why it has an impact, why it's likely to lead to particular efficiencies, lower costs, et cetera.

COMMISSIONER AZCUENAGA: I guess I'm asking, though -- in that context, if you're not looking at integration, is there anything you would look to to -- as a substitute to just determine the likelihood of competitive benefits from a collaboration? Are there any short-cuts is another way to put it.

MR. GELLHORN: Well, the primary short-cut frankly is market power. If the parties don't have market power, then it seems to me there is no anti -- significant antitrust concern and it ought to be forgotten at that point, but beyond that, no, I don't think there are short-cuts.

I think you have to look at what are the claimed purposes of the agreement, what relationship those claims have to the market that they are seeking to enter, what are the claims on the other side of adverse effects, and what kind of evidence do they rely upon? And I suppose at that point I'd be happy to look at Steve Salop's decision tree and see if I could figure out what it really means.

CHAIRMAN PITOFSKY: John?

MR. BAKER: One more question on this area of financial integration. I take your argument to be that if the firms are -- in the joint venture are not integrated that there is no reason to assume that's a bad thing, and it could be a good thing.

MR. GELLHORN: Um-hum.

MR. BAKER: If the firms are financially integrated, would you presume that there are some efficiencies, and perhaps there could be something bad going on, as well, but -- that is, could -- so that if you're -- if you're worried about the dangers of avoiding a sham joint venture, if you are looking at that from an enforcement agency, couldn't the illustration used be the one that puts something in a box, these ones are not likely to be sham, maybe they are bad on balance, but these are not likely to be sham, but the ones we ought to look at more closely are the integrated?

MR. GELLHORN: Well, it's appealing, and I suppose papering over some of the riffs in the cases, which those who draft the guidelines will inevitably have to face, so my initial reaction is that's intriguing, and I wouldn't ignore it.

On the other hand, I wouldn't make it a very heavy thumb on the scale, because one of the advantages of not having integration is that the venture may be of shorter duration, it may have more split-offs, and as a consequence, it has the ability for the future to create more competition. To the degree to which you push the parties more toward merger, while divestiture is not unknown and we constantly see it in the market, it is costly. And so I'm not certain that -- even that that's a good idea, because it tends to encourage parties to do that which is not necessarily beneficial, but it's an interesting idea.

MR. BAKER: Okay.

CHAIRMAN PITOFSKY: Thank you.

MS. HILDER: I just have one question that's again on this same issue of distinguishing between something which is truly a joint venture and something which is not and grasping around for something to hang on to, and you had mentioned market power as something to look at fairly early on, and I guess one question about that is obviously the difficulties in doing that and whether -- even if one takes sort of a percentage cut-off, how do you decide what the market is, and if you have got any guidance on that issue.

MR. GELLHORN: Better heads than mine have certainly struggled with that without any clear answer. It seems to me, however, that it's really not different from how you decide what the market is in the merger and how you determine market share, and indeed, one of the difficulties when you have a merger is the merging parties may be in several different markets. So, how do you weigh each of them in balance?

You tend to answer it by something I don't particularly approve of, and that's the fix-it-first approach, where the agencies become one of the negotiating parties to some degree, a rule that I don't think the government is well suited for.

I would suggest that if anything, the drawing of a market may be easier in connection with a joint venture. What's -- at least in the beginning, what's it proposing to do? Who else is in that particular field? The boundaries are always different in drawing markets, but I don't see anything unique about joint ventures on that scope.

Now, if we're talking about -- and that's the second stage -- drawing the market and its operation of the parties once it's been in business and achieved some success, then it seems to me that itself is going to give you a fair amount of information and probably is one of information overload.

MS. HILDER: I guess the only question is we have put a lot of resources into the market power assessment in the merger area because we're presuming up front that there are efficiencies that flow from it and we're confronted with this -- this collaboration, whatever it is, and trying to decide whether or not it's even worth going down that road and putting the resources into measuring market power.

MR. GELLHORN: Well, I'm not certain that we -- that I'd accept the premise that we put a lot of emphasis on market power because we assume that mergers are efficient. I would say that instead there are many reasons for a merger. Now, one clearly is just to buy out the owners who want to get liquid assets.

We start from the premise that mergers are desirable because they have substantial economic efficiency opportunities, and if you can't get out of a market, you're less likely to want to go into a market. So, mergers provide opportunities for exit as well as entry.

It seems to me that joint ventures operate on the same basis, and indeed, I read the hearings -- was it last fall or two years ago when you first started this round as giving you a fair amount of evidence that joint ventures really were an effective device for entering into this global marketplace that's changing technology.

CHAIRMAN PITOFSKY: Susan?

MS. DeSANTI: Yeah, I want to follow up with a more general question about your testimony and where I infer it to go and see whether I'm on the right track in understanding it.

In general, your testimony seems to have an underlying premise that you sort of take a worst case example of a joint venture and almost say, well, assume it's a merger, if a merger would not be problematic here, then a joint venture is unlikely to be problematic, as well, but my sense of that is that it ignores certain spill-over effects, certain possibilities for collusion between the parties that although from a purely market power perspective might not seem troubling to an economist, might seem troubling to an antitrust law enforcer from the outlook of deterrents and having specific rules that firms should follow always, regardless, regarding how they interact with their competitors.

And I'm wondering whether you can speak to how your analysis has implications in that context.

MR. GELLHORN: Well, the way I would view it is once a joint venture, for example, is in operation, and the question then comes has it -- has it misused its position as a joint venture because of the rules they have adopted? Some of the suggestions earlier about exclusionary conduct.

The question I would ask is or the answer I would give, despite Lloyd Constantine's very opposite approach, is to look at whether or not the particular rule under examination is one that was a necessary or an important part of the joint venture, or whether it appears really not to have related to the joint venture but rather was an effort to achieve another end.

And this is a very traditional, ancillary restraints type analysis. I think the most recent clearest opinion on that is Judge Bork's in Rothery, where he went through that process and analyzed why -- the benefits of the particular rule, and one of the questions here would be did they have a free rider problem, is that what they are addressing, or are they really just trying to "leverage" their market power in a way in which they otherwise couldn't do?

So that I wouldn't necessarily be either more or less hospitable to those operational rules.

CHAIRMAN PITOFSKY: I think this is a good point to take a short recess. Let's take a ten-minute break, and then we will resume.

(A brief recess was taken.)

COMMISSIONER AZCUENAGA: Chairman Pitofsky has asked me if he was unable to make it back for this part of the session to introduce the next two speakers, and it's my great pleasure. As I told most of you at the last set of hearings, I missed almost all of the witnesses, because I was serving a three-month stint as a juror over here in the D.C. local courts. So, I was -- I learned a great deal from that, I hope, and I'm sorry to miss you. So, it's my pleasure to see some of you today.

The next speaker is Steve Salop, a familiar friend here. He is professor of economics and law at Georgetown University. He has also served on the board of directors of Charles River Associates. From 1990 to 1991, Professor Salop was a guest scholar at Brookings Institute, and in the spring of 1986, he was a visiting professor at MIT.

Before joining the Georgetown faculty in 1982, Professor Salop held various positions in the Bureau of Economics at the Federal Trade Commission, including the positions of associate director of special projects and assistant director for industry analysis.

So, welcome back, Steve.

MR. SALOP: Thank you.

I'm in a peculiar position today. I'm here as the designated academic talking about the clean sheet approach to joint venture analysis. At the same time, I've written on many of the issues that people have talked about, including I was involved in the Visa-Dean Witter case, and I have written an article with Dennis Carlton. I have also written on interchange fee setting as price fixing on the NaBanco -- on the NaBanco case and on ATM networks that was mentioned earlier. That was a case in which it was argued that firms that set interchange fees is price fixing absent surcharges.

So, I'm happy to talk about that -- that later in the question and answer session -- section, but what I am going to talk about in my 15 minutes is the use of decision theory in formulating antitrust rules.

There has been a lot of -- a lot of cases written, a lot of cases, a lot of articles, on the use of truncated rule of reason. The Commission has had a number of important opinions on that. Per se rules, quick look, so on, cases in the Supreme Court, cases like NCAA and Trial Lawyers at the Commission, Mass Board, Cal Dental and so on. There has also been rules and commentary on market power as a filter versus efficiency as a filter.

Now, most discussion of these rules has been what I would refer to as formal and interpretive, interpretive in the sense that the Court or the commentator starts off with a view of what did the Supreme Court mean in NCAA and Trial Lawyers, what did they mean for us to do here? Formal in the sense that, well, if we view price fixing as per se illegal, then what are the implications of that for a collusive joint venture or an exclusional joint venture, like Visa? Similarly, in retail price maintenance, RPM starts as a formalistic rule and then it's extended to maximum RPM by extending the formalism to there.

And I took a different approach here. I said let's begin with -- with economic analysis of decision making under uncertainty, that is decision theory, and ask what -- what does decision theory have to say about the types of antitrust standards that we should have. And it is really kind of -- the paper that I've given you is really a first step rather than stating what the best rule should be in every circumstance. Instead, what I've done was tried to rationalize all of the alternative standards that courts and the Commission have set out, and then use that rationalization that can form the basis of many empirical analyses to see whether the assumptions necessary to make that rationalization correct, in fact, hold up.

And then I have also suggested some changes, but that has really been kind of secondary to the paper. I really thought that would be really what you would do in the course of rendering your staff report and your

Federal Register notice and so on.

So, let me start with decision theory and then talk a little bit about decision theory and then go on and talk about antitrust standards.

Decision theory starts from the premise that decision makers, all decision makers, whether it's firms, individuals or commissions, face imperfect information, and that imperfect information can never be eliminated. You will always be in an imperfect information situation.

However, you can resolve some of the uncertainty that you face by collecting information. Unfortunately, the collection of that information is costly in dollars both for you and for the parties, and in time, as well. And, of course, when you inflict information costs on the parties, as a court or commission, you are cognizant of the fact that real resources are being used up.

Now, given that information is imperfect, a court or an individual must accept the potential that the decision may turn out to be erroneous after the fact, and that's just a fact of life, that it may turn out that you made a mistake; however, what you have to do is try to do the best you can with the information available so that you don't make a mistake from an ex ante point of view. You have to make a rational decision ex ante even though it may turn out to be erroneous ex post.

How do you do that? You balance the potential errors, the errors for -- you know, if you find for the plaintiff, there may -- or you enjoin conduct, it's possible that that was incorrect. On the other hand, if you go the other way and find for the defendant, allow the conduct, that may have been an error, as well, and you need to balance off the probabilities and magnitudes of harm against the -- on either side.

Now, that immediately leads to kind of an interesting and rather counter-intuitive result. Suppose as a commission you think there is some probability that -- suppose you -- suppose the defendant's claiming that the -- that net the conduct will lead to benefits of, say, of a hundred million dollars, and suppose you think that the defendant's correct, say with probability of 75 percent, suppose you're pretty sure that the defendant's estimate is correct, but suppose the staff's estimate is not that this conduct will lead to benefits but will lead to harm, and suppose the staff's estimate is that it's going to lead to a billion dollars of harm, ten times the benefit that the defendant claims, but the staff's only right with probability 25 percent. Suppose you think one or the other has to be right, which way should you find?

Well, intuitively, you would say, well, gee, we should certainly find for the defendant, because the probability that the defendant is right is 75 percent; however, decision theory would say, actually, it's much harder. You should find for the plaintiff in that case, because although it's more likely that the defendant's correct, if the plaintiff turns out to be correct and you find for the defendant, the losses are huge, ten times. So, on an expected value basis, you actually should find for the plaintiff, for the staff in that case.

So, decision theory tells you to balance off not just the probability, not just the preponderance of the evidence, but also the cost of errors. What you really want to do is look at the social costs of each type of errors.

The second point is that once you recognize that information is costly, and now I'm getting to the issue of truncation in the analysis, you should only gather information in the situation where the benefits of that information exceed the costs. Otherwise, it's better to make the decision on a summary basis, on the basis of limited information, rather than go ahead and inflict the costs on the parties and on yourself of -- of gathering that information. And this gets into the whole question of per se rules on Mass Board, quick look, rule of reason and so on, that I'll talk about in a little more detail in a minute.

The third point, I guess if you are going to do -- if you are only going to collect partial information, what information should you collect? Well, it seems straightforward, if decision theory holds up, that you should collect the information that's lower cost. If you have got two types of information that will give you equal benefits, take the one with the lower costs, but what -- suppose they have got the same costs, what should you do or what's the other balance?

Well, the information that's got the largest benefits is the information that's most likely to dispose of the case. This was a point initially made by Bill Landis in his article. The reason why you want to take information that allows you to dispose of the case is because you then save the cost of gathering information on the other issue.

And when I say dispose of the case, I don't mean necessarily find for the defendant. You can dispose of the case on a summary basis for the plaintiff or the defendant. So, the issue that you should look at if you're only going to look at one issue or the issue you should look at first would be the issue that resolves the most uncertainty, the one that you're most uncertain about.

So that if you think that the benefits of conduct are, say, between 150 million and 160 million, you're not sure where, and if you do further analysis, you'll be able to calibrate it where between 150 million and 160 million it is, but suppose the harms, the uncertainty about the harms, is much greater. Suppose you think the harm is somewhere between 50 million and 500 million? In that case, if it's equally costly, equally difficult to look at either issue, you should look at harm first. You should do market power as a filter, because there is much more uncertainty.

Once you -- once you found out about market power, unless it happened to turn out to be that small range of 150 to 160, you can resolve the case without looking at benefits, by just relying on presumption of benefits, whereas if you looked at benefits first and calibrated, oh, it's exactly 157.4, then you are still going to need to look at market power. So, you gain nothing by looking at efficiency first in that example. You should look at market power.

So, the idea is that you should gather

information sequentially. After you gather some information, you should then go on and decide whether to resolve the case on the basis of that limited information or then go on, and you could look at either issue first, efficiency or market power, and in some circumstances, you could gather a little bit of information on both issues, on efficiency and market power, rather than going all the way on efficiency or all the way on market power. And again, all of this would depend on the relative costs and benefits of looking at different information.

And now, to try to explain this, even to someone -- based on everything that Ernie said, I can see it's going to be very hard to explain it to him --

MR. GELLHORN: I'll hang in there.

MR. SALOP: -- I have just drawn this little decision tree, and not -- just to use to help me a little bit, the rule of reason is a case in which we gather information on benefits and harms -- by benefits, by the way, I mean what would be the efficiency benefits absent any market power harms. So, it's just gross. And by harms, I mean what would be the anticompetitive effect absent any efficiency benefits, okay? So, that's also gross. And then net welfare effect under the consumer welfare standard is then benefits -- balancing benefits and harms.

So, the rule of reason, we gather -- classic rule of reason, we gather information on benefits and harms, and then you make your decision, either find for the defendant or find for the plaintiff, or if you're the Commission, where you're the plaintiff, so it's kind of embarrassing to say you're finding for yourself, you either permit the conduct or prohibit the conduct, okay?

And I really want to work with this second one. So, now, when the classical rule of reason makes the most sense is when there is economies in scope in gathering the information, that when you gather information on market power, that also tells you something about efficiencies, and when you gather information on efficiencies, it also tells you about market power.

Or secondly, where there is a lot of -- about the same amount of -- just a lot of uncertainty on each issue, so you need to resolve both, and you know that before you start, or the costs are very low, where it's pretty easy. But I think the main -- where it really bites is where you think there is economies of scale -- economies of scope in gathering the two kinds of information.

Like sometimes we say, well, gee, if there is no market power, not only does that reduce the likelihood that there is going to be anticompetitive effect, that's Ernie's point, but also, Frank Easterbrook's point would be where you don't have market power, then it must be that the conduct is procompetitive. They must have efficiency benefits in mind. So, there you're gathering sort of the market power tells you about both harms and benefits, okay? So, that's really good information to look at first, because you get a big bang for a buck.

Okay, well, if you don't do classical rule of reason, what's the other extreme? Well, the other extreme would be per se illegality, that you start off, and in the stage one here is where you have an initial characterization, what's written in the complaint, what you know to be true, what you know about that type of conduct, and we often call things per se illegal, which is prohibiting on the basis of no additional information, just the initial characterization.

So, you do -- when is it appropriate to do per se illegality? Well, where you have a strong presumption, where based on your initial information, you are fairly certain that the conduct is going to be net anticompetitive, and where it's very costly for you to resolve the uncertainty by gathering more information, and that's basically what the courts have said. And you recognize that sometimes when you do -- when you call it per se illegal, it is going to be a mistake, that it will not be the appropriate solution.

Okay, well, similarly, where the cost of information is high relative to the benefits of information, that doesn't mean that you only hold things per se illegal. There could be -- you could find for the plaintiff -- for the -- excuse me, for the defendant at that point, permit the conduct on the basis of just presumptive information, per se legality, okay? And we do that in certain conduct -- in certain conduct, as well.

If you're a law firm, even though you're setting prices, we say presumptively that -- we are not even going to have a proceeding about that. We are just going to say that it is legal, okay?

Now, in most cases, though, we don't stop -- we say, gee, there is benefits to gathering some information, and -- but we don't always go all the way to collecting all the information on both issues. You go to some kind of truncated rule of reason, and what the courts seem to be saying in NCAA and what the Commission said in Mass Board was -- and I want to skip this step four for a minute -- we get to some point where we are going to get some information, so we are at this step five, and should we -- the choice really is should we gather information on both issues and go the classical rule of reason, or should we truncate?

We could truncate either by using market power as a filler, what Gellhorn wants to do or what Easterbrook wants to do, and look at the potential for harm, or should you hold that in abeyance for a moment and gather information on benefits? So, in Mass Board, we say if a -- if conduct is characterized -- that's here, back at the characterization stage -- as inherently suspect, then the first thing we want to do is analyze the benefits, okay?

And on the basis of the analysis of the benefits, we may reject those benefits, in which case we prohibit the conduct, okay, so you gather information on the benefits. If you find the benefits are low, and there we use something like less restrictive alternative, reasonably necessary, reasonable necessity standard, we just reject it, or alternatively, if you do find some benefits, then you go on and you gather information on harm. That is, you go essentially to the rule of reason. Okay?

Now, note there is a third branch here on my little picture, and that is you could on the basis of the benefit information decide to permit the conduct summarily. That is, if you do this Mass Board analysis and you find the benefits are really high, you might say, it's not worth it to gather information on market power. We are just going to allow this. So, that's one way you might want to go.

Now, similarly, instead of doing benefits, with other areas of antitrust, the first thing you do is analyze harm, okay? You decide it's better to analyze harm, and then you have the same sort of choices, okay? Which is appropriate, first -- should you do benefits first or harm first? Well, it depends on the degree of uncertainty and the costs.

Mass Board, NCAA are premised on a view that it's difficult to measure market power harms relative to how easy it is to evaluate efficiency benefits, and that's what Liz was -- Liz Hilder was talking about earlier, that if it's very -- if you think it's very hard to measure particular market power but not so hard to measure efficiency benefits, then you probably ought to look at efficiency benefits first, and what's peculiar and counter-intuitive is the Chicago types all want to say it's easier to measure efficiency benefits. In fact, the implication of that is that you should look at efficiency first, that you should go to -- to the truncated -- more the quick look, not market power as a filter.

By contrast, the people that say -- that say, gee, it's easy to measure market power, then that says you should use market power as a filter, okay? So, really very, very counter-intuitive.

Now, another element, and I sort of -- my interpretation of the recent Commission controversy in Cal Dental, although I must say other people could have different views of this, has to do with something that I call the recharacterization stage, that so far I've said either you gather lots of information about benefits and harms, as in the classical rule of reason, or you truncate and then you either look at benefits first or harms first, and what's optimal is going to depend on the relative costs and benefits, but very often it seems to me you can get very low-cost information on benefits and harms just from observations, judicial notice, and you ought to use that information.

In other words, I don't think it makes sense -- take a situation just -- I have an example in my paper much like Steve Calkins' son, and that is suppose you have two farmers, and one night at the grange, the two farmers are overheard agreeing to fix the price that they are going to sell wheat to the local grain elevator, and they are overheard by some overzealous staffer from the Division or the Agency, and they admit that they have agreed to set price, and they say the reason they want to do is to protest USDA policies, okay, and that is going to make them feel good and maybe -- who knows, you know, maybe some senator will grab hold of it and they will -- they will -- they will get policy changed.

Okay, now, if you just apply Mass Board to this or NCAA, you are going to say, okay, we have an agreement to fix price, so gee, well, the Supreme Court said we go to immediately look at benefits, what are the benefits here? Well, these guys are -- it's going to make them feel good, they are going to protest USDA. Well, that doesn't count. So, that efficiency claim is -- is irrelevant, and so this conduct is found to be illegal. It's enjoined, okay?

Now, the farmers come in, and they say, look, these are two farmers, and they each have seven hectars, okay? They couldn't possibly cause any harm. What should you do with that information? Okay, you could say, oh, yeah, well, there could be a transitory effect, right, that's the trial lawyers' cheat, okay? Or you could say the Supreme Court told us not to look at this information, you know, we're supposed to -- we read

NCAA, we read Calvani, and we're supposed to go directly to benefits. This is definitely inherently suspect, okay?

Decision theory would say that's crazy. Here's this obvious low-cost information. The chances of there being market power in this case are zero. Why not use that information? So, you could use that information, recharacterize this case, and say based on the recharacterization, what we know now, there are some -- there are personal benefits. They may not be social benefits, but it's making these guys feel good, and there is no chance of anticompetitive effect. So, why not just permit the conduct here at stage four?

Or you could get that -- that information and you could -- you know, it's possible that you go the other way. Gee, based on that information, we will just prohibit it.

So, two points. One is I read part of Pitofsky's opinion in Cal Dental, and he's not here to say, you know, he didn't mean that, as saying I want to -- I want to gather a little bit of information and recharacterize, and at the same time, I read a lot of the controversy within the Commission, you know, that part that gets to us on the outside through FTC Watch, as saying through Commission practice, there has been a systematic attempt by some members of the staff to take us immediately to the -- to the inherently suspect branch up here and ignore, not permit, the Commission to take judicial notice of very obvious low-cost information about lack of market power with respect to some of these professional associations.

So, what I'm saying is decision theory allows you, within the spirit of -- within the spirit of NCAA or Mass Board, to use that low-cost information on lack of market power in order to dispose of the cases at this early stage. And I say legally, I try to be very impractical in this -- in this paper, but I think as a legal matter, using inherently suspect, you can say an agreement to fix prices by two farmers in one county, two small farmers in one county of Iowa is not inherently suspect. I mean there is no reason why you can't make that declaration.

And I'm saying this approach of kind of getting the low-cost information first is an approach that I originally learned from Professor Kauper, who had an article maybe 10 or 15 years ago on the quick look, and he suggested there quite, quite strongly that what you should always do is look at the lowest cost information first, whatever that is. Sometimes that will be market power, sometimes that will be efficiency, sometimes it will be -- it will be a combination.

The other point I would say is you should always be cognizant of the fact that after you gather partial information, you can go and do the counter-intuitive thing. You could permit -- permit up here or down here, you know, sometimes you look at harm, you find out there is market power harm, but you don't necessarily then have to measure efficiency benefits. You could decide as a summary basis to prohibit at that point. And that would be a case like you go back and look at the old, old vertical basis, long before the sixties, you know, a case like Standard Stations. What the courts did there was they said where there is market power, vertical restraints are likely to be net anticompetitive, so we are not even going to allow them to defend on efficiency benefits.

So, that's the basic story. I'm happy to try to interpret the various things that Ernie Gellhorn said and Paul Allen at Visa and Evans and Schmalenzy, as well, in the questions.

I guess the other thing I would say is sort of Evans and Schmalenzy, who testified last week or so, who commented on Carlton-Salop -- the Carlton-Salop paper, I would say they apparently followed the decision theoretic approach of deciding that our paper wasn't any good before -- without the need to understand it, because that would have been more costly for them.

Thank you.

COMMISSIONER AZCUENAGA: Thank you very much, Steve. Economists, no matter who they are, always make some compelling points, and I think you have made a number of points that certainly I think merit attention.

Before opening up to questions for a few minutes, I would like to dispel the notion of controversy inside the Commission and stand up for our staff. I think that under the Mass Board approach, we did have a lot of confusion about exactly where it was going, and I think that's partly the result of the fact that we develop our cases very slowly through opinions and didn't have many opportunities to interpret Mass Board before we finally decided to get rid of it, and I think that the staff and everyone who contributed to that analysis did it in good faith, and we just had a hard time working through it. I think it was a good effort, however.

Having said that, let me see if there are -- I think we will take a few questions, and then because we are running a little behind schedule, turn to Cal Goldman, and then wrap it up with final questions overall.

MR. SILVIA: I did notice that in -- looking at the thing about harms and benefits and the relative costs and collecting information about market power versus efficiencies that with respect to merger analysis, certainly, when one looks at the merger guidelines, almost all of -- a good chunk of that, the majority of the guidelines, go to the market power type questions, which suggests that perhaps in the merger context that generally the costs of getting information about market power is low relative to efficiencies.

I don't know if you would agree with that as, you know, a general observation, but if that is so, why wouldn't the same presumption hold for joint venture analysis and all harms/benefits analysis, that we should always go along the same path in the decision tree as we do with mergers?

MR. SALOP: You know, I think if you would have this effort after the '82 guidelines -- the '82 merger guidelines where efficiencies were never really used, that's -- the '82 guidelines, the '84 guidelines definitely represented the presumption that it was a lot easier to measure market power than it was to measure efficiencies.

Now, under the, you know, I guess version 3.1 of the merger guidelines, you know, after the 1996 revision, I don't think you can say that anymore. It's now my understanding that the Government has concluded that it's just as easy to measure efficiencies as it is market power, because they are both in there with -- with appropriate weight. I don't think the fact that one section has -- takes up 11 pages and the other section takes up only one page means that it's easier to do market power than efficiencies. I think it's an issue of kind of there is no longer any sequencing. You look at -- now the rule is you look at market power and efficiencies at the same time, not -- no type of sequential decision making. And so no, I wouldn't say that it now reflects, you know, a bias towards market power.

Secondly, it's also not true that the rule that's good for mergers is necessarily the rule that's good for joint ventures. I mean, as a general matter. For example, we have very different rules with respect to horizontal price restraints than we do from unilateral vertical nonprice restraints. The Supreme Court said in GTE Sylvania that vertical -- that unilateral vertical nonprice restraints, unilateral in the horizontal sense, I mean, with the vertical agreement, they are virtually always going to lead to efficiency benefits, and so there you measure market power first, whereas horizontal price restraints, there we think -- sort of the traditional jurisprudence is that joint price setting by competitors almost always is anticompetitive. It's exceptional that there is going to be any efficiency benefits, and with that presumption, you ought to look at efficiencies first.

I personally think that in situations -- I mean, I could not disagree more strongly with Ernie Gellhorn. I think that you need to analyze the efficiency benefits relative to reasonable alternatives, because otherwise -- and this might go beyond the scope of my paper -- otherwise, the joint venturers, where they want to engage in anticompetitive joint ventures, they will just bundle it with some procompetitive effects, so that they will get all the benefits without letting any of the benefits accrue to consumers. I mean, it's an agenda manipulation issue.

So, you have to say, okay, if we don't allow you to do it this way, how -- what reasonable way would you carry out the joint venture, and where that reasonable alternative is one that does not lead to any market power harms to consumers, that's definitely preferred from an antitrust point of view.

COMMISSIONER AZCUENAGA: Jonathan?

MR. BAKER: Let me ask you a question which comes from thinking about the implications in your decision before the truncated review and see if I'm -- see what you think of this.

It seems to me you're proposing what's in effect going to be a different order of the quick look review depending on the case. That was really the burden of your example. You weren't doing it by category, you weren't really saying this category you were going to have no matter what the specifics will be, won't always be looking at efficiencies first, but it could be low cost or it could differ case by case, and that seems to be that the litigants might have a tough time knowing in the first place what the -- where they have to put their effort.

And so as a practical matter, if I'm thinking of coming to the Commission on the outside with the proposing of entry under your standard, and I might be thinking about collecting information on both efficiencies and market power, and all -- and once I have done that and presented it to the commission, it is suddenly cheap for the Commission to evaluate it anyways, so it is low cost and could improve decision making, so everything turns into the full-blown rule of reason. How did I do?

MR. SALOP: Ah, B-plus. The -- yeah, I --

MR. BAKER: I will ask Professor Gellhorn for a grade in a moment.

MR. SALOP: I think I have a lot of ambivalence in the paper about whether the characterization is based on the case or the category, and I think you -- your point -- your point is very good. I think that -- I think probably the way it ought to be is that at the first stage, the characterization depends on the category, but then if you can get low-cost information about the case, then you can do a recharacterization.

Now, your point about the parties manipulating the process by bringing in a lot of information, I think that's a -- that is a pretty cool point, and I guess the answer -- part of the answer is that it's not just bringing forth the information but it's evaluating the information that's costly, as well. I mean, if you were willing to rely on the information that the parties brought in all the time, all of antitrust would be very low cost, right? I mean, you could just dispense with the process, right, altogether?

MR. BAKER: Just let you run the regressions for me, Steve?

MR. SALOP: So, I don't -- I think sort of they would -- they would bring the information in, and what you might decide to do in certain cases is say we don't want to see this information. It seems to me the really -- perhaps the most counter-intuitive and confusing aspect of this is the situation of when you throw information away. In decision theory, you should never throw information away. I mean, that is really the craziest thing of all to do, but yet we see in all these cases that have evaluated the quick look, all the truncation, not necessarily your cases, but the Supreme Court cases, the Supreme Court gets a lot of these cases with a full record. So, in NCAA, they get a full record, and then they say, oh, by the way, we do not want -- we want to ignore all this market power information that we already have. And so it seems really peculiar.

What you ought to do is courts ought to be making a decision before the litigation, before the information is generated, that they don't want to see it. Another example -- I mean, for another example is in the Brown -- Brown University case, Lloyd's alma mater, the Court -- the Court allows Dennis Carlton to testify on lack of market power by the Ivy League schools, and then in writing the opinion says, oh, by the way, I don't care about what Carlton said, market power is not an issue.

Well, what the Court should have done is made that decision earlier. Once Carlton testified, the Court should have probably -- much lower cost for the Court to evaluate at that point. So, it seems to me that part of this is that in making your decisions, you should try to front-load the decision of what kind of procedure to use, and if you don't front-load it, if you have all the information, unless you find that it's very difficult to evaluate it, you ought to use it.

COMMISSIONER AZCUENAGA: Susan, we will take one more question and then go to the last witness.

MS. DeSANTI: This is just a follow-up, Steve, to Jonathan's question which goes to the issue of whether your framework can be used on a case-by-case basis or whether it has to go along with a set of rules as to what -- or presumptions as to what's generally the case.

Given that you can have a situation where a lower court or the Commission as a decision maker decides, well, this is the -- this is the type of information that we believe is most determinative of this issue, but then you can have a higher court, an appellate court, that decides that there is some other piece of information that is, in fact, determinative should be the correct information to use to decide the case. If -- if using your framework the lower court -- the lower body decision maker hasn't collected that information, doesn't that make the process more inefficient rather than more efficient?

MR. SALOP: Because there is a chance that it will be remanded?

MS. DeSANTI: Yes, and that that information subsequently will be demanded by an appellate decision maker.

MR. SALOP: Well, that's a fair point. I mean, that's a -- as a lower court, you face that uncertainty. I mean, I guess I would like to say if the Supreme Court would set down clear rules on this, on the categories of cases that should use each procedure, then you wouldn't have that -- you wouldn't have that uncertainty.

What seems peculiar, though, is if you have the information and if -- if you had to collect that information and evaluate it in order to -- in order to satisfy what the -- what the -- what the appellate court might want, then when you make the decision on the truncated basis, that's just a law journal article, right? I mean, you might as well sort of make it on the rule of reason and say, by the way, appellate courts, we think we wasted our time in this case. That's the appellate court, I guess.

You know, you might as well do it on a rule of reason, but then do a different opinion, write an opinion that says we are doing this because we think it's necessary, but -- you know, necessary perhaps to satisfy some higher court, but you know, we really think his information that we used is unnecessary in this case. It's a different view.

COMMISSIONER AZCUENAGA: Thank you very much.

Actually, this is a subject we could easily discuss for the rest of the day, but I'd like to turn to our last witness, Cal Goldman, who comes all the way down here from Canada to join us, and Cal is also a long-time friend of the Commission, and we know him well, but for the record, I'd like to introduce him.

Cal is the senior partner of the competition law and trade practices group at Davies, Ward & Beck in Toronto. In 1986, Mr. Goldman became head of the Competition Bureau in the Government of Canada. From 1987 until he returned to private practice in October of 1989, he was a vice-chairman of the OECD Committee on Competition Law and Policy.

Mr. Goldman is immediate past chair of the National Competition Law Section of the Canadian Bar Association and chairman of the Competition Policy

Committee of the Canadian Council for International Business. He was a member of the ABA's Antitrust Section Task Force and a negotiator on the American Free Trade Agreement and is currently a member of the ABA's Antitrust and Global Economy Task Force.

Mr. Goldman has published extensively and spoken widely in Canada, the U.S. and elsewhere on competition law, trade practices and the interface between competition policy and trade policy.

Welcome, thank you.

MR. GOLDMAN: Thank you, members and staff of the Federal Trade Commission, I appreciate the invitation and the opportunity to appear today to provide you with some observations pertaining to our experience in Canada with the review of joint ventures and strategic alliances, and in so doing, I hope to touch upon some of the specific questions that the Commission posed in its announcement of this project on April 22nd.

In Canada, as in the United States, innovation, the accelerating rate of technological change and globalization, are all leading to an increase in the use of joint ventures and strategic alliances. My presentation will briefly describe the reasons that businesses in Canada are forming joint ventures, and then I'll again touch -- very briefly touch upon the Canadian provisions that are mostly applied under the Canadian Competition Act to the formation of joint ventures, as well as the Canadian Competition Bureau's enforcement policy with respect to joint ventures, and then I hope to make some general observations for the future concerning the treatment of joint ventures in Canada and the United States.

Now, in making these comments, I certainly appreciate that the law in our two countries is not identical, but it does have significant similarities, and this is especially the case since the 1986 overhaul of the Canadian legislation. In my experience, cross-border mergers and joint ventures which have been and are likely to continue to increase will have impact both upon business planners in both jurisdictions and upon the enforcement authorities in both jurisdictions. It is simply impossible not to recognize that the conduct in one country increasingly bears on the activity and policies of the other.

Rationales for the formation of joint ventures have been described at length elsewhere, and I will be very brief on this subject.

I think the most important factor is the requirement to rapidly and flexibly combine complimentary core functions to develop and improve products and services. A joint venture may facilitate the rapid formation of new products, businesses or standards and allow businesses to benefit from substantially increased economies of scope and scale. There are many types of joint ventures and goals, and they include, just for a short list, at this stage the following:

Information technology joint ventures, which we have seen, research and development joint ventures, out-sourcing joint ventures, which are becoming more common, technology transfer joint ventures, which may be particularly used in the context of foreign direct investment, where a joint venturer, for example, may be desirable for a local venturer's knowledge of the market or in some cases be mandated by restrictions on foreign direct investment. There are also production specialization agreements, and in Canada, in fact, we have a specific section of the Competition Act that addresses that subject, which has not yet been widely used. So, if I have time, I will touch on some of the reasons for that.

In the written remarks which I plan to deliver with my colleague Richard Corley before the end of July, we will spend considerably more time than I have today on the framework for joint ventures and on the overview of the Canadian competition legislation. I don't want to use the time today, given what I know is your own familiarity with the Canadian legislation, to take you through the main provisions, but I should say that in our experience, joint ventures are most frequently dealt with in Canada under the mergers or possibly the abuse of dominance provisions, and in less frequent instances, they may also raise issues under the provisions pertaining to conspiracies. The dividing line between the noncriminal enforcement and review of joint ventures and the criminal review is a source of some continued uncertainty in a number of jurisdictions, including Canada. That's one of the subjects that I intend to focus upon in my time this morning.

Canada's substantive merger law is, of course, given your familiarity, quite similar to the United States, except that we do have a statutorily mandated trade-off between anticompetitive effects of a proposed merger and efficiency gains. We do use the test of whether the merger or proposed merger prevents or lessens or is likely to prevent or lessen competition substantially, which is analogous to the test in Section 7 of the Clayton Act.

We also have, as I've said, a specific provision on efficiency gains in Section 96, and the Canadian merger review provisions incorporate a threshold standard that is clearly broad enough to encompass most joint ventures, because the merger provisions do not apply only to acquisitions of control, they apply to acquisitions of a significant interest in the business of another entity. Where "significant interest" means an ability to materially influence the operations through acquisition or establishment of contractual rights, and that, in and of itself, encompasses just about every kind of conceivable joint venture.

Which brings me to my first substantive enforcement policy observation. This is similar to one that I made earlier and I believe I touched upon in my remarks to the global hearings in this room, and that is just like the situation pertaining to other merger assessments. In cases where the antitrust enforcement authority is looking at anticipated anticompetitive effects that are unclear following its assessment of a joint venture, and where transactions are likely to generate relatively certain efficiency gains, it is my view that those transactions ought to be assessed with great caution, and where appropriate, they should not be enjoined but should be, as I will amplify upon later if I have time, subject in very close cases to monitoring by the antitrust authority, so as to ensure that the actual competitive trade-off is not significantly different than that which is expected, and the efficiency gains, in fact, do accrue to the benefit of the economy.

There is in Canada a specific exemption for research and development joint ventures. I don't propose to take you through it. It will be discussed in our paper. Suffice it to say that it has not been made use of formally to the extent, I believe, that those drafting the legislation had anticipated. Similarly, the provision dealing with specialization agreements, which is specifically incorporated in the Canadian Act, has not been made use of in formal proceedings before the Competition Tribunal, and some may suggest that the reasons for that are because the specific provisions are somewhat narrow and restrictive.

Others, and I put myself in the other category, tend to believe that one of the reasons why people haven't had to resort to them is because the merger provisions in themselves have been applied I think it's fair to say, in a sensible and balanced manner, and in the history of the new legislation in Canada, which is now over 11 years, there hasn't been a need to resort to the other specific sections.

Canadian joint venture enforcement policy, which I just want to deal with specifically in, of course, only its public context, because I believe it bears directly on some of the issues that you are addressing, and that is because the Director of the Competition Bureau recognized in the early 1990s the same point, of course, that you have focused on, which is certainty is critical to business planning, and conversely, uncertainty can have a serious chilling effect upon potentially procompetitive activity. Now, that's equally true in Canada and other parts of the western world.

In order to address uncertainty, successive Directors of the Canadian Competition Bureau have endeavored to reduce the potentially chilling effect by enforcement policy announcements, guidelines, information bulletins, even detailed press releases where cases have not been challenged, all of which are delivered in an attempt to reduce uncertainty for business planners.

Now, in 1995, in an effort to help reduce uncertainty in Canada with respect to the treatment of strategic alliances, which included specifically joint ventures, and I have the debate with colleagues all the time in Canada that we try to define what is a strategic alliance as opposed to a joint venture. Let's just assume that the whole family was encompassed within the framework of a 1995 information bulletin released by the Director of the Competition Bureau entitled Strategic Alliances under the Competition Act, and that initiative was widely viewed as a very worthy one. I believe that its effort today is still regarded as a laudable one, one that has received some praise, although I also believe it's fair to say that the bulletin that is now in public use doesn't go quite as far as some would have hoped in trying to remove some of the uncertainty in this area.

It certainly is a vast improvement, a very significant improvement, over the first draft that was released of the bulletin, and I want to just echo Professor Gellhorn's comments about the importance of consultation on drafts of bulletins in a very difficult area such as this, because when the first draft was released, it did generate a considerable amount of constructive commentary, a good part of which was considered and without doubt applied in the subsequent draft, there was a second draft and the final bulletin that came out.

There are still some of us who believe that in one particular area, and the one that I want to bring to your attention, the bulletin could still be improved upon, and that is the very important issue of trying to give guidance to business planners and their counsel on where the dividing line is, where you delineate those joint ventures that will be assessed under a criminal review standard and those joint ventures that will be subject to noncriminal administrative law or merger review standard or Section 7 of the Clayton Act standard, and we have exactly the same dichotomy in issue in Canada that you are facing here.

We have our criminal conspiracy provision that can lead to very significant penalties, as members of the Staff and Commission are certainly aware, and they are certainly aware of the close working relationship between the Canadian Bureau and the U.S. Antitrust Division on criminal matters, and, of course, the noncriminal merger assessment, which shares a lot in common with your own and that of the Antitrust Division.

The importance of this distinction, which you touch upon in your list of questions, I believe it's around page 5 of your April 22nd release where you ask about the dividing line, is one that I cannot underscore enough, having worked through a good number of the consultations from my perspective in the private sector and when I was heavily involved with it in the Canadian Bar Association.

And I want to just dwell on that for a moment, because indeed the very issue that you ask about whether procompetitive joint ventures may be chilled by a lack of a clear enforcement policy, can find itself moving in a regressive fashion. You can find the answer to be one that you had not hoped for if the articulation of policy is not clear in trying to delineate when certain types of joint ventures, including ancillary restraints, will give rise to criminal review, because I can tell you from my experience in the private sector that if there is any kind of gray area that does cause people to second-guess and rework and then, of course, decide that, well, the only safe haven may be a merger, and a merger, as Professor Gellhorn indicated, does give rise to consequential effects that may not necessarily be as procompetitive as a joint venture, this is this area.

It is the fear of a criminal investigation. The Canadian bulletin, and we will deal with this in the paper, does have some very positive statements in it, and I commend them to you. The reference to the standard of market power, which is addressed very clearly in the bulletin, is quite constructive. The reference in the bulletin to very limited review of vertically integrated operations is also very constructive. There is also a reference in the bulletin to a general statement that the Bureau will will generally examine alliances or ventures under the merger provision unless there is a basis for believing that the agreement is a sham.

That's a useful statement, but some of the subsequent statements are less decisive on the scope of possible conspiracy review, and the new Director of the Bureau, Mr. Konrad von Finckenstein, is very much aware of these points, and I believe that we can make a very good piece even better by further consultations.

Our written paper will deal with a few specific suggestions about where the dividing line can be drawn, but I would like to suggest to you that there are certain criteria that can be incorporated generally to help the business community in this area. Of course, the statement about sham negotiations or a sham agreement is very important. That is a flip side of saying that there may be evidence of a broader agreement, an agreement between the parties which is not subject to review, which is not publicly disclosed, and those cases, I think, are fairly clear.

If you have other evidence of covert conduct where the parties reflect a clear anticompetitive intent, these are all factors that can lead to a criminal review, but it's very important to perhaps consider other elements, and one that I'd like to raise with you for both the agreement itself and ancillary restraints is an issue of whether there should ever be a criminal investigation in either jurisdiction, if the entire agreement, by that I mean the entire framework, including the ancillary restraints, are disclosed publicly, and there is no other agreement, there is nothing else going on, and particularly if that entire agreement is subject to review as necessary by the antitrust authority.

In my respectful submission, in instances such as that, the antitrust authority has all the power in the world to address the issues under a U.S. merger review or perhaps, and I don't want to wade into the niceties, it's like taking coal to Newcastle when I come down here, or under rule of reason analysis, a line in the sand that says in those instances, there will not be a criminal review, will encourage people to be inventive, to be innovative, to come forward and even to consult with the antitrust authorities as opposed to risking any chilling effect.

And in Canada, one further point that I've touched on in my earlier submission during the global hearings, is the advantage of confidential guidance. I guess what I'm saying, and I don't want to repeat what I said in my submission of December 1995, but as recognized by the Director in the very first paragraphs of the strategic alliance bulletin, confidential guidance can give business planners a great deal of comfort on difficult, specific instances that cannot all be covered in any kind of bulletin.

It is literally impossible in this area when you deal with the complexities, the number and types of industries and joint ventures that are not only occurring but will occur, especially in the information age, to try to cover this off in any form of bulletin, but a broadened form of confidential guidance which is made use of in Canada, and as I indicated when I was here in December 1995, in some instances it's even made use of by parties in both the U.S. and Canada who come to see the Canadian Competition Bureau, because they can get guidance on a confidential basis, when they can't get the same from either the Antitrust Division or the Federal Trade Commission.

So, in fact, on a trans-border mega transaction, in some instances -- and it isn't widespread, but I have participated in them -- parties will be seeking guidance from the Canadian authorities on an analogous line to

Section 7 of the Clayton Act, and I commend that to you in addition to your considerations under the bulletin.

Now, let me conclude my remarks by saying first I have little doubt that the number and types of joint ventures are going to increase in the North American environment. Secondly, that where the anticompetitive effects are uncertain and the efficiency gains are relatively certain, I would suggest that antitrust authorities be very, very cautious about moving against the joint venture. Third, that guidelines, if they are to be issued, I do commend the form of a draft bulletin with extensive consultations that we experienced in Canada.

Next, the guidelines should focus clearly on general criteria that fundamentally reduce the chilling effect of the threat of criminal investigations, and in my view, that is the most important of all the criteria that you can incorporate in any such guidelines in this area where there is a risk of the authority or authorities of the United States looking at a matter under two different standards.

And then with respect to one further issue that I didn't touch on in my earlier remarks, I'm just reading through and cutting out in the interest of time, I would also suggest that further consideration in this difficult area, and this is -- this is a corollary to my point about not moving too quickly in cases where you're not sure how the trade-off will unfold -- I do suggest that some of the Canadian experience under the monitoring process is one that you may want to have further regard to.

In fact, from '86 to '95, the Director has permitted over 50 mergers to close subject to some form of monitoring. It's a form of closing where there is no challenge, but there is some form of ongoing observation, perhaps with an information reporting requirement. And I'm of no doubt that business people would generally rather see that than see a challenge of the transaction.

Having said that, I also recognize that antitrust authorities need to avoid becoming regulatory agencies, but given the rapid rate of technological change in many industries and the desire to avoid inhibiting potentially procompetitive joint ventures, I suggest monitoring can play a useful role in selected, appropriate cases. And I recognize that Chairman Pitofsky has already made a point similar to this, at least in one transaction, I believe it was the Ely Lilly case, and his remarks to the American Bar in the summer of 1995.

So, in conclusion, I hope these brief comments, which will be expanded upon considerably in our written remarks, may be of some assistance, some limited assistance to you. I recognize that I speak from a certainly different but somewhat analogous perspective, and I'd be pleased to try to answer any questions.

COMMISSIONER AZCUENAGA: Thank you very much, Cal. You have a wealth of experience in the international arena and have seen this obviously in more than one country. I'd like to start with just a very general question.

I understand that your practice is less and less exclusively Canadian and that a lot of the questions that you face on a daily basis involve transactions that also have U.S. implications. If this agency were to succeed in proposing a brighter line standard, such as the one you've proposed, and it differed from whatever was available in Canada, to what extent would that help you in your practice or to what extent would it have an impact on your practice?

MR. GOLDMAN: If the line is narrower than the one that we are advocating that the Canadian Bureau draw, and I believe that the Canadian Bureau is still assessing where they want to draw the line, then, in fact, there could be a distortion, and there is a risk of a distortion. It really is becoming the fact today that the majority of transactions that we face, at least in Canada, given it's the smaller of the two neighbors, at least the ones that raise any real concerns, are of a Canada-U.S. nature or connection.

That isn't the case, I believe, in the U.S., but I have listened to the statistics by members of the Antitrust Division talking about the volume of cases that they are dealing with on an international plane today compared to even ten years ago, and it's risen dramatically. So, my suggestion is, of course, that each jurisdiction, we all recognize, has to make its own assessments in accordance with its own law and guidelines, but that consultation between the enforcement agencies, yourselves and the Antitrust Division on the one hand and the Canadian Bureau on the other, on where this line ought to be properly drawn would be a very constructive step.

I believe it's an important step given the nexus that has developed in trans-border criminal investigations as well as trans-border merger and other types of relationships between the enforcement agencies and given the realities of business in the North American environment.

In fact, it's actually fortuitous that the

Canadian Bureau has not, at least in my view, refined the bulletin of 1995 up until this point in time. It actually gives an excellent door that the parties may want to walk through with respect to where this line ought to be drawn. It could be detrimental if there was a more restrictive criminal review policy in the U.S. We have lived with that before. We do not have in Canada per se illegality, but the questions of agreement and the questions of intent are quite similar. I think it would be constructive if there were consultations in this area.

COMMISSIONER AZCUENAGA: Thank you.

Any other questions?

MR. COHEN: I would just like to take you up on your offer to provide us a little bit more background on the special exemption for specialization agreements.

MR. GOLDMAN: The specialization agreement provision in the Canadian legislation has a requirement in it that parties agree that one will produce product A, whereas the other will produce product B, on the understanding that each will cease producing the other product, and it does permit even an exclusive buying arrangement. I mean, it's really designed to achieve longer production runs and efficiency gains that are to arise prima facie on that basis.

Any specialization agreement, according to the Canadian legislation, has to be the subject of a public hearing before a Competition Tribunal, similar to going to a competition court, in an entirely open forum. It will, of course, involve the opportunity for third-party interventions, and in the first couple of years of the Canadian legislation, there were some very active interventions, not in specialization agreement cases, but in some of the merger cases, even with respect to consent orders.

You at least -- or I should say the other arm of the enforcement authority here experienced some of the same consternation, if I can say that respectfully, with respect to the Microsoft case when a proposed consent order was at least initially set aside, and it does create some uncertainty in the profession if one had an analogy to Microsoft in the early stages of the legislation.

So, the risk of interventions, full public hearing, public assessment of your proposed plans and whether the trade-off of the efficiency gains would be sufficient to offset anticompetitive effects, again, in a public forum, have all combined to create, I think, some inhibitions among members of the business community in putting forward one of these public specialization agreements.

In fact, there has been, again, in my view a greater willingness to go the full merger route or at least have acquisitions, or relationships that are less than controlled, dealt with under the merger provisions, which don't necessarily in Canada have to result, and in most instances do not result, in a full public hearing before our tribunal. I think that's the best explanation I can give to you.

COMMISSIONER AZCUENAGA: Thank you.

Any other questions for Cal?

There is such a wealth of experience and expertise in this panel that I know we could continue all day, but other people have some commitments, but before we adjourn, I believe Jonathan Baker had one more follow-up question that he would like to ask based on an earlier discussion.

MR. BAKER: Thank you.

This is a brief lingering question on alternatives, and I will ask it for Professor Gellhorn and Professor Salop, slightly differently for each of you based on your remarks.

Professor Gellhorn, you said we shouldn't challenge a joint venture as overbroad on a less restrictive alternative analysis, but it's all right to do so on an ancillary restraints analysis, and I'm wondering what difference you had in mind.

Let me get Steve's out, just so you guys can -- and Steve, would an implication of your framework be that we ought to spend very little time on less restrictive analysis early in the review of the joint venture, in what might be the sort of facial review stage, when it's very costly to examine whether there are less restrictive alternatives, but perhaps more effort later when doing a fuller rule of reason analysis? Should we go down that road based on other things we have learned where there might be scope economies with examining either market power or the efficiencies?

I don't mean to have this be a long answer, but --

MR. SALOP: You want me --

MR. BAKER: Either of you who -- I think it's the same question really.

MR. SALOP: Well, I think you do it whenever -- I mean, there is no reason not to do it in the beginning if it's -- you are going to be able to dispose of the case on that basis. So, I mean, I view less restrictive alternative really as another term for reasonably necessary for the standard, and sure, if it turns out that there is a reasonable alternative that they could have used, then why not observe that, why not make that observation early on if it's going to make a difference in the outcome? I don't see why you would need to --

MR. BAKER: Because it might be expensive to observe it earlier or cheaper if you were looking at the efficiencies and market power later.

MR. SALOP: No, if it's easier to do it in the beginning, then do it in the beginning, if it's easier and it makes a difference, then do it in the beginning, sure.

MR. GELLHORN: I didn't mean to suggest different standards whether we are talking joint ventures or ancillary restraints. It seems to me basically we have not adopted in most areas of antitrust, and I would abandon that here, the use of less restrictive alternatives. The question really is in my view whether or not the particular restraint being reviewed has harms that outweigh the likely benefits, and that's not related to whether or not there are alternatives to choosing.

The reason I'm hostile to that is that I view the antitrust evaluation as a difficult process, at best being done in a somewhat crude way, because we are not able to measure either probabilities or costs to the degree to which I think Steve's wonderful construct requires, and while I'd love to be able to draw with crayons as much as he can as an economist, I just -- I have a lot of problems with saying our information is that good, and the same thing applies here. I don't think that the agency is in a position to evaluate effectively among choices, whereas I think it can and necessarily has to say, no, you have gone too far.

MR. BAKER: Saying that this venture or this -- without an ancillary piece, is -- is legal, but with it -- with the piece itself is illegal? Isn't that comparing to an alternative?

MR. GELLHORN: Not in terms of is something else better or the way you should go about it. It seems to me all you need to say is, I won't accept it at this point. Now, yes, as between alternatives, you are doing it, but you are not -- your focus is quite different, and my problem is that the search for the best tends to drive out the good. That's the problem.

MR. SALOP: I just -- I don't think you need to do all the numbers to make my framework useful. I think you are using my framework all the time, whether you put numbers -- whether you apply numbers or not, and I -- I wanted to ask you a question, and that is, I tend to view less restrictive alternative and reasonable necessity as two terms for the same concept. You seem to use them quite differently. So, I wanted to know what you thought the Supreme Court had in mind when it said certain conduct was not reasonably necessary to achieve the -- to achieve the efficiencies claimed by the parties.

MR. GELLHORN: I guess I view them as different. I'm not certain a reasonable necessity argument is a particularly useful construct by the Court, so I guess my ultimate answer is that that's not an avenue I want to pursue very far and I would urge the Commission not to pursue very far. I think antitrust is tough enough following fairly discrete categories. Once it gets into the position of starting to evaluate how a business ought to operate, essentially you're turning yourself into a utility commission, and happily deregulation is pushing us the other way.

MR. SALOP: But isn't that easier than evaluating the overall costs and benefits of a joint venture? Isn't that a lot easier for a commission to say, had you done it this way, you would have gotten the same benefits, and it wouldn't have caused anticompetitive harm? Isn't that easier than saying, well, gee, based on all the numbers and curves and use of crayons, that on an expected value term, we think this is leading to plus 3? I mean, I don't understand. If it's hard, it would seem to me you should try to dispose of it on the easiest basis, not -- not on the classical rule of reason. That's the hardest thing to do of all.

COMMISSIONER AZCUENAGA: Well, I think without giving Professor Gellhorn a chance to respond I'll take the opportunity to bring the formal part of these proceedings to a close, and any further discussions can take place off the record.

It's not unusual to have a group with this kind of expertise and ability not to provide us with unanimous views. Unfortunately, this does not give us a clear map of where to proceed from here, but as usual, I think that we have learned a great deal, both substantively and about how we think about these processes, and I would like to thank you all very much for coming.

(Whereupon, at 12:35 p.m., the hearing was adjourned.)

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C E R T I F I C A T I O N   O F   R E P O R T E R

DOCKET/FILE NUMBER: P971201

CASE TITLE: JOINT VENTURES PROJECT

HEARING DATE: JUNE 30, 1997

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: 7/1/97

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SUSANNE Q. TATE

C E R T I F I C A T I O N   O F   P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

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DIANE QUADE