

FEDERAL TRADE COMMISSION

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FEDERAL TRADE COMMISSION

In the Matter of:)
HEARINGS ON THE)
JOINT VENTURE PROJECT)

Tuesday, July 1, 1997

Room 432

Federal Trade Commission

6th and Pennsylvania Ave., N.W.

Washington, D.C. 20580

The above-entitled matter came on for hearing,
pursuant to notice, at 1:35 p.m.

BEFORE:

MARY L. AZCUENAGA, Commissioner

JANET D. STEIGER, Commissioner

ROSCOE B. STAREK, III, Commissioner

Federal Trade Commission

6th and Pennsylvania Avenue, N.W.

Washington, D.C. 20580-0000

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ALSO PRESENT::

STEPHEN CALKINS, General Counsel
SUSAN S. DeSANTI, Director, Policy Planning
WILLIAM E. COHEN, Deputy Director
LOU SILVIA, Bureau of Economics
ROBERT LEIBENLUFT Bureau of Competition
JONATHAN B. BAKER, Director, Bureau of Economics

SPEAKERS:

THOMAS R. REARDON, M.D., Vice Chairman, AMA
ED HIRSHFELD, ESQ. Vice President, Health Law AMA
JAMES B. KOBAK, JR. ESQ., Hughes, Hubbard & Reed
NICHOLAS VONORTAS, George Washington University
WILLIAM J. KOLASKY, JR., ESQ.
Wilmer, Cutler & Pickering
JAMES RILL, ESQ., Collier, Shannon, Rill & Scott

P R O C E E D I N G S

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COMMISSIONER STEIGER: Good afternoon. In the interests of the outstanding individuals who are giving so generously of their time this afternoon, we will try and honor that by keeping on schedule as best we can.

And we are pleased today that we will hear first from the American Medical Association. Their testimony will be presented by Dr. Reardon.

Thomas Reardon is a general practitioner from Portland, Oregon and Vice Chair of the Board of Trustees of the AMA, and has been a member of the Board's Executive Committee since 1994. He is also past president -- now, you give me the county, Doctor. I am not going to try it.

DR. REARDON: Multnomah County.

COMMISSIONER STEIGER: I think once will be enough to say that -- Medical Society and the Oregon Medical Association. He has been very active in the general practice of medicine for over 30 years.

He is accompanied today by Ed Hirshfeld, Vice President and Associate General Counsel for Health Law of the AMA. Prior to joining the AMA in '88 Mr. Hirshfeld was a partner at the Chicago office of Gardner, Carton, and Douglas, where he specialized in antitrust litigation

and counseling, especially for the health care industry.

Welcome. We understand, Doctor, that you will present the prepared statement and then we will badger Mr. Hirshfeld with questions.

DR. REARDON: Thank you. Members of the Federal Trade Commission and staff, my name is Thomas Reardon, M.D. I am in family practice in Portland, Oregon. I also serve as Chair of the American Medical Association Board of Trustees.

Today I am pleased to offer our views on federal antitrust law and enforcement policies affecting joint ventures. We commend the Federal Trade Commission and the United States Department of Justice for undertaking this project.

Joint ventures are frequently used by businesses that must respond to rapidly evolving markets. That is certainly the case in health care. It is important that antitrust laws facilitate and not impede competitive responses to evolving markets if consumers are to realize the maximum potential of innovations that drive change.

My comments today will focus on market trends and the effects of current antitrust laws and enforcement policies on physician network joint ventures. In that regard, the AMA commends the agencies for issuing the "Statements of Enforcement Policy in Health Care," on

August 28th, 1996. The statements were a significant improvement over previous versions, and we believe that they have facilitated the formation of physician networks.

The AMA will submit a written statement by August 1st, 1997 that will address the questions listed in your Federal Register notice in more detail than I can provide in the time allotted here.

I will begin today by talking about the developments in health care delivery and finance. And I will begin by describing trends in the health care industry that enhance the importance of physician joint ventures.

As you know, managed health care plans are widely credited with stabilizing the rapid growth rate of health care costs. This has been accomplished primarily through reduction in the use of the hospitals. Savings have also come from other sources, but the greatest amount has come from reduced hospital use.

Two factors are threatening this source of savings. One is limits on the extent to which hospital use can be reduced without further endangering patients. There are more savings available here -- hospital use rates in many parts of the country are higher than in areas where managed care plans dominate. But it will not

be long before limits are reached. New efficiencies must be found if health care costs are to be stabilized.

The second factor threatening hospital savings is public concern about the effects of reduced use on the quality of care. For example, due to public outcry, federal legislation has been passed mandating minimum hospital stays for mothers giving birth.

Public concerns may force managed care plans to be less aggressive in reducing hospital stays, thereby blunting it as a source of savings. New sources of savings and ways to improve quality must be found.

One way that substantial gains can be achieved in both areas is through the operation of physician organizations or PO's in a competitive market. POs are making substantial advances in providing high quality care to patients more efficiently by applying innovations in clinical management and medical information technology.

The main innovation in clinical management is continuous quality improvement or CQI, a process whereby PO physicians review detailed data about their own performance and that of their referral providers, and then determine how to enhance quality and efficiency.

The innovation in medical information technology is new computer software and hardware that enables

physicians to gather and analyze the data used to support the CQI process. These innovations allow physicians interactive access to detailed information about the cost and quality impact of treatment decisions.

Improvements in quality and efficiency are implemented by making systematic changes in the way that medicine is practiced. Protocols are developed to achieve the best possible outcomes most efficiently, given the facilities and resources available.

PO physicians follow the protocol unless, in their medical judgment, an element of the protocol should not be used due to the individual needs of a patient. Use of the protocol is monitored to determine what modifications should be made to further improve quality or efficiency.

Successful CQI requires participation by the physicians that deliver care in their review and analysis of data, and in the development, implementation, and monitoring of the protocols. The physicians must cooperate and educate each other about the optimal methods to deliver care.

This must be done at the local level by providers using detailed data about their own performance and having detailed knowledge and experience about the resources and equipment that are available to them in

caring for patients. These innovations cannot be implemented from afar by health plan managers that are remote from patients, the physicians, and the process of rendering care.

Shifting medical management from health plans to POs will yield substantial benefits to patients. This is made evident by comparing CQI with the medical management techniques of health plans. The AMA believes that public concerns raised about quality are largely attributable to those health plan techniques.

The primary technique used is called preauthorization. It requires a physician to call a reviewer and ask for authorization to hospitalize a patient or to continue a hospital stay. The reviewer is remote from the provision of care and does not have firsthand knowledge of the patient.

Reviewers generally rely on predetermined guidelines for hospital stays in making their decisions. As a result, there is risk of error. Sometimes the risk of error is increased by inappropriate use of guidelines.

For example, an actuarial firm, Milliman & Robertson, has used actuarial data to develop guidelines for hospital stays. These guidelines are based on stays achieved by the least costly cases. It is reported that

the guidelines are based on the 90th percentile, with the 100th percentile being the least costly cases.

In other words, in the database used by Milliman & Robertson, 90 percent of the actual cases had hospital stays greater than the stays called for by the guidelines.

The guidelines offer no information on how to achieve the least costly cases. They present best case cost scenarios towards which providers can aspire. Meeting the guidelines is dependent on having the same kinds of patients and resources, such as adequate home health services, as did the physicians who achieved these results.

However, many payers are treating the guidelines as a standard as opposed to a target. The AMA hears regularly from physicians who are confronted with hospital stay requirements based on the Milliman & Robertson guidelines. Inappropriate use of these guidelines inevitably can lead to errors.

Safeguards against error include reliance upon physicians to press the case for hospitalization if the physician feels that hospital care is essential for a patient.

In addition, most health plans have appeals process procedures available to patients. However,

physicians are often fearful of termination from health plans if they challenge plan decisions, and the appeals procedures are cumbersome and time-consuming. Under these circumstances, it is inevitable that the safeguards will not catch all the errors.

Another technique is physician profiling. It involves comparing information about the hospital use rate of a physician with other physicians. Health plans create profiles to identify physicians who use more hospital services than others.

Often these physicians are terminated from health plan participation. Sometimes the health plan gives the physician an opportunity to reduce hospital use prior to termination.

However, these plans rarely provide the physician with information about how to reduce usage without endangering patients. This puts pressure on physicians to reduce usage without the informational tools necessary to achieve it. Again, under these circumstances it is likely that errors will result.

POs using CQI can avoid these problems. Physicians using interactive data can craft protocols for care using the facilities and resources available to them that will lead to improved quality and greater cost efficiency.

They also have the ability to depart from those protocols when, in their judgment, it is necessary for the health of the patient.

In summary, the AMA believes POs using CQI can substantially improve quality and reduce costs. I should point out that the AMA believes that other forms of health care delivery can also improve efficiencies, and that the AMA supports a pluralistic health care system in which patients have a wide choice of health plans and providers. POs should be a part of the mix.

Let me talk about the importance of flexibility in PO joint venture analysis. The CQI process requires a high degree of cooperation among physicians, and that is often accomplished through joint ventures. If patients are to realize the benefits of CQI, it is important that PO joint ventures be facilitated.

Antitrust joint venture analysis needs to be flexible to facilitate POs. The AMA does not believe it is possible to determine an optimal financial and operational structure for POs. On the financial side, many have argued that the best results occur when POs compete for capitation contracts.

However, not all payers want that. For example, self-funded health plans face regulatory barriers to the use of capitation. Anecdotally, the AMA is aware of a

number of self-funded corporations that are looking for alternatives to capitated arrangements. The AMA believes that payers are likely to use a variety of financial schemes with POs and that POs will use a variety of methods to compensate their physicians.

On the operational side, many have argued POs need to install multi-million dollar medical information systems. Certainly the key to CQI is access to interactive data, but a variety of ways are available to attain it.

For example, a PO can work with a service bureau and pay it to gather and aggregate the data needed. That kind of arrangement allows the PO to minimize its own investment in computer hardware and software.

Also on the operational side many have argued that the POs are most efficient when fully integrated. However, recent studies of independent practice associations shows that they can be as effective at reducing costs as fully integrated multi-specialty group practices.

Further, not all multi-specialty group practices use CQI or otherwise coordinate their care. It is the intent and will to engage in CQI that is determinative as opposed to the form of PO organization.

Finally, I should point out that the kind of POs

that can apply CQI do not spring forth, fully formed, like Athena from the forehead of Zeus. Instead, these organizations are built over time as the physicians gain the necessary experience and resources.

Further, many payers are interested in POs that are in early stages of evolution as opposed to the advanced stage, since their employees want the kind of arrangement offered by those POs.

In summary, joint venture antitrust policy needs to be flexible enough to accommodate many different forms of POs because it is impossible to determine what kind of a PO is best for any market. In addition, policy must be flexible enough to accommodate the evolution of POs from simple organizations to those able to engage in CQI.

Let me now turn to the impact of the statements of enforcement policy in health care.

The AMA believes that all three sets of statements of antitrust enforcement policy for health care issued by the agencies, including the 1993, 1994 and 1996 versions, have facilitated the formation of certain kinds of POs.

As you know, case law does not provide adequate guidance for the typical attorney advising a PO. The statements provided the guidance that POs and their attorneys need to have comfort that they are in antitrust

compliance.

Each set of statements has provided additional assurance by clarifying the scope of POs said to fall within a safety zone or qualify for the rule of reason. Significant clarifications introduced by the 1996 version include additions to the definition of substantial financial risk, more guidance about the size of networks likely to pass a rule of reason analysis, introduction of the concept of clinical integration as a way that fee for service networks can qualify for rule of reason analysis, and provisions that allow messenger model networks to operate more efficiently.

It is too soon to determine the full impact of these clarifications. Early indications are that the greatest impact is from provisions that allow the messenger model to operate more efficiently, and increased guidance about when networks larger than the safety zone limits are likely to pass a rule of reason analysis.

We have been informed by physicians that both of these provisions have allowed physicians to form networks with a higher degree of comfort than in the past. However, the issue of appropriate size limits remains unclear, and there is a strong need for more information about the agencies' views on this issue.

Unfortunately, there is substantial confusion about what constitutes sufficient clinical integration for a fee for service network to qualify for the rule of reason analysis. Well established networks with capitation arrangements generally feel that they have sufficient clinical integration to negotiate fee-for-service contracts with payers as an alternative to their capitated arrangements.

However, physicians attempting to establish a new network, or to enhance the operations of a messenger model network, are not able to judge when they have attained sufficient clinical integration.

There appears to be a substantial disagreement among attorneys about what constitutes sufficient clinical integration. Some feel that multi-million dollar investments in medical information systems and a high degree of coordination of the physicians is required.

Others feel that the effort to use data about clinical performance to improve network performance is key, and that the data can be obtained from service bureaus or payers without making substantial investments.

Given uncertainty about what constitutes clinical integration, it appears that further clarification of

this concept by the agencies will be necessary before it is widely relied on in the PO formation. This could come through advisory opinions and business review letters, speeches, or as a revision of the 1996 statements.

In addition, a few attorneys are making use of the new definition of substantial financial risk that allows physicians to establish cost or utilization targets for the network as a whole, with the physicians subject to subsequent substantial financial rewards or penalties based on group performance in meeting the targets.

This is being used to structure arrangements with self-funded employers in ways that give the physician an incentive to control utilization, but which do not require the network to obtain a state license to operate a health plan.

However, the number of attorneys who understand and use this provision is limited. It appears that many experienced antitrust attorneys do not understand the meaning and potential use of this definition. Further clarifications of this definition would help the antitrust bar and physicians better understand this dimension of the statements and result in a wider choice to patients.

Further, a problem that existed with the

definition of substantial financial risk in prior guidelines continues with the 1996 statements. It is uncertainty over when fee withholds are substantial enough to constitute substantial financial risk. The agencies have issued advisory opinions and business review letters which provide some guidance on this issue, but it is still a frequently asked question.

Finally, the AMA has been told that the new examples appended to the 1996 statements have been helpful to attorneys and are a substantial improvement over past versions of the statements. This is a technique that could be used in other communications that provide information about the agencies' views or in further revisions of the statements.

Let me speak now about suggestions for further clarification of the statements. The AMA regularly hears from attorneys and physicians that further clarification is needed to accommodate loosely integrated fee-for-service networks.

A number of attorneys have told us that a gap in the statements interrupts the natural evolution in the market of POs from messenger model networks to more sophisticated organizations. Physicians starting out in a network development find it easy to begin with a messenger model, but find it difficult to make the leap

from messenger model to clinical integration or risk sharing.

There is a middle ground where the physicians have increased their level of coordination and feel a need to engage in joint negotiations. The statements do not accommodate this stage of PO evolution.

A number of attorneys that work with physicians advocate that POs be allowed to negotiate fee-for-service arrangements without clinical integration, provided that their networks include no more than 20 to 30 percent of any specialty in the market.

They have suggested that given the current market realities of contracting for groups of patients, it would actually enhance competition to allow these networks to exist. They would have to bid against each other for the business of payers.

It is believed that this competition would spark the development of clinical integration because a bidding network would have to find ways to differentiate itself from others by offering lower fees, better quality, or both. The AMA expects that the number of attorneys advocating this argument will grow.

Let me turn to some suggestions for joint venture law. Our comments reveal the difficulty of drafting antitrust guidelines for POs. Each time the agencies

issue new statements, questions arise about their meaning and lawyers argue that some kinds of pro-competitive POs are erroneously considered to be illegal per se.

Sometimes these questions and arguments are legitimate, so the agencies revise the statements. As a result, the statements have increased in size from 46 pages in the official 1993 edition to 141 pages in 1996.

The core problem is the regulatory nature of the approach to joint ventures by the agencies. This approach, and the problems that it causes, are aptly described by Clark C. Havighurst, a professor of law at Duke University, in an article entitled "Are the Antitrust Agencies Overregulating Physician Networks?"

Professor Havighurst points out that the agencies regulate physician networks by evaluating the merits of the products that they offer and allowing only those networks with products perceived to be of sufficient value to be legal.

In doing so, the agencies act in place of the market by determining which products have merit, rather than facilitating competition by allowing the market to determine the merits of the products that are offered.

Professor Havighurst traces this approach to the Supreme Court's decision in *Topco Associates, Inc. versus United States* 405 U.S. 596 in 1972. That case involved

a joint venture among several independent grocery chains to develop a private brand of products to compete more effectively with national grocery chains.

In aid of that effort, they agreed not to sell the private brand products in each other's territories but to compete in all other respects. The Court found this to be an illegal horizontal division of markets.

Professor Havighurst argues that this agreement was reasonably ancillary to a procompetitive purpose. He argues that the only plausible explanation for this result was a perception that the joint venture was a promotional gimmick and not a new or useful product for which antitrust rules could be bent. Professor Havighurst points out that this is a value judgment that the market, not antitrust enforcers, should make.

In his article, Professor Havighurst argues that the rule of reason should be of wider application to physician network joint ventures. He believes that networks should be viewed as joint selling agencies, and reviewed under the rule of reason to determine whether they have a procompetitive or anticompetitive impact on the market.

The AMA supports Professor Havighurst's views and commends them to the FTC as a way to avoid the problem of having to create and interpret concepts such as

substantial financial risk and clinical integration.

It would also allow a more natural evolution of POs that is based on the real demands of the market, and that is responsive to what payers and patients want as opposed to what is viewed as meritorious by the agencies.

Clearly, the statements define what kind of POs are deemed of sufficient value to be offered to consumers. The market can make this decision for itself.

Finally, let me turn briefly to the National Cooperative Research and Production Act of 1993. To the best of our knowledge, the National Cooperative Research and Production Act of 1993 has not been a significant factor in the development of POs.

Antitrust attorneys have not advanced it to their physician clients. This is probably due to the availability of the statements, and to questions about whether POs would qualify under the Act.

In conclusion, let me thank you very much for this opportunity to comment on antitrust joint venture law and policy. I would be happy to answer any questions. Thank you.

COMMISSIONER STEIGER: Doctor, we indeed thank you for your contribution, and we will look forward to the additional submission on August 1.

I think I would like to direct a question to Ed Hirshfeld, if I may.

MR. HIRSHFELD: Sure.

COMMISSIONER STEIGER: When we started looking at the global hearing report, toward the end of those hearings, I and others asked whether it would be in the view of our experts possible that the health care guides indeed could have some broader relevance in a wider joint venture context. I don't know if you want to hazard a guess to that.

I could narrow it and ask you if Professor Havighurst's views applied more widely than simply in the giant health care field?

MR. HIRSHFELD: Yes, I think Professor Havighurst is talking about joint venture analysis in general as opposed to simply in the health care field, and so the principles he discusses could be of broader application.

COMMISSIONER STEIGER: Do you see this as an extension of rule of reason analysis? I am rather curious about that, the Havighurst concepts.

MR. HIRSHFELD: I am not sure what you mean by an extension of the rule of reason analysis.

COMMISSIONER STEIGER: Expansion. May I say expansion.

MR. HIRSHFELD: Certainly it would expand the

number of organizations that could come under a rule of reason analysis, at least in the health care area. I think that part of the issue here, at least in health care and comparing the way health care is treated compared to other industries, inevitably depends on views of the market structure.

For example, in the health care industry, you have a situation where there is the ultimate consumer, you and myself, you have got employers that develop health plans for them, and then you have intermediaries which package the health plans that are sold to the employers and which ultimately are filtered down to us.

So you have to set -- and the insurers. You have to set an intermediary that stands between the physicians and the ultimate consumer. And those intermediaries perform the function, have historically performed the function of organizing networks.

I don't think there is any dispute that organizing physicians in a network for the purposes of serving a health plan and arranging for discounts or consistent standards from them is a benefit to the market. In health care you have got a set of intermediaries that stand ready and have done that for a long time and continue to do that.

And I think part of the perception there is that

as long as we have got those intermediaries, why do we need to have physicians organize these things for themselves? Shouldn't we require that physicians really meet a very high standard or a high threshold before they are allowed to organize it for themselves in terms of the efficiencies that they generate?

In other markets where you don't have those kinds of intermediaries that stand ready to organize the sellers, I think the threshold can be a little bit lower for when the sellers are allowed to organize because the perception is that unless the sellers do organize in that way, then the efficiencies that they can generate through that kind of organization won't benefit the market.

In addition, in health care there is the concern that physicians are going through a wrenching change. Well, we talked about some of the promise of the future and the benefits that can be attained. We are all very much aware of physicians that are going through a lot of economic and cultural trauma in this change and would like things to be the way they were and do frankly want to organize into things like unions and collective bargaining units to prevent change from occurring.

So there is a great deal of concern that if we allow physicians to form joint ventures or allow wider application of the rule of reason, that we are going to

allow some of these anticompetitive conspiracies to come through the sides of the tent.

So all those factors go into deciding how wide an application rule of reason should have in the context of any particular industry, especially here in health care.

And I think Professor Havighurst's view, and I think our view as well, we support it, is that the competition among physicians has become intense enough that the concern about allowing anticompetitive conspiracies to come through the sides of the tent and allowing them to occur in a market and basically dominate a market are substantially less than they were 20 years ago.

And so it is possible to, you know, broaden the rule of reason application to these joint ventures because of market structure, because of what is occurring in the industry. It is more likely that these networks are, as a matter of fact, going to have to behave more competitively than they did in the past.

And I think Dr. Reardon can tell you something about that based on his own experience in Oregon, which is a pretty intensively managed care state. I don't know if you have any comments you would like to make in that regard.

COMMISSIONER STEIGER: If I may add a follow-up

that he could answer at the same time. I think one of the things that we hear repeatedly is that the term joint venture covers an amazing range of practice.

Are you seeing, Doctor, more short-term smaller joint ventures, for example, or interest in those, say, for a particular treatment, particular use of treatment materials or are you seeing an interest in broader, longer-term joint ventures?

DR. REARDON: Thank you. First let me comment about Oregon in general. I come from a market where there is probably 80, 90 percent managed care penetration, probably 50 to 60 percent in HMO and the other in PPO. There has been no premium increase in Oregon in the last four years. I am not sure when the next will occur because of an intensely competitive market. Everyone is afraid to raise premiums because they will lose market share.

We have several large players who have more than 100,000 patients enrolled in their various plans. So competition, managed care plus competition has been very instrumental in containing costs in our area.

Now, in response to the joint venturing, what I am seeing is a formation of organizations of -- first of all, integration consolidation of the physicians. We are seeing more and more single specialty practices

consolidating. For instance, orthopaedic surgeons. Now there are 24 in a practice. Urologists consolidating, more for competing, competing for business as well as providing care. And they find that working together they can have better coverage, they can provide better care for patients.

Also it facilitates the use of clinical guidelines. And it facilitates the collection of information so that they can measure what they are doing.

We have some smaller players in the Oregon market. I happen to be with one of those organizations. We are struggling. We think we will survive, but we are going to have to be innovative and find some way to differentiate ourselves from the rest of the market in order to survive.

For instance, one of the things we could do as an organization is to have open access to specialists, have a point of service option. Along with open access to specialists, another thing we can do is get a large number of specialists in our panel so that patients have more choice and so primary care physicians have more choice of who to refer to.

So we are wrestling with that concept. Do we have a small consolidated panel or do we open it up to many physicians? Another way that I have heard of in

Minnesota is using a panel of nurses to screen calls and then they refer on to primary care specialists, depending on what the call is and what the problem is.

So I think unless my particular group finds a way to differentiate itself from the market in Oregon, we will have a serious time surviving. Now, is that bad? No, I don't think it is bad. I just think we have to be more innovative and more creative in the way we deliver health care. So that's what is happening.

COMMISSIONER STEIGER: Extremely interesting answer. Let me turn to our experts. Bob, does this prompt something from you that you would like to raise?

MR. LEIBENLUFT: I do have a question or two. I notice, Dr. Reardon, in your statement you mentioned several issues which there is a tension between them, you mentioned Professor Havighurst's criticisms that the agencies sometimes seem to have a preconceived notion of what they thought was the right product, and you also describe how POs, the important thing with POs is what they actually do, their form, and that there will be a number of different forms they might take, and we really have to see what they are actually accomplishing.

On the other hand, you also suggested that there is even more need for more clarification with respect to clinical integration.

And I guess my question is do you have any suggestions as to how the agencies might issue guidelines, either in health care or in other fields, allowing the market to develop innovative forms of developing and arrangements, but still providing that kind of guidance that you think is necessary for the members of the AMA and others out there?

DR. REARDON: If I may, let me begin and then maybe Mr. Hirshfeld would like to add to that. Certainly we would like to have the POs judged more by rule of reason than just a per se violation based on what they do or don't do.

For instance, in the evolutionary process of forming a PO, you begin by forming the organization and then you have some sort of review. You may have preauthorization, you may have second surgical opinions, you may have concurrent hospital review, respective hospital review, and then you can progress on to collecting the information data on performance measurements within your organization or you can collect economic data on the performance of physicians within the group.

And then you use this information to, within your group, to improve the effective care you provide. So I think it is this range or this evolutionary process that

troubles us because we need a guideline as to when you think there will be enough clinical integration.

So if you use rule of reason, you would look at that and say: If this organization makes the market more competitive, even though they haven't reached this point of clinical integration, they are more competitive, that would be okay. So I think we are looking for some flexibility to say, for less rigidity, saying you have to reach this level of integration before we would give our blessing. We think there are many ways which organizations can be competitive.

Ed, Mr. Hirshfeld may want to add to that.

MR. HIRSHFELD: Sure. Just to encapsulate it, I think Professor Havighurst's point is then that we would support, to the extent that there is a fairly regulatory process, then you need a lot of -- you do need detail and there will be increasing demand for detail.

So that's why there is the demand for increased detail about what clinical integration is, for example, or increased detail about what is substantial fee withhold.

But if you move towards the kind of analysis where you look to see, is this obviously a conspiracy or not, and in your Clarksville example, for example, in the guidelines, is it obvious anticompetitive conspiracy?

Then if you can sort of take that quick look to see whether this is obviously a conspiracy or not or are there plausible efficiencies, and if there are plausible efficiencies, then move on to the rule of reason, relying primarily on whether there is market power there and whether the market power can be exercised in an anticompetitive way, then you probably wouldn't need as much detail in the guidelines. I think that's the point that Professor Havighurst is trying to make.

MR. SILVIA: Dr. Reardon, you mentioned in your testimony about an evolution of networks from messenger model type networks, loosely combined networks, I guess, to more sophisticated networks.

And you said there was this middle ground in which there was some increase in coordinated activities, and at the same time this was accompanied by a feeling that they needed to jointly negotiate. I wonder if you could give me some examples of what is this middle ground in terms of the increased coordination of activities and how is that related to the need to have joint negotiations?

DR. REARDON: Well, I think what we are referring to is the fact that as a PO forms and begins to function, you have certain levels of integration. I mentioned a few of these, which is preauthorization, review, writing

and developing the necessary information.

Another thing that a PO can do or an organization as you go through this evolutionary process and maturity, then you get in more financial risk and again there are some variances of whether you have to have capitation or how much withholds creates a substantial financial risk. So when they begin they clearly have limited clinical integration, but you go through a process to where they have more and more clinical integration as they mature. They simply just do not start as a fully mature, organized, clinically integrated organization when you formulate them on January 1.

It may take months or years. The advantage they have is that a large insurance company or a large hospital can come in and oftentimes, because of resources, do a lot of that very quickly or they come in and do it for the doctors.

We would like to see physicians have the opportunity to organize and go through that evolutionary process where they can do the same things and be competitive.

MR. HIRSHFELD: If I can add to that a little bit, the issue is experience, partly experience and resources. The middle ground comes when you have operated a messenger model network successfully and you

want to move on to a higher level of coordination and you feel that you can do that, but you may have to rely on, for example, a service bureau to provide the data or you may actually rely on a third-party administrator to perform the preauthorization function, so the network itself is not actually doing it, but they are using data, for example, that a service bureau has provided to them or relying on a third-party administrator that they have hired. Then it is not a salaried, not someone who is on their staff, it is an outside professional to perform the preauthorization.

And then they are starting to get into the rudiments of utilization review, but they haven't really taken it all in-house yet. I think a lot of attorneys would question: Is that clinical integration or not? And I think looking at the bar that is set on the guidelines they would say no. Then the question is why is there a need to engage in joint negotiations at that point? I think the feeling is there that network management wants to have control over that critical issue, that the payer will want to know. What is this going to cost?

So instead of relying on, you know, the messenger model, which can result in some variances or unpredictables about what the physicians are actually

going to do, then the network management does have some control over what the fee schedule will be. It can assure that it will be at levels that are competitive.

DR. REARDON: If I may add to that, for instance, the organization I am with is a 70-person primary care group in 21 offices. We are in the process now of computerizing each office, so that at some point in time in the near future we will be able at any time at the central server to say how many women, how many 55-year-old women had their mammograms last year? How many two year-olds are totally immunized? How many patients who have a diagnosis of hypertension have diastolic pressures above 90? That's the type of information we need to go to.

However, putting that sort of information system in is quite expensive. One of the other things we are doing now and with the patient data we have about claims, is we have hired an outside consultant, Dr. Zack from Data Medicas to analyze that data for us, give us better information on how each physician is doing within the organization so we have something we can do some internal quality control and control on costs. This is all very expensive.

COMMISSIONER STEIGER: General Counsel Calkins.

MR. CALKINS: I was struck by your observation,

Mr. Hirshfeld, that using my words, not yours, doctors are treated worse than most manufacturers or suppliers and you said that it is because there are third parties that doctors have these difficulties, and I was trying to think of other industries, and is there a comparable situation where manufacturers or providers are allowed to have joint selling arrangements judged under the rule of reason? And I didn't come up with a lot without having done any research or preparation for this, but you may have had something in mind as to the comparison. If so, I would appreciate your stimulating my thinking.

MR. HIRSHFELD: Yes. The item that came immediately to mind was the newspaper industry. There is a business review letter about, I am sorry, I didn't refresh my memory on the exact details of it, but it involves joint selling of advertising space, I believe.

And, you know, that and other situations, I think, can be understood where you don't have an intermediary, which is organizing newspapers for the purpose of selling advertising space to buyers. That if they want to do that, then they have got to do it themselves.

And the -- why don't I stop there. There are some other parallels I could get into, and I wasn't intending to say that there is a seriously dramatic

difference here, but I think it does inevitably shave the answer when you know that there are -- when you are concerned about the possibility of sellers cooperating and the possibility -- when sellers want to cooperate, you are concerned about the possibility of anticompetitive effects from it.

But realizing that there are some efficiencies there, but there is no other way to generate those efficiencies, other than allowing the sellers to organize and go directly to the buyers. But what is unusual about the health care industry is you have this set of intermediaries which can perform that function.

So we are constantly concerned about, you know, questions about why don't we just allow the insurers to do that, and what can physicians do that is different or better than the insurers. We feel in making our case to allow physicians to organize, we have to be able to demonstrate what a physician network can do that is better, or allows medicine to go a step ahead more than allowing HMOs or PPOs or third-party administrators to perform this function.

MS. DeSANTI: Just so the record is clear, could I note there are some special statutory exemptions for newspapers, and I am not sure whether this type of arrangement is covered by any of them, but I would just

like to echo Steve's comments that this might be something that it would be useful for you to explain in more detail in your written statement. It would be helpful if you could give us other examples that you have.

MR. HIRSHFELD: Okay.

MR. LEIBENLUFT: Maybe to expand on that just one more question, part of the statement seems to suggest you are advocating a 20 or 30 percent screen, that if networks are below that, you wouldn't require evidence of clinical integration.

I was wondering if you would require evidence of any kind of procompetitive potential or would that just be basically a per se legality category and whether you think that should apply beyond physician networks?

MR. HIRSHFELD: I don't think it would be a per se legality area. It would be a rule of reason. And, very frankly, you know, we did advance these concepts a few years ago. And there was pretty unanimous opposition to them.

So we didn't want to be so bold today as to say that's exactly what we are advocating but we did want to let you know that among the antitrust attorneys that work with physicians, we are hearing a lot of comments now about why should this be -- why isn't this considered

procompetitive.

We, antitrust attorneys working with these organizations, and, granted, I identify with them to a certain extent, feel that they should be allowed. And we may come forward with more formal recommendations on that in the future, but the statement is couched in terms of this is what we are being told by attorneys in the field, but we didn't come to the point of making a formal proposal for it, but we did want to lay the foundation because we may well make a proposal like that in the future.

MR. CALKINS: One last little clarifying question. I read the statement as saying that protocols are good and guidelines are bad. And for those of us who don't spend a huge amount of time on subtleties of wording and such, aside from who the author is, what is the difference between a protocol and a guideline?

DR. REARDON: I wasn't aware we said that.

MR. HIRSHFELD: We weren't intending to draw a distinction. The statement talks about inflexible use of guidelines that are not evidence-based as opposed to the use that is evidence-based, meaning that physicians have crafted the protocol based on data concerning their own experience.

DR. REARDON: Basically guidelines or protocols

are intended to try and take some of the wide variation in practice out of the system and this does exist. You may not be familiar with Jack Quinberg's work, but a protocol is a guideline for the physician to follow, but giving them clinical leeway that not every patient meets the guideline or protocol, so you treat patients as individuals, that you can follow best practice or this recommendation for the highest percentage, but having the leeway to individualize.

MR. HIRSHFELD: There is one interesting comment that was made by Brent James, who I don't know if you are aware of, but he is a significant contributor to the concept of applying continuous health care and has written widely about the subject and says that in guidelines or protocols that have been developing in health care, they have a series of steps. You know, sometimes the series of steps is fairly complex, and that at each step the physician can use that part of the protocol or not.

And they actually graph what percentage of the guideline steps are used by the physicians. And they find that on average it is about, if they are doing a really good job, it is about 90 percent. And he feels that if a physician consistently used 100 percent of the recommendations of the guidelines, the physician would

probably be a bad physician, probably guilty of malpractice.

COMMISSIONER STEIGER: Well, you have been very patient, gentlemen. We thank you both for coming and for answering our questions.

MR. HIRSHFELD: Thank you.

DR. REARDON: Thank you.

COMMISSIONER STEIGER: We are going to hear now from James B. Kobak, Jr., a partner at Hughes, Hubbard & Reed in New York City where he chairs the firm's antitrust practice group. He has represented clients in both domestic and international matters involving antitrust, trade secrets, patents, trademarks.

Mr. Kobak also teaches intellectual property and antitrust law at the University of Virginia Law School and at Fordham Law School. Since 1995 he has chaired the Intellectual Property Committee of the ABA Antitrust Section, and, in addition, has published numerous articles on antitrust and intellectual property law.

We are delighted to have you with us and thank you so much.

MR. KOBAK: Thank you. I am delighted to be here. As you know, I prepared a statement which I submitted, so I will try to keep my remarks this afternoon brief.

As you know from my statement I tried to approach this question particularly from the point of view of joint venture rules and needs as they affect technology ventures, ventures where contribution of technology are key or which themselves involve research and development.

I think there are a few characteristics of these types of ventures that the Commission ought to keep in mind. It is true that there are many of these ventures being formed these days, but I think the Commission should be aware that, at least in my practice, there are also many instances where parties are very hesitant to join them.

They have discussions, sometimes the joint venture emerges; sometimes it doesn't. I have seen a lot of distrust and fear of people who fear they may lose control of their technology. I think, in addition to affecting the incentive whether to enter a venture or not, these kind of concerns also often lead to limits on the scope and use of technology.

I think for antitrust enforcement purposes, one of the consequences of that is that the Commission could have some confidence that very often these types of ventures are only formed when there really is a need for them, that they probably will not be overly broad, that, if anything, the incentives will be perhaps to keep them

too narrow, and that there shouldn't be too many spillover effects.

I think parties in these ventures are often very hesitant to reveal their deepest secrets, whether it is marketing strategy or research strategy.

So when I approach these questions, I think a key question to ask is to look at the technology of research that's involved and see if it is real. Is there something real and substantial there, either that the parties are contributing or that they are trying to develop or is it just a trivial smoke screen?

And is there a real reason that the parties need to get together to accomplish what they are trying to do? I think parties do need a certain degree of what I call breathing room for restrictions in these types of ventures. I think they need to feel that they are in control of their technology, that they will be able to maximize the value of that technology, and they won't run the risk of losing it either to a joint venture that they have created or to their joint venture partner who may later become their enemy.

I think it is wrong for the antitrust agencies to get in the business of micromanaging some of these restrictions or the structure and rules that the joint venturers agree on among themselves to structure and run

the venture. I also think it is very dangerous to look at these kinds of restrictions in hindsight.

I think the parties need to have some degree of assurance when they enter, certainly a major venture of this kind, that the rules that they have agreed on among themselves will be the rules that will apply at the end of the day and they won't find that there are surprises and things that they thought they had control over, they find they don't have control over.

I think that in my experience these kinds of ventures are increasingly international, and I think that, if anything, that probably increases the uncertainty that parties have about their rights, which just because of differences in intellectual property laws between different legal regimes, I think it probably contributes to some degree to a degree of distrust, and to a further feeling that the parties have that they really need to have some degree of certainty in how the venture is going to operate.

If the rules, the antitrust rules that are applied are too rigid, parties may feel that their technology is too vulnerable and they may be hesitant, even more hesitant to participate in these types of ventures.

I also think that the increasing

internationalization underscores a real need for harmonization of principles and rules that apply to joint ventures around the world. And I think that's one area where, although there may be fairly widespread agreement on the general antitrust principles that are applied, a lot of the particulars and a lot of the procedures vary very substantially, probably more so in this area than in many other areas.

One of the most difficult questions I think that people have entering ventures of this kind is what I call the question of exclusion. Do you have to let everyone in the industry in? Are there people you can exclude? I think the government's position on this as expressed in the Intellectual Property Guidelines and as it is expressed in the National Cooperative Research Act is fairly clear, but I think that many of us in practice still have a bias when push comes to shove not to exclude or not to go too far in excluding because, frankly, people are afraid of treble damage suits, or even if it is under the NCRA, single damage suits.

It is possible that ventures can be operated in a way that they become more inclusive as time goes by. I think that should be suggested in these hearings. And I think sometimes that's possible, but sometimes that's not very easy to accomplish. And I think in many cases

people are dealing in an atmosphere of some uncertainty and they need to have as much certainty as possible at the outset.

I think this is a difficult problem, and I think the thing that makes it difficult is the coexistence in our legal system of government enforcement with the private right of action. And I am not sure, frankly, how far guidelines, further guidelines can go to solving this problem.

And I think the problem of private enforcement makes me a little skeptical or perhaps I should say agnostic about how helpful or effective a broad set of guidelines can really be in this area. I don't think this is like merger law where the guidelines are so influential and so helpful, but I think that's largely because so much of the enforcement is undertaken in that area by the government, and there is not quite the same degree of concern about private action.

I also think that the general principles and rules that ought to apply are pretty well understood, the general legal framework. I think the thing that makes it difficult is just the infinite variety of factual circumstances that those rules have to be applied to, but all that makes it very hard for me to see how one set of guidelines could cover those situations.

I guess I am not smart enough to understand what the unifying field theory is, except at a very, very overall general level of abstraction.

I think there is a danger if guidelines are created they sometimes are interpreted as relatively formal documents, even though that may not be the intent of the agency. I think sometimes there is a tendency for the analysis in the guidelines to, if you will, channel and imprison thought and argument so that it all follows the wording of the guidelines, even though economic thought and experience may tell us that there are things that aren't adequately covered in any given set of guidelines.

I also think that you would be surprised sometimes, but out in practice you do run across people who, for instance, in the Merger Guidelines, will take things that are written in the Merger Guidelines very, very literally, much more literally than I think the agencies intended that they be taken.

I thought the Intellectual Property Guidelines were very helpful, but I guess I saw them as a different kind of guideline, more almost like a restatement of a law. I thought that was very helpful because I think there was a lot of confusion about what the government's policy and what the interface between intellectual

property law and antitrust laws should be.

I am not sure that that same degree of confusion exists as to what the overarching theories, at least, that ought to be applied to joint ventures are. And as I said before, I think that the variety of joint ventures is so immense that it is hard for me at least to contemplate a set of guidelines that could adequately deal with all those circumstances and possibilities.

That's not to say that I don't think there couldn't be very limited policy statements about particular areas where the Commission has experience in certain types of ventures. I think there could be amplification, speeches, further amplification of reasoning in consent orders and so forth, and I think all those things are very helpful.

One thing, as I mentioned in my statement, that I think sometimes makes people reluctant to undertake a business review procedure or even to file under the National Cooperative Research Act is this concern for secrecy. And I think that one thing that might be very helpful to people would be some kind of more confidential way that perhaps at the outset of planning they could approach the Commission or the Department of Justice and get some kind of informal guidelines, and this is certainly a system that has started to grow up in a lot

of other areas of the world.

As I mentioned before, I think any efforts that could be undertaken to harmonize the rules and the approaches to joint ventures, particularly in the research area and as they involve restrictions in technology licenses as part of joint ventures, with the international, other international antitrust authorities, would be very welcomed.

This is kind of an aside, but many of us work who in the intellectual property area have been saying for many years that it would be helpful if the Hart-Scott-Rodino rules that are applied to the valuation of exclusive licenses could be clarified.

I think the safety zone in the Intellectual Property Guidelines is a somewhat useful feature. I don't think people rely on it to any great degree today. I think that is partly because it is set at what I think is too low a threshold. I think if it was more of a 30 percent level, it might be more meaningful to people.

I think a very important thing is that the way the guidelines read now, even if you think when you form the joint venture that it is only going to have a 20 percent market share or it only does have a 20 percent market share, and that's even assuming that you can adequately define what the market is and so forth, the

problem is if it exceeds expectations and sometime down the road has a greater market percentage, it doesn't seem to be eligible for safety zone treatment any longer.

And I think as several other witnesses have mentioned throughout these hearings, it is very important for people who practice in this field and for their clients to have some predictability and certainty at the outset that what the rules are when they form something and what the situation is, reasons why they did something, are the rules that should be applied, rather than looking at things too much by hindsight when the situation may have changed.

I think you have to remember that it is very important to encourage people to enter into these kinds of collaboration. If you make it too hard for people to exit from these ventures, they are not going to enter them in the first place.

Thank you.

COMMISSIONER STEIGER: Thank you very much. I would like you to expand, if you could, since you have said that even if this Commission and the Department can't do a global set of guides here, that there might be specific areas that would be useful for further comment.

And I would like you to explain a little bit more about why you think the thresholds for, in the HSR for

filing are particularly low, in your words, for joint ventures and how you would treat the valuation rules as it applies to intellectual property?

MR. KOBAK: In joint venture rules, when you form a corporation, value that's agreed to be contributed to the venture at any time by the joint venturers, and they set that amount at \$10 million, and you often have in joint ventures at this time existing licenses and perhaps agreements to include future licenses, future products, future improvements, future technology, it is very hard to value those things, but if you are talking about what could be very substantial and important technologies, they could conceivably have a very great value and the \$10 million figure is very low.

I think a lot of us are very unsure about exactly how you go about evaluating a license to an intellectual property right, particularly for a product that might not exist yet, if you don't have any kind of minimum royalty. It is pretty easy if you have a minimum royalty provision or something like that in a license, you can, you know, multiply it out and determine whether it meets the threshold, but if you don't have something like that or if the minimum value is very low, you really don't have much guidance.

And you may find, even in your client's

documents, that different people in the company may evaluate the technology with different value. And I think it is just an area where the bar and clients could, would very much appreciate further clarification.

And it is actually still a surprise to many intellectual property lawyers that exclusive licenses are even subject to Hart-Scott-Rodino if you are talking about an important product.

COMMISSIONER STEIGER: Has the section done any work on the specifics as it relates to Hart-Scott filings, do you know?

MR. KOBAK: I don't know. I know we have had programs from time to time and this has been one of the questions that has been addressed. Maybe Mr. Kolasky would know in more detail than I remember today.

MR. KOLASKY: The section has had a working group working with both the Federal Trade Commission Premerger Notification Office and the Justice Department Premerger Notification Office to discuss various forms in the Hart-Scott process.

Unfortunately, the subject of the thresholds has been declared off limits to this point, but this is a subject obviously that the section does have a great interest in.

COMMISSIONER STEIGER: Steve, you had a

question?

MR. CALKINS: Just a quick follow-up question. You talked about the difficulties of uncertainty in forming joint ventures. That was discussed at our hearing yesterday where Professor Gellhorn proposed a solution of expanding Hart-Scott-Rodino to cover many more joint ventures in order to bring greater certainty to the field.

I take it your interest in greater certainty means you would sign on to that suggestion as well?

(Laughter.)

MR. KOBAK: Well, I think a preferable solution might be to have some kind of informal channel where maybe you didn't have to file all the documents and notification and so forth, which in some of these ventures might actually be hard to do because you don't have existing products.

But, frankly, I can tell you that there have been circumstances that I have been involved in where people have, when they have had a choice, say, between a partnership and a corporate form, may have chosen the corporate form so they will get some government review because they would rather know today that there is a problem and find out about it ten years ago.

I want to think that through. I wouldn't say I

endorse it enthusiastically, but, on the other hand, I certainly would not dismiss it, by any means.

COMMISSIONER STEIGER: Very well. Yes, Lou.

MR. SILVA: Yes. I was interested in one point you had in your statement about the problem of incomplete agreements between the joint venturers and going to the antitrust enforcers with incomplete agreements and then there was this process of tinkering, I guess, with the agreements.

And I certainly recall, in my experience, many joint venture cases I have worked on where parties have not worked an operating agreement, there might be production agreements, and that kind of thing. I was wondering if you had any opinion whether it might be preferable to have parties to a joint venture have a complete set of agreements before they come to the antitrust enforcers in order to avoid this gaming problem you talk about?

My understanding is that's the procedure they have in Europe, that the antitrust authorities there will have the complete set of finalized agreements.

MR. KOBAK: The problem with that is I think you might kill off a lot of ventures because I am not sure the parties would want to undergo a review unless they knew they were working toward a deal. And if they had to

work out the details first, but you still had this antitrust uncertainty as well as everything else, I think that might kill a lot of things off.

In one of the examples that I was mentioning, there actually was -- I mean, the agreement in principle was a pretty elaborate document. It was 30 or 40 pages long. And it was mostly the license agreements and things like that that hadn't all been worked out.

So that was more a question of the, in that case, the Antitrust Division really saying: Well, we think this provision has a little bit too much control on one side or the other, so we think you should think about changing that. So it wasn't so much saying we haven't worked this out yet. It had been pretty well worked out, although everything hadn't been signed on the bottom line.

MR. COHEN: In order to make things a little bit more concrete, at one point you talk about a need for a little bit more breathing room for some of the restrictions that are imposed on the use of technology out of concerns for maintaining secrecy and proprietary control over your technology.

Could you give an example or two of the types of restrictions that you have in mind and try to explain why there isn't already sufficient breathing room for them?

MR. KOBAK: One of the things I have in mind is a covenant-not-to-compete-type provision. And as I read the Intellectual Property Guidelines, that's one category of restriction that's treated relatively harshly. And I think often there is a need for that kind of restriction.

Often you don't know exactly what someone will do with your technology. And rather than having a lot of elaborate provisions, it might be much more efficient to just have them agree for some period of time, say, after the venture breaks up or even while the venture is operative, that they will basically stay out of some area. That's the example or that really is the key example of the type of restriction I think comes up most often.

COMMISSIONER STEIGER: Susan?

MS. DeSANTI: I had a couple of questions. One, your premise seems to be that the tendency that your experience shows for companies to want to hoard their intellectual property means that, as I understand your paper, justifies an inference that when there is, in fact, a sharing of that property through a joint venture, the antitrust agencies should assume that that, in fact, is efficient, good for competition, procompetitive. Is that a fair summary?

MR. KOBAK: Yes, in general.

MS. DeSANTI: I am wondering about whether something along the lines of an opposite inference couldn't also be justified in the sense that there have been examples through history of anticompetitive cross-licensing agreements, patent pooling, putting the assets together to keep out new entrants to raise entry barriers, so given that one might have an opposite inference, is it really justified to only say that that miserly tendency works in one direction?

MR. KOBAK: I think there are two things. One is I think in some of those cases when you looked at the technology, I wouldn't say the venture is a sham, but it might be that the technology was a lot less substantial than the restrictions and the impact that it seemed to have, so you might ask yourself: Is that really the reason the parties are doing this?

And, second, I wouldn't say -- certainly you could have a situation where all the parties in an industry or people with the two or three controlling sets of patents or likely future patents decided that they would pool those and not let others play or what have you. And I think that there certainly could be anticompetitive tendency there, but I think you are really talking about almost a monopolistic or an attempt

to monopolize type principles coming in at that point.

MS. DeSANTI: And my further question on the uncertainty issue is given that there are all kinds of uncertainties about what the future is going to be, it seems that those are the same uncertainties that the antitrust agencies are dealing with, since obviously the assessment of the competitive consequences of anything depends on what the circumstances are at that point in time.

MR. KOBAK: Yes.

MS. DeSANTI: So I am wondering how it would be the case that we could necessarily provide more certainty to companies, given that we are operating in the same realm of uncertainty with respect to what the facts are going to turn out to be?

MR. KOBAK: I recognize that that's a difficult problem. One of the examples that I have was this one business review, where I thought the antitrust agency in that point -- there was quite a lot of material that the companies involved had generated about what these products might do, future products might do, what the shape of the markets would be, but obviously no one had a crystal ball.

If you read scientist A's study, scientist A would say the thing he was responsible for was going to

cure everything. Probably wasn't -- but I think the parties were able to make a relatively reasonable assessment, and I think the agency was. It may not have agreed 100 percent, but broadly they agreed.

And I thought that was a fair approach. I recognize there could be circumstances where a technology is so speculative or something that it may not be able to be marketed and so forth, that you may not be able to make an accurate prediction, but I think many times you can.

I think just as the parties have to make their estimates and proceed accordingly, I think it would be very helpful if the antitrust agencies were to do the same thing to the best of their ability and then let the parties proceed.

If it turns out that a venture comes to control 40 percent of the market when everyone thought it was going to control 28 percent of the market, that shouldn't make a great deal of difference at the end of the day.

MS. DeSANTI: Should it make a difference at that point in time when the venture controls 40 percent of the market or let's make it even more egregious, as an example, and say 60 or 70 percent of the market. Should it make a difference at that point in time in how the agency assesses the conduct of that venture at that point

in time?

MR. KOBAK: Possibly, but, you know, that's where you get into this problem of we set it up, we are the ones that did the research, we have contributed a lot, what do you do now? You let people into the venture. Do you license things to them that you didn't intend to do?

I think it is a very difficult problem, but, again, I think if the parties thought that that wasn't what they were doing and it was just happenstance or something that maybe one technology never came to fruition, I am not sure you should judge those restrictions too harshly by hindsight because I think in the long run you will only prevent people from entering this kind of venture.

MS. DeSANTI: So I guess I am having trouble understanding, are you saying that at the point in time when a joint venture would, say, control 60 to 70 percent of the market, the output in the market, that at that point in time the Federal Trade Commission or the Antitrust Division should look at conduct by that joint venture, say with respect to either exclusion issues or any other kinds of conduct, licensing, how they go about licensing with other entities, as though they were a venture that had a much smaller share because that was initially anticipated?

MR. KOBAK: No, but I don't think you should -- I think you should be very conscious of where they came from, how they got there, what the reasons were, what they did to invest it and not just look at it in a vacuum as if the only fact was this is the kind of thing that is controlling 70 percent of the market. I think that could have a big influence on the way things are evaluated.

MR. CALKINS: Last quick question. I was struck by your observation that private litigation biases your advice or biases your advice of some private lawyers towards inclusion, even if you can find speeches by Bill Baxter saying that you should keep ventures down to a small size.

And the point made a lot of sense to me. And, of course, it is an important issue for antitrust. So I was disappointed to have you follow that up with the observation that even clear guidelines on the issue might not well do a lot of good.

And I guess my indication would be to the extent you have any bright ideas of other things that would do good, whether it is a well-timed amicus plea or something else, I would encourage you to speak up because it may be that that's an area where some clarity would do the market a lot of good.

MR. KOBAK: I guess the point I was trying to

make is I don't see that a guideline in itself can cure that problem. I think to the extent the guideline is a useful restatement of a law that can be cited to a court, that's helpful. A speech can be helpful. Appearing as an amicus, I think, would probably be most helpful of all in appropriate cases.

I think when either the Commission or the Justice Department does that, it has had a big impact on a lot of cases in this area, in the intellectual property area, as well as in the antitrust area.

COMMISSIONER STEIGER: Thank you very much. We turn now to Professor Nicholas Vonortas, Associate Professor of Economics and International Affairs at George Washington University's Center for International Science and Technology Policy and its Department of Economics.

His areas of specialization include the economics of technological change, industrial organization, and interfirm cooperation. Before coming to Washington he taught economics at New York University. And in addition to teaching, Dr. Vonortas has worked as a consultant to NASA, the Small Business Administration, the World Bank, the National Bureau of Economic Research, and the Department of Commerce publishing extensively in the areas of cooperative research, competition in R&D, and

strategic alliances.

And if you can't help us, given that range of expertise, we might be in more trouble than I think we are. Welcome, please, Professor. We are pleased to have you with us.

PROFESSOR VONORTAS: Thank you very much. Let me first apologize for my strong accent, but I will try to do as well as I can.

COMMISSIONER STEIGER: Then we will apologize for ours. If you have one, we do too on the other side.

PROFESSOR VONORTAS: I believe that I was invited here to talk to you about a long-term research project that we are conducting at George Washington University here. And this project actually is in many senses a continuation of my interest on these cooperative agreements since the mid-1980s.

As you notice, I do not have a written statement because I never talk from written statements. I rather have two papers I sent you, two papers which are excerpts of a book that is about to come out now on these things.

Now, let me tell you briefly what this is. This is the broad picture, actually. The people who talked before me quantitated on the detail. I will give you here the forest. And the heart of this project is what, to the best of my knowledge, is the most extensive

database on the research joint ventures that have been registered under the National Cooperative Research Act, actually, and the National Cooperative Research and Production Act from the very beginning, 1985, until two months ago -- well, six months ago. That's where our data is now.

We have them all. And what makes this database actually particularly useful for the analysis that I have in mind is that we complement the data, that data on the joint ventures, which, of course, we get from the Federal Register, with data on the individual participants in these joint ventures, which we gather from independent sources, commercially available.

So we have a huge thing sitting in the computers which can actually answer or at least attempt to answer a number of questions. May I use this?

COMMISSIONER STEIGER: Please.

PROFESSOR VONORTAS: This will be a list, and there are a few more, of questions that we are dealing with with this database. And I believe that these are the type of questions that have been raised in the literature, the literature that many people in this room are familiar with, and that is the industrial organization literature, but also in the literature on the evolution of technology and the literature on science

and technology policy.

The research that is going on with this database is actually convincing me of one thing. It is convincing me that the way I was thinking about joint ventures until I got this data in my hand was not entirely right.

The way I was thinking about the joint ventures was the classic way that I was taught in school to think about joint ventures, and that is the cost reduction thing and some general idea about risk, and anticompetitive concerns and all that.

In fact, let me assure you that the way it works from this database, it is that those joint ventures that have been registered with your agency and the Department of Justice are simply a microcosm of what others have described in databases as strategic alliances.

There is a problem here. I was hearing the previous commentators, and I was hearing the questions, and one of the problems that I think we have in this area is a definition, is a definition of a joint venture. We have a big problem there in that what we had in mind as a joint venture and what we still teach in industrial organization classes, our classes to be a joint venture is not really what the firms are doing today.

It is only a small part of what the firms are doing today. What the firms are doing today is what has

been called strategic alliances, for the lack of any other term. That's the best we have been able to do.

And these joint ventures have registered, actually replicate in many respects what people have shown with very different databases on alliances to be going on. In particular, there are really two or two and a half areas, technological areas where activity is going on. It is information technology, No. 1, and that's the most extensive. It is new materials, No. 2. And then there is some activity, not very much, but some in biotechnology. And that's it.

That's what characterizes all the joint ventures, 98 percent of the joint ventures that have been registered. These joint ventures, and I can tell you there were 575 of them for the first 11 years, from '85 to the end of '95, and there are 96, we just finished counting 96 more in 1996.

Those joint ventures are really pretty heavy in technologies that have no well-defined technological paradigms. You see, this is a term that is not being taught in industrial organization classes. Nobody knows in such a class what a technological paradigm is. And yet we, economists these days, understand quite a bit about what the technological paradigm is. It is the root of technological advance. It is the way technological

advance progresses.

So all these three technological areas, and particularly information technology, is technological areas where there is a lot of technological uncertainty. There is no well-defined technological paradigm.

So what the firms really seem to be doing with these joint ventures is much more than the usual things that one has in mind, one who has just finished the industrial organization class. And those things actually are not different than what all the business literature, business representatives say they are doing. They are actually trying to decrease their risk.

In fact, the best way I have managed to characterize this is they are actually buying call options on technology. That's what they are doing, the same way investors in the financial market buy a call option on the stock of a firm because they are not very certain, they have a hunch but they are not very certain about whether the hunch is correct or not. That's exactly what they are doing.

They are doing call options on technologies. And they have hunches. It is pretty uncertain. Technological end market uncertainty is pretty high. They are simply not ready to spend the resources that are necessary for all those to follow, all those. They will

get into those joint ventures and many of them will fail, so be it.

Why should we think about joint ventures as being something stable? In fact, I would be very skeptical if they would, all of them would be stable. And I don't want them to be stable. The reason why they are being done, actually, is for helping people to overcome this fear that they have that they are going to waste a lot of resources.

So in this publication that we are preparing, as a matter of fact, one of the papers that I have submitted is coming out, is already about to come out in Research Policy and the other one is submitted and hopefully will come out.

But we have created beautiful pictures of the joint ventures. And I can show you one, just one, to see what is going on to get an idea about what things are going on in this joint venture area. And this comes from the second paper that I have submitted.

This, you see, one axis here, you can have the technological field of an RJV, and on the other axis you can have the primary industrial activity of the participants. And you can put them together and see where the activity is. And guess where it is? You cannot see it. It is on 73. You see 73 is somewhere

there. And it is software, 73 software. And it is on 48 down here, this is a big spike, and that is telecommunications.

And you have, if you go on the other side and you see what the industries are, you will realize that there is software, computers, machinery that uses -- actually combines computers and software, that's where the activity is, and new materials. That's the best thing.

So to make the story short, the idea in the work that we are doing with this data is that economic theory as we have them, the mainstream economic theory can take us indeed some way, and we can start asking some basic questions with that theory. What is the effect on society? What is the effect on competitors? It helps us, mainstream theory just helps us think about the issues.

However, the analysis, I find it very poor. How far the mainstream economic analysis can take us is very poor, and for one reason. And that very important reason is that we have not done well with technological change. We really don't understand technological change.

Mr. Kobak there was telling us about the fears that the companies have of losing what they have, the most valuable thing, actually, that they have, their technology. And we as economists do not really

understand that very much, I think.

I happen to, because of my business at the university, I do not talk with economists only. I talk also with noneconomists, extremely smart people who are interested in science and technology policy. And from them I have really managed to expand the way that I can see. I can look at things, and indeed they have a very different view of the world. They understand this competition or competitiveness and all that, but there are things that they have in their minds that we economists are a little bit behind in understanding.

So what I am saying here, I am saying the following. I want to come down to guidelines because I think that's where all this leads to.

Before we come up with guidelines or you come up with guidelines, I think we need to think very hard. The guidelines, I have a problem with guidelines. And the big problem that I have with guidelines is that they are like a steam roller. They are steam rolling over all the industries.

They go out there and say: If you have 40 percent of the market, you are out or 50 or 20 or whatever. Industries are very, very different. And situations are very different from one another. And I am sure that we don't want to be unfair in that respect.

So I would urge that we think about research joint ventures a little bit different than we have up to now. I really think that this idea of technology options, thinking of the firms as buying an option to technology through these joint ventures takes hold.

Now, this is not, of course, I am not the only one to advocate such a thing. In fact, you can go two years back, three years back, and you can find that very nice book by Dixit and Pindyke on uncertainty in investment. And you will see that all in that book, they don't really talk about research joint ventures and all the complications that they bring, but they put down some -- they have the groundwork to start doing some theory on that.

And actually I am involved in doing theory on that right now. I cannot present it to you because it is in the beginning stages, and I am not certain about it myself, but hopefully in a year or so I will have something.

Now, I want to tell you also that I don't know what you have in mind with this, but next year, this work has been funded by the National Science Foundation, and the National Science Foundation actually is funding somebody else too who has, from the University of North Carolina, who has a complementary project to mine.

And I am looking at the big picture and I am looking at the questions of interest in industrial organization economists and policymakers and the regulator and whatever. He is looking actually at case studies, so he is going here and taking interesting case studies of this and looking at them in some depth.

One of the things that I have in mind to do, actually, his next survey is to find out something about the questions of intellectual property. Intellectual property in these joint ventures, given that they are research joint ventures, intellectual property is of course the primary concern or one of the primary concerns.

And we know just very little beyond the case studies that you have. We know very little about how people behave, actually, on this.

Surprisingly we know much more about the European joint ventures. Actually I am about to leave for Europe next year on sabbatical. And I am going to be doing the same work on European joint ventures.

And surprisingly for me, at least, I found out already that I know much more about them than about the American joint ventures. And the reason is simple. The community, you know, in Europe, there is this framework of programs where, like ATP, something like ATP or what

we have here, the advanced technology, there is a very elaborate agreement. If you participate in the competition, if you get funded, then you have to sign an agreement. And in Annex 2 of that agreement, that applies to all joint ventures of the community will fund at any point in time, really is very clear about what is happening with intellectual property. And there are rules about what is going on with intellectual property in joint ventures.

The equivalent American program here, the Advanced Technology Program, with which I am fairly familiar and for which I have sort of worked a little bit, does not have anything like this. So when one reviews the applications that come in, as I have, and I review them because I was extremely interested, actually, in seeing what kind of projects people come up with in these joint ventures, they have very little idea about what is going to do, what they are going to do with their intellectual property. Very little.

This is, as you said, this is projects that are very far somewhere in the future, five years or so in the future. And when it comes to intellectual property, they have, well, we will license it, we will actually try to make it known to competitors and that's it. And everybody is nodding their heads and saying, okay, fine,

they will do. And the project goes and very little comes in. Okay. I will stop here and I will perhaps accept your questions.

COMMISSIONER STEIGER: Thanks.

MS. DeSANTI: One of the things that I was struck with in looking at your materials and in hearing your presentation today is the seeming absence of pharmaceutical research.

Do you have any insight into why such --

PROFESSOR VONORTAS: I think I do.

MS. DeSANTI: Could you elaborate?

PROFESSOR VONORTAS: Intellectual property rights, it is a question of intellectual property rights. Pharmaceuticals have much better intellectual property rights protection. And in that case the cooperative agreements that they strike are very different than these cooperative agreements.

Here people are searching. They are searching in the air. They don't know what it is. They don't know where technology is. Mr. Ellison from Oracle says that tomorrow the machines that we have on our desks are going to be dumb machines, they will know nothing, they will hook up to the Internet and they will get everything that they need from the Internet. That's one way of doing it.

Then it is Mr. Gates from Microsoft who says:

No, no, no, the machines that we have on our desk will become smarter and smarter. And these are very opposing views of the world. Now, both of these companies are searching and they are searching very much.

I can show you some other very interesting pictures, actually, and I didn't do so because I don't want to confuse you very much, but I can, I may try to confuse you.

This is IBM in joint ventures only, not anything else, not other agreements that IBM has by the hundreds. This is only these joint ventures.

Now, if any one of you could tell me whether Mr. Gessner really thinks that he can manage anything like this? I mean, of course he cannot. I mean, he is a very clever man. You see what are the squares, you see the little squares there on each link of IBM with other companies? These are how many times IBM has met with these companies in this joint venture. This is what -- and see how many times it has joined with all those things? And I have plenty of those pictures.

And it is not only IBM but it is foreign companies. One-third of the participants in these joint ventures, one-third are foreign-owned. And we know that because we trace the names in the Federal Register.

I have some pretty cheap graduate students.

That's my advantage, actually. And with a little money that the National Science Foundation provides, I can have them trace actually a name that somebody will see it, and I am sure you are doing the same, looks like a very American firm, actually it is owned by the Japanese or German or an Italian firm or somebody else.

So I trace all those back and I know actually how many foreign companies participate. And of those that I can identify, and I can identify about 85 percent, 83 or 85 percent of all the names that show up in the Federal Register, some of those names are completely unidentifiable, I can't find them anywhere. But one-third of them are foreign-owned.

And perhaps an interesting detail is that about one-third of the American-owned public corporations are actually, they figure they are in services. That's what they call themselves, service firms. But one-third of them -- which until recently we thought they were not R&D intensive.

MS. DeSANTI: Well, at the risk of further confusing myself with additional charts, let me just follow up because I am wondering whether, in fact, the differences in stronger intellectual property rights for pharmaceutical companies when -- and I raise that question in part because computer software at this moment

has three different types of intellectual property protection that is available to it. It is one of the most heavily protected or protectable, at least, assets out there.

And I am wondering, given your description of all of this, whether it may not be the case that one of the distinguishing features between, say, pharmaceuticals and computers or telecommunications is that the paradigm of what technological advance is going to look like in the pharmaceutical industry is, although still uncertain, a somewhat clearer paradigm than what it is in the telecommunications or the computer industry where you have such a wide discrepancy between leading manufacturers as to what next year's model of communications is going to be?

PROFESSOR VONORTAS: Yes, that may be it, but that may be some -- I mean, yes, but I wonder why biotechnology is more certain as a technological area than software. I mean, biotechnology is a very open field and we know very little. Simply, I think I don't have a lot of pharmaceuticals here because pharmaceutical firms -- now, see, this database has a bias.

What is a big bias of this database is that these are companies that feared that they are going to be taken to court. So these are cases where companies were afraid

that they would have a problem, so they came to you and registered.

Pharmaceutical companies actually enter into these agreements but they enter into different types of agreements. They go and sign an agreement or buy a biotechnology firm. There is a huge pharmaceutical with a very tiny biotechnology, they are not afraid of having a problem and they don't show up here. They show up in those other databases of alliances that I told you about.

COMMISSIONER STEIGER: Thank you. We have reached the time when in the interest of our wonderful court reporter here, we are going to take a 15-minute break, if that's okay with our other two panelists, if you can indulge us in that, and we will resume at 3:30.

(A brief recess was taken.)

COMMISSIONER STEIGER: Thank you. We continue this afternoon's hearings with William Kolasky, who is a partner at Wilmer, Cutler & Pickering in Washington where he has practiced antitrust law since 1977.

He is an active member of the ABA Section of Antitrust Law and member of the editorial board of Antitrust Law Developments Fourth Edition. He has represented clients involved in a number of private antitrust actions, most recently representing Jerry Jones

of the Dallas Cowboys in their antitrust action against the NFL.

In addition, he has extensive experience representing clients before the Antitrust Division and the FTC in various antitrust matters, including joint ventures.

Welcome, Bill, and thank you for being with us.

MR. KOLASKY: Thank you very much. I, too, have some prepared remarks, which I have given you, and I am going to depart from them somewhat because I want to follow up on some of the comments that the professor just made, and I think they are very significant, and that is the scope of what we mean by the terms strategic alliance and joint venture.

I was one of the principal authors of the chapter on joint ventures for the most recent edition of Antitrust Law Developments. And then after that I have been doing a fair amount of research and writing concerning strategic alliances.

One of the things that struck me when I was working on the joint venture chapter for Antitrust Law Developments is how few litigated cases there are involving joint ventures in the last several years. And I think one of the reasons I am as strong a supporter as I am of having the agencies develop joint venture

guidelines is that much of the case law that is out there is very old, much of it is not well or at least carefully reasoned, and I think that a policy statement from the agencies providing a modern and sound analytical framework for dealing with joint ventures and more broadly with strategic alliances would be very useful.

The second thing I was struck with when I was working on strategic alliances was exactly what the professor was just saying, and that is how many strategic alliances there are today. He put up a slide showing IBM's joint ventures. Well, the joint ventures are only the tip of the iceberg.

One study I saw said that IBM is a party to more than 10,000 strategic alliances. The number of strategic alliances according to another survey is increasing by some 25 percent per year.

And you find if you go to the newspapers there are strategic alliances in virtually every area of business; telecommunications, aviation, which are the two that I focused on in my prepared statements, but also electronics, computers, the automotive industry, pharmaceuticals. Every industry seems to be making extensive use of strategic alliances.

The other thing I was struck with is the variety of types of strategic alliances that exist. To name just

a few of the most common ones, minority equity investments, exclusive supply arrangements, joint R&D ventures, joint production, specialization agreements, joint purchasing, joint marketing through copromotion and cobranding, particularly in pharmaceuticals, and many other similar types of arrangements. There is just an immense variety of these things.

The other thing that you find when you begin researching in this area is that there is a large, a voluminous body of literature concerning strategic alliances in the managerial journals, and in the business school literature, but there is almost nothing written about them in either the industrial organization economics literature or in the law review literature.

And there are no, I repeat no litigated cases that use the terms strategic alliance as part of their substantive antitrust analysis.

So what is going on? Why is this? Well, part of the reason I think is just a question of semantics and vocabulary. We antitrust lawyers, antitrust scholars, and antitrust enforcers have for many years used the term joint venture very, very broadly. It was defined, I think, by Chairman Pitofsky and by Rick Rule when he was head of the Antitrust Division as basically any collaborative agreement between actual or potential

competitors falling between a cartel and a full merger. That takes in a very broad spectrum of agreements.

It turns out if you look at how the term strategic alliance is defined, both by foreign competition officials and in the managerial literature, it is basically the same definition.

Taking as my example the recent November 1995 policy statement on strategic alliances published by the Canadian Bureau of Competition, they define a strategic alliance as any form of inter-firm cooperative arrangement beyond contracts completed in the ordinary course of business.

So they would basically include even mergers within the term strategic alliance and, in fact, in the managerial literature, you find that some managers, some business scholars think of mergers as a type of strategic alliance.

The other thing which comes through clearly as you think further about this and read the literature is the reason for this different vocabulary. Business executives and corporate lawyers have a very narrow definition of joint venture. They view joint ventures as limited to agreements that create a new and separate business entity under the joint control of independent parent firms.

In some cases state corporation laws have actually adopted that definition of a joint venture. Interestingly, some antitrust commentators and some courts have also adopted this narrower usage.

One of the most influential articles on joint ventures written by Professor Joseph Brodley of the Harvard Law Review back in 1982 adopts this narrow definition of a joint venture. And several courts have, in turn, embraced that definition.

So I would urge that the Commission and the Division as it thinks about joint ventures adopt the broader definition, the traditional antitrust definition, and include in their review not only joint ventures in the sense of newly created jointly-owned entities but rather all strategic alliances, meaning any cooperative arrangement going beyond contracting in the ordinary course of business.

The other thing which I think is important to focus on as you think about these concepts is to broaden your view beyond arrangements between actual and potential competitors. Again, even though the broad definition of joint ventures that Chairman Pitofsky enunciated appeared to limit the term to agreements between actual or potential competitors, when you look at strategic alliances, you find that nearly half of all

strategic alliances do not involve competitors. They involve firms that stand in a vertical relationship to one another in the sense that they have complementary resources to bring to bear to a particular strategic objective and that's what they are trying to do through the strategic alliance.

The fact that such a large percentage of strategic alliances are basically vertical in nature means that most of these alliances ought not to raise any antitrust concern whatsoever. For many years, I think both the agency and the Courts have recognized that there are only very narrow circumstances in which vertical arrangements, purely vertical arrangements will raise serious antitrust concerns.

As you think about strategic alliances and guidelines, therefore, it is very important that they be written in a way that not only embraces the broad range of these types of agreements but also provides an analytical framework that will not chill the ability of firms to enter into these arrangements freely without fear of antitrust liability.

I think that goes to the point of what types of guidelines the agency should adopt. Clearly any guidelines should be modeled after the Merger Guidelines, which provide a broad analytical framework for dealing

with these types of arrangements.

I think the type of guidelines that we have in the health care area, while very useful for that particular industry, would be a mistake in the case of strategic alliances because you don't want to try to cabin these very imaginative and creative arrangements into a few particular cubbyholes.

Another important point about strategic alliances is that while they often involve equity investments, they also are quite typically entered into through various contractual arrangements. That means that the agencies and the courts have to take a somewhat broader view, I think, of integrative efficiencies.

Risk sharing in the traditional narrow sense that it is used in the health care guidelines is not really, I think, the determinative issue. The issue is are these firms bringing together complementary, productive resources and using them in a way jointly that will allow them to do something that neither firm could do individually or do it more efficiently.

So the test really is: Is there an efficiency justification, whether the integration is by contract or by ownership?

Also, the agencies, I think, need to be sensitive to the way in which these arrangements are structured.

Again, the managerial literature explains that strategic alliances typically do not rely on the legal enforceability of contracts for their glue. Instead, they try to create a structure that aligns the interest of the two firms so that they don't have to worry about going to court to enforce their agreement.

The reason for that is, of course, all of the transaction costs that Oliver Williamson taught us about, I guess it is now two decades or more ago, impounded rationality and opportunism. So these strategic alliances use exclusivity and reciprocity arrangements in order to align the interests of the firms so that you don't have to -- so as to reduce the risk of opportunism, so they can go forward without having to negotiate every single detail of their arrangement in a lengthy contract.

My paper discusses the airlines and telecommunications strategic alliances, which I think are some of the largest and most visible strategic alliances. And they serve, I think, simply to illustrate that even those strategic alliances that involve a competitor may have significant procompetitive potential and deliver important consumer benefits.

What I would like to spend my brief remaining time on is to speak briefly to the analytical framework that I would urge the Commission to include in any

guidelines that are developed in this area.

For purposes of doing that, whether it is fair or not, since he isn't here, I have taken the speech of the Acting Assistant Attorney General Joel Klein gave to the ABA last fall, his step-wise approach to horizontal agreements, because I think it has some statements that I view as being of concern, especially if they were to be applied to strategic alliances.

Traditionally, the courts, from the Supreme Court through most of the circuit courts, who have considered the issue have set forth a very clear analytical framework for evaluating horizontal restraints.

The first issue is to look at whether the agreement is naked; that is, does it serve any potential procompetitive purpose whatsoever? If not, it is per se unlawful.

But if there is a plausible procompetitive business reason for the arrangement, then you go into the rule of reason. And under the rule of reason, the first question is whether the arrangement has restricted output and raised price or in some way gives the firms market power or facilitates the exercise of market power.

Only if you answer that question in the affirmative do you turn to a detailed examination of the proffered efficiency justifications, including whether or

not the particular restraints are reasonably necessary to achieve them.

Were you to reverse that order and put everyone at risk when they enter into a strategic alliance or a joint venture that they are going to have to show that every single detail of their agreement is reasonably necessary to achieve the procompetitive objectives, you would chill much of the activity that is now going on out there in the marketplace and is delivering important benefits to consumers.

So I think it is very important that any guidelines make it clear that the antitrust enforcement agencies are not going to take action except against those strategic alliances that pose some demonstrable risk to competition.

I think I have probably used up the time I have available. I am happy to take questions and I am delighted to have an opportunity to participate in this process.

COMMISSIONER STEIGER: We are delighted to have you with us. I wondered if you could comment a little more, in a little more detail on how would you treat ancillary agreements? Is there any rule of thumb you offer for us here or do we go back to reduction of output?

MR. KOLASKY: Well, I think the test with respect to ancillary agreements clearly has to be whether they are reasonably necessary to accomplish the procompetitive objectives of the venture.

If, as long as the venture itself is procompetitive, has efficiency justifications, then I think you have to look at individual restraints. And if they are reasonably necessary, then they ought to be lawful.

I don't think you should apply a pure less restrictive alternatives test. I think that the test is is there some obvious less anticompetitive alternative that would achieve the same objectives?

COMMISSIONER STEIGER: And would you include exclusivity under that analysis?

MR. KOLASKY: Well, I think exclusivity has to be judged at different points. As one of the earlier speakers, I think Mr. Kobak was discussing, I think you look at it differently when the venture is first being organized than you do after the venture has been in existence for some time.

Professor Areeda in his treatise suggests that once the venture has been formed, if it has survived the initial detailed scrutiny, it should for all intents and purposes be treated as a single firm on a going-forward

basis, except with respect to restraints that affect the behavior of the parties to the venture or that may spill over by perhaps facilitating collusion in some other market.

If you take that approach, then your approach to exclusivity, that is to whether or not the venture should admit any new members should be the same as it is in any single firm monopoly case.

COMMISSIONER STEIGER: I think that leads me to repeat Susan's question, if I may. What do you do if down the road, without defining how long that road was, you find that the venture has reached a 50, 60 percent market power level? Do you then treat their conduct as though they were a single firm and would that cover what you have just raised, which is a monopoly, attempted monopolization analysis?

MR. KOLASKY: My view is that as long as they have reached that point through honest industrial means, that, yes, you do continue to treat it as a single firm and you do not force them to admit others.

COMMISSIONER STEIGER: Commissioner Azcuenaga?

COMMISSIONER AZCUENAGA: Bill, you mentioned a lot of outdated law. Is there anything in particular you would like to see here for us that you would not like to see in the guidelines?

MR. KOLASKY: Well, of course one could begin with the case that everyone likes to beat up on and that's Topco.

COMMISSIONER AZCUENAGA: I should say except for Topco.

MR. KOLASKY: Another area that is in need of clarification is the one Mr. Calkins referred to, and that is the area of joint sales arrangements and agreements. There are cases from the '50s, mostly lower court, District Court cases, that speak very loosely about those being per se unlawful.

In fact, if you look at those cases closely, they, in fact, fit the -- the facts of those cases, they, in fact, fit the analytical framework we now apply to joint ventures; namely, there was in fact no integration whatsoever, no efficiency justification, and therefore they properly reached the conclusion that they were per se unlawful.

If, on the other hand, a venture as arguably might have been the case with another infamous old decision, Appalachian Coals, that perhaps allowed the parties to sell over a broader area more effectively than they could individually, then I think you should use a rule of reason analysis as the Supreme Court did in Appalachian Coals.

I happen to think they reached the wrong result but not because they used the wrong analytical framework.

COMMISSIONER AZCUENAGA: I see you mention the 1988 International Guidelines and we have actually talked about those before, and there has been some question whether we need guidelines or not because we all seem to use the '88 guidelines anyway, including me.

Is there any particular kind of joint venture or strategic alliance that you could describe a specific example of one that would not be covered under the 1988 guidelines?

MR. KOLASKY: Boy. That's a question I honestly haven't thought of. I can't say that I have gone back and looked at each of the examples, so I would have to say that I can't think of any.

I think the one subject, though, that the 1988 guidelines don't cover adequately, at least, is the question of to what extent you treat a joint venture as a single entity once it has been formed, basically the issue that Judge Easterbrook addresses in the Chicago Bulls case. I think that's an important issue that should be addressed in any new guidelines.

COMMISSIONER AZCUENAGA: I guess a final question I have is do you have any suggestions for us on

evaluating efficiencies that are specific, that you experience in your own practice?

MR. KOLASKY: I was distracted for one second.

COMMISSIONER AZCUENAGA: I was talking about efficiencies. And we have talked a lot about defining efficiencies, and I was wondering if there is anything that you would like to highlight in terms of an efficiency that we might not recognize or should recognize that you have seen in your own practice.

MR. KOLASKY: Yes. I think two or three. One are the efficiencies that I think can be derived through specialization. Again, this is the idea of contractual integration.

In the purchasing area, for example, I have seen in my practice instances where instead of creating a new purchasing cooperative, the firms will designate one firm as the agent to purchase on behalf of a group of firms, so I think it is very important as you look at efficiencies to recognize that there are important integrative efficiencies that can be achieved through contract.

And then the other is the -- and this comes back to the exclusivity question, here I am thinking not so much as exclusivity in the case of, say, a joint R&D venture but really exclusive supply arrangements, and

that is the fact that the transaction cost economies that may be achieved are a very important source of efficiency and they shouldn't be left out of the equation.

COMMISSIONER AZCUENAGA: Thank you.

COMMISSIONER STEIGER: Commissioner Starek.

COMMISSIONER STAREK: Bill, could you elaborate a little bit on how you would envision an analytical framework for analyzing horizontal restraints? How would it incorporate, in your view, the various quick-look or truncated approaches to rule of reason analysis?

MR. KOLASKY: That's an excellent question. It is one that I struggled with when I was litigating the case that was mentioned earlier.

I think one of the things that is very hard is to try to characterize a particular restraint as inherently suspect and using that as the way to get into the truncating analysis.

The way I like to think of it is that in a lot of cases the effect -- either the effect on competition or the efficiencies, the necessity of the efficiencies, will be fairly obvious. I think NCAA is a perfect example of that. That was a case where the District Court found a restriction in output, so you didn't have to analyze market power, market structure because there was an actual finding that output had been restricted by the

agreement.

That then made it very easy for the Court to evaluate the proffered procompetitive justifications because in each case, as the Court said, were the justification valid, you would expect an expansion of output, not a restriction of output. And, therefore, they were able to truncate the analysis in that manner.

So that's the way I think that it can be done.

MR. COHEN: One thing that struck me in your statement was your specific focus on minority equity investments as a separate category. Could you elaborate a little bit on that?

MR. KOLASKY: Yes. I realized as I was doing some of my research that I had worked on one of the very early strategic alliances without knowing that I was doing it.

Back when I first became a partner at Wilmer Cutler in 1979, the first case I worked on was Ford's 35 percent equity investment in Toyocogyo, a Japanese auto manufacturer that makes Mazda. The strategic alliance literature now describes that as one of the very early and one of the most successful strategic alliances.

And what I remember both from doing the investigation and what the literature reports, of course,

is that the reason Ford made that substantial equity investment in Toyocogyo is they were hoping to get three things in return. No. 1, they were hoping to out-source components to Toyocogyo, especially engine trains.

Second, they were hoping it would become a source of completed automotive platforms, i.e., cars, which it has. And, third, they were hoping to learn about best practices, in other words, to learn about some of the efficient Japanese manufacturing methods that we have heard so much about in the two decades since then.

And the reason they were taking an investment, besides the fact that Toyocogyo needed an infusion of capital, is that they wanted to assure that somebody that they were going to become dependent on for the engine train, for one of their most important automotive platforms, what became the Ford Escort, was somebody whose interest was aligned with theirs and would not behave opportunistically.

That's a good example of how minority equity investments serve, as I say, as the glue to cement a strategic alliance.

MR. CALKINS: Just a quick follow-up to that. I may have misheard you. You started off talking about the definitional difference between the word joint venture and strategic alliances. And I am quite sure that you

urged us to look at a broad range of activities, including equity investments and such.

I thought I heard you say and we should use the term joint venture; whereas I would have thought that it would have been your description that your conclusion would have been, since there is such a wide array of activities, some of which don't really fit what sort of is the common sense idea of joint venture, it would be much more helpful, clear, precise to use the broader term of strategic alliances so as to prevent confusion and to make it clear that we are talking about, among other things, a 35 percent interest in a Japanese firm. So why isn't the broader term preferable?

MR. KOLASKY: It may well be. I view the two terms, as I say, largely interchangeable, given the way we antitrust lawyers have used the term joint venture. The reason why I would opt or urge you to take that approach of using them interchangeably, rather than treating joint venture as a narrower category, is despite these few outlier cases that adopt Professor Brodley's narrow definition, most of the case law does, in fact, adopt the broader Pitofsky rule definition of joint ventures, so we have a well-developed analytical framework for evaluating joint ventures, which I hope is reflected in Antitrust Law Developments and I would like

to see us abandon that.

COMMISSIONER STEIGER: Several years ago the German cartel office hosted a cartel conference with a rather provocative title: "Strategic Alliances, Old Wine in New Bottles" asking the question as to whether we indeed were just seeing a new permutation of cartel-like activity being blessed.

What would be your defense of what you term strategic alliances against the claim that they are, in fact, simply new bottles with old wine in it?

MR. KOLASKY: Actually I think they are old wine in new bottles to some extent, but I think they are not cartel activity for the most part because at least the ones that I have looked at are not naked in the sense that they are formed for no reason other than to try to restrict output and raise price.

Almost every one I have looked at seems to involve some integration, some bringing together of complimentary assets. And to the extent that they have involved competitive problems as the telecommunications strategic alliance that the Justice Department challenged did, there are ways to address those short of blocking the strategic alliance altogether, so that you can allow it to capture the procompetitive benefits and deter or avoid any anticompetitive problems.

COMMISSIONER STEIGER: Susan.

MS. DeSANTI: I wanted to just speak briefly to the issue that had come up between you and Steve Calkins.

First of all, I wanted to complement you on that chapter in Antitrust Law Developments Third. The level of excitement --

MR. KOLASKY: Fourth.

MS. DeSANTI: Thank you for the correction. The level of excitement in my shop when your draft arrived was extreme. And I must say you did a wonderful job in taking what we in our shop have come to appreciate as an extraordinarily different area of the law and really bringing some analytical clarity and directness to it.

And we very much appreciate the work that you have already done. And the only thing that we are sorry about is that you haven't given us all of the answers yet because you have written it in such a fair-handed way as is the usual ABA style.

And I do want to note also that we have, the Commission has so far taken a very broad definition of what was termed in the Federal Register notice competitor collaborations as an approach which I anticipate is likely to continue.

I wanted to ask you whether you feel that --

whether your experience is that the business literature, the business strategy literature, the managerial literature has anything to offer to antitrust in terms of assessing the competitive issues that may arise and whether that is also an area that we should be taking a look at?

MR. KOLASKY: First of all, thank you very much for the compliment. And I want to be fair and also say that Bill Rooney from Wilkie Farr & Gallagher contributed very importantly to the chapter, so I should not take all the credit by any means.

I think the managerial literature is valuable because that's where you find the best discussion I have seen of the transaction cost economies and rationale underlying these strategic alliances.

The literature, I think, does not have very in-depth discussion of the competitive effects of strategic alliances, but it does have very good discussion of the business reasons for them and the transaction cost economy justifications.

COMMISSIONER STEIGER: Thank you. Yes, Steve.

MR. CALKINS: One small point. You hold up airlines as an example where there was not a demonstrable risk of anticompetitive problems. You don't note with respect to the Northwest-KLM -- and we are not here to

second-guess the Justice Department or anything of the sort -- but at least one of us reads the Detroit newspapers, which happened to be complaining bitterly that the two routes on which there was an overlap included pretty much all of the Detroit-Europe travel, and the prices between Detroit and Europe are now extraordinarily high.

And, in fact, this example that you have is an example of a good one, is now the source of bitter complaint about anticompetitive activity. I have no personal knowledge about the pricing, I just read the Detroit newspapers. And I note you don't discuss the current complaining about that particular joint venture, you simply hold it up as the model of a good one where there has been, as you put it, an alignment of the interests of two firms, but you don't note that some people are complaining that that alignment may be unfortunate.

MR. KOLASKY: That's certainly a fair question. One of the last things I read before I came over here was an article in the Wall Street Journal suggesting raising the same issue with respect to the Lufthansa-United alliance, and I think several things need to be said.

I don't know the facts with respect to Northwest-KLM and the Detroit to Europe routes. I know

more about the Lufthansa-United routes that are discussed in the Wall Street Journal article.

And several things need to be said. First of all, obviously you need to look at the effect overall on both service and fares, not just singling out one or two routes.

Secondly, with respect to increases in the fares on particular routes, it is very important to know what two points in time you are looking at because there are periods, obviously, when some of these routes were operating well below cost. And, therefore, the fact that fares may have risen on a particular route faster than they have on other routes does not necessarily mean that they have risen to super-competitive levels.

What we have observed generally is that these alliances have improved service very substantially for a very large number of travelers and the benefits on the whole outweigh any particular problems.

COMMISSIONER STEIGER: I suspect worldwide city payers will go on being discussed, Steve, especially if it is my two routes that are affected.

Thank you very much.

MR. KOLASKY: Thank you.

COMMISSIONER STEIGER: We turn to our last speaker of the day, and we are, indeed, fortunate that

another extraordinarily distinguished antitrust practitioner has agreed to come and offer his views on joint ventures this afternoon.

Jim Rill is a senior partner at Collier, Shannon, Rill & Scott in Washington, D.C. From '89 to '92 Mr. Rill was the Assistant Attorney General for the Antitrust Division, United States Department of Justice.

While at Justice Mr. Rill negotiated a U.S.-European Union Antitrust Cooperation Agreement and along with this agency issued the 1992 Horizontal Merger Guidelines.

An active member of the ABA Section of Antitrust Law, he served as its chairman. And in addition to his ongoing law practice, currently is a member of a number of editorial boards of antitrust publications.

And I always feel better when he visits with us because he is an acknowledged expert in consumer protection law as well, and I happen to think antitrust and consumer protection are the two sides of one coin.

Welcome, Jim Rill.

MR. RILL: Thank you very much, Chairman Steiger, it is a habit I don't choose to break.

Let me first not apologize for not having a written statement because Susan asked me to be more or less a wrap-up on other people's statements. I don't

have all of the statements of other people, but that won't stop me from commenting on them.

The hearings are very timely. The project is an excellent one. We are seeing increasing numbers of joint ventures in important industries, increasing by magnitudes. Why? I suspect the shrinking globe, the increasing number of joint ventures that involve international concerns, that involve global alliances, ones that Bill just talked about in the aviation industry are examples of what we are seeing happening every day.

And in the high tech, the increasing part of the economy that can be described as high tech, we are seeing enormous amounts of complementary efforts going on. One only needs to pick up the newspaper and look at what is happening in telecommunications industries, entertainment industries, or what is rumored to be happening to understand the importance of the project that you have under way.

And in that connection I want to say that your hard work is really just starting. As I read the statements, I read the transcripts of testimony given in the earlier part of last month and statements prepared today, there are so many more questions raised than answers given.

Difficult percipient challenging questions that

now you have to go back into Susan's shop and worry over for the next number of months. And there are important policy decisions you have to make, as you know, in the course of this.

The elimination of the joint venture, elimination of the 1988 International Guidelines with the joint venture sections left a void, as Commissioner Azcuenaga points out, and Jim Atwood and others testified a lot of us still read those sections of the guidelines and rely on them, find them instructive.

So I think I would encourage the Commission, in cooperation with the Department of Justice, to have a go at guidelines. As Chairman Steiger is aware, this was something that we considered in 1990-1991-1992. We were being encouraged in that consideration by policy people in the administration, chairman of the Council of Economic Advisors and others. We focused on the Merger Guidelines, and I think that was the right focus.

But I think I agree with Bill, with Joe Griffin, Harvey Goldschmidt and Ernie Gellhorn, a not unanimous but certainly preponderant view that guidelines in this area are needed by business and, indeed, by the bar, and even by the bar who makes a living thinking about antitrust issues.

I think that perhaps to pick up on an idea of Jim

Atwood and Jim Kobak that rather than a full set of comprehensive guidelines along the format of the Horizontal Merger Guidelines, that perhaps a way could be found to deal with particular issues, focused issues, rather than to write the entire erector set of a joint venture structure.

I don't know, do they still make erector sets? But I think with a set of particular issues to be covered which could be called policy statements, could be put out in question form, along the lines of the joint DOJ-FTC international, the new International Guidelines, that that might provide more useful information of the direction and the intention of the agencies than to attempt to do a full structured set of joint venture guidelines.

By the way, I agree fully with Bill's comments that we should take or you should take an expansive view, not a Brodley view, of what constitutes a joint venture.

Other areas should be, I think, and I hope I am not being presumptuous in making these suggestions, but other areas that you would consider in the meantime for clarification mentioned earlier, I think, in the colloquy with Jim Kobak, more amplification in consents involving joint ventures of what the Commission's thinking was in going after the joint venture would be very helpful.

I think the Commission has made progress under Bill Behr in the direction of making statements, in aid of comment, really statements in aid of something, instead of trying to see how cleverly the complaint can be paraphrased. The Justice Department has it a little easier or a little tougher because they have to live with district courts under the Tunney Act, so they have to say something intelligible. I think it would be a course the Commission should follow as well.

Speeches, amicus briefs, can and should focus in this area. An area of further clarification that I think would be extraordinarily useful as well would be, perhaps in speeches or press statements, an explanation of why in a particular joint venture setting -- perhaps other settings also -- the Commission didn't challenge the transaction.

This is something that I tried to do, with only moderate success at the Department of Justice, and I know there have been shortcomings of it, but I think it would be extremely helpful to the extent confidentiality permits it, to the extent that statements can be made that don't unduly freeze the agency, I think it can be extraordinarily helpful to do that.

What questions would I recommend addressing?
Just to be provocative, I would eliminate -- I would put

out a guideline or statement that eliminates the per se rule for joint ventures other than in a case where you would refer it to the Justice Department for criminal prosecution.

It is not that easy to identify even those cases sometimes, and we struggled with that at the Department, but there are guidelines at the Department that you could, in your cooperative effort, you can work through those guidelines as to criminal prosecution.

They were, in fact, illuminated to some extent in a speech by Rick Rule around 1988 or '89 just before he left that I thought was quite good. I don't think history justifies continuation of the per se rule; other than in those cases where criminal prosecution would be appropriate.

I think as we move more into high-tech areas, the network industries, there is such an uncertain expectation of harm in many joint ventures, many competitor collaborations, that a per se rule simply doesn't make sense right now.

Parenthetically I have some concern -- it is a shame Commissioner Varney is not here because I am going to comment on one of her opinions. I have some concern with what I see to be a re-expansion or re-enlargement of the per se rule in the international interpreters case.

Just in passing I have difficulty dealing with the difference between -- I am not in that case -- difficulty dealing with the difference between the ability of the client to select airlines as contrasted with the ability of the interpreters to put out numbers of people that will have to work on its staff on an interpretation matter or what constitutes a workday. They blend too much, and I think there is a danger there of expansion of the per se rule.

I also think that kind of parenthetical references to BMI and NCAA as being overread are not helpful. And they appear in both International Interpreters and California Dental. I don't think that -- I think BMI and NCAA are there, and they should be, and I recognize this is kind of a free shot because neither Commissioner Varney who authored International Interpreters or Bob Pitofsky, who authored the other are here or I probably wouldn't have said it.

COMMISSIONER AZCUENAGA: There are others who voted for them.

MR. RILL: I understand. The concern with rule of reason is overwrought. I have tried rule of reason cases. They are not that difficult. I think the problem with the Detroit Auto Dealer case was not the litigation of the liability, the litigation of the unlawfulness,

except it was the wrong result, but having said that -- I was in that case -- but the remedy that caused a lot of difficulty that produced perhaps the extenuated history of that case, I am beguiled somewhat by -- I am confused but also beguiled by the Beckner and Salop decision tree approach.

It may suggest, though, however complicated the statement, it may suggest an easy road to rule of reason. It is a very practical solution, that one decisionmaker would deal with the important decisions and the easy decisions, and then see if the harder decision needs to be made after that, but that gets us to what sort of rule of reason approach seems appropriate.

I think if per se labels are to be minimized, then I would say the Commission essentially -- and I know again I am in a controversial area -- that a full-blown rule of reason seems appropriate. And one that starts with a market power screen. And I know that the California Dental, International Interpreters versus Mass Board issue is one that people read a lot of articles about. Every Commissioner present has expressed him or herself on it. I think it is an interesting issue, but it seems to me that -- and I think this is the point of a number of commentators at the hearing, including Bill, that there is no reason to avoid an efficient full-blown

rule of reason analysis that would incorporate a market power screen.

This is inconsistent, I think, with, while we are picking on people who aren't here, Joel Klein's step-wise speech last November, which I think concerns me because -- I believe this is Joel's view, but it threatens to switch the burden of proof to the defendant, the parties, the joint venture parties, to demonstrate ab initio the efficiency justification for the venture, in effect then to prove that it is not illegal.

The market moves too fast, the technology is too dynamic, the law simply, I think, is inconsistent with that kind of an approach.

The issue of exclusion has been discussed a great deal at the hearings. I agree with Bob Skitol's testimony and something I think Bill suggested today, Kolasky suggested today, and that is it depends.

With respect to a new product, I think over-inclusion is very dangerous. It limits independent sources of innovation and independent sources of competition. It chills the incentives of the venturers to have to support free riders. I think this is a point made by Evans and Smaulenzi in the Europaper. I think it is a correct point.

I think an interesting question on exclusion is

the one raised today and that is, well, what about X time down the road and we see the venture with Y percent, say 60 percent, 70 percent of a market? I come out on the same side as Bill Kolasky and Phil Areeda and the not surprising position taken by the general counsel of Visa that they probably should be treated, that level as though you would treat a single firm and look at the conduct of the "dominant" firm to determine whether monopolization is going on under standard monopolization principles.

But let me go further on the "it depends" point. And Ernie Gellhorn, I think in his prepared testimony, made some very excellent points regarding not a new product but a product standard, and the standard in the organization is something of a joint venture, if you will, is a collaboration among competitors.

I think there the dangers of exclusion, particularly in today's market with the increasing use of product standards, the danger of exclusion there is very, very high. I recognize fully the concerns with tampering too much with the standard process. I think it underlies some of the statements Commissioner Azcuenaga, you made in the Dell Computer case. And I understand that.

On the other hand, the risks of exclusion can be so devastating for competition in an industry that I

think the Commission should take a harder look at what might be done, without getting into the unfortunate history of the late '70s, I guess, when the Commission decided to write a due process Robert's Rules of Order book for standard making organizations, which I think the Commission never finally adopted, and I don't think anybody wants that, but there are some steps that can be taken regarding transparency of standard process, ownership interests, and other proprietary interests that can frankly poison the standard-making process, so I strongly agree with Professor Gellhorn that that's an area where the Commissioners can take a harder, not softer look.

Spillover issues are certainly an area of concern. Rick Rogers' statement on behalf of NAM raises those. I would not, however, endorse some of the views that the Commission should attempt to write guidelines around the Alcan-Arco consent decree, which is sort of a procedural blueprint or perhaps even GM-Toyota. I don't know the answer to it, I simply say that I know it is a concern area.

We are continually confronted with the venturers in the high tech and more standard industries where the joint venture is attempting to rationalize facilities, efficiently-utilized facilities, the production joint

venture then transfers to the venturers for independent marketing of the product. And then, well, what price and how do we discuss price and who discusses it and what is the transfer charges here?

Some of the testimonies touched on that. I don't know what advice I would give, but I don't know the advice you should necessarily give. I would hope they would be consistent.

But it is an area where there is some concern. My only concern there is that whatever guidelines, there should not be unduly restricted. I think it is an area where the Commission needs to give broad latitude.

I was a little surprised, I think Bill was too, about Steve's comment on marketing joint ventures. I had not thought in this day and age that marketing joint ventures that weren't to be prosecuted criminally would be treated as per se offenses or be considered under a per se rubric.

On global issues, I don't know that we need a guideline. The Merger Guidelines themselves take into account global markets. And I think the Commission has rigorously taken into account global markets where they exist. Where they don't exist, they shouldn't be taken into account. It is a problem I had with some legislation in Congress during the time I was at Justice.

Besides, the only global admonition I would expect is don't copy the EC yet. And I think the EC is now deciding it is not going to copy the EC, as I understand they are running away from the concentrative, cooperative dichotomy that produced the '94 unfortunate experiment.

But I think as Jim Kobak said and others have said, Jim Atwood, Joe Griffin, this is an area, joint venture, as well as the merger area, where increasing cooperation, communication, joint information sharing, to the extent it is permissible, is really strikingly important because the ping-pong game that can be played among various agencies creates frictions for the formation of these ventures. It can cause them to go down.

I wouldn't get too concerned right now -- perhaps I disagree with Jim on this -- with harmonization. I tend to agree with the statement that Ann Bingaman made early in her tenure that harmonization will not occur in her lifetime. And I don't think that was a comment on her actuarial probabilities, and it isn't going to happen.

And the fact that it isn't going to happen because of national cultural economic differences should not stand in the way of cooperation. And I think that X

guidelines, that that's an area of real focus for two agencies.

I think I have very little to add to what Bill Kolasky said on efficiencies. I am glad he went first because he saved a lot of time.

I would add one thought, and that is a return to Chairman Pitofsky's article on production efficiencies and declining industries with excess capacity as an efficiency that might be more broadly recognized in the joint venture context than it is recognized in the revised Merger Guidelines.

Without, frankly, too stringent a requirement on pass-through, because we are dealing with perhaps fixed cost savings that might not easily be passed through, declining industry situations or could very well be, and the same would be true with soft efficiencies in those situations -- declining industries strike bad industry with chronic excess capacity. Those are my suggestions.

Again, I regret not having a paper, but I think my role was more to comment on what others have said and try and permeate that with some of my own views, which I hope are helpful. And I encourage you in this, I think, very, very laudable project that's under way.

And if there is any way I can help down the road, I would be glad to do it. Thank you.

COMMISSIONER STEIGER: Thank you. Please take it as a mark of our esteem that we gave you the very difficult job of wrap-up. Always the hardest part of any program like this.

Does anyone want to hit Jim Rill with some questions? Commissioner Azcuenaga.

COMMISSIONER AZCUENAGA: Yes. As usual whenever you start talking about these things, you want to dive right in. We can discuss these things all night. But it has been fun and it was useful.

But given the lateness of the hour, I am going to confine my questions to a few, at least initially. You have a great deal of experience in the international area and you did comment a little bit on that.

I was going to ask you about both Canada and the EC. And I guess given what you have already said I will just confine it to Canada. Do you see value in our working with Canada on this project? And how likely do you think it would be that we could achieve some sort of harmonization with them?

MR. RILL: I think the opportunities for harmonization with Canada are very, very high. I noticed that Cal Goldman was scheduled to appear yesterday. I don't know whether he did or didn't.

COMMISSIONER AZCUENAGA: He did.

MR. RILL: I haven't seen the statement. I hope he said the same thing, but I think the opportunities for joint efforts with Canada are high and very necessary.

Canada is our largest trading partner. It is probably one of our largest sources of mutual investment. We are in the NAFTA era. There is a NAFTA article in the NAFTA agreement, I believe it is 15, which calls for coordination of competition policy between Canada and the United States and Mexico.

And I think that under that rubric the Department of Justice and the Federal Trade Commission could put a particular effort on maybe even harmonization, greater convergence with Canada, Mexico, and the United States.

COMMISSIONER AZCUENAGA: Another issue that I have been thinking about, stemming from talking with Canadians and comparing systems is the question of the criminal authority over joint ventures.

And you have already raised the possibility of getting rid of the per se rule. Obviously we have the statute to deal with, but if we could make a recommendation to Congress, would you suggest that we recommend getting rid of criminal authority vis-a-vis joint ventures?

MR. RILL: No. I would keep criminal authority where it is with the criminal prosecution under the

standards that Justice Department would or should use properly in determining whether or not to prosecute conduct criminally.

I think that there is a grave risk in attempting to use labels to decriminalize or to reach any, really, any result. I think that one could take -- however, I am not sure it is necessary to have legislation to do it -- the guidelines used by the Department of Justice, perhaps refashioned, for the decision to prosecute criminally -- maybe you strip out the one on whether they can win or lose the cases, but the substantive aspects of the guidelines, and apply those.

And really the Commission then could be out of the per se business, which may not be a bad thing. And I don't mean bad as a criticism of the Commission.

COMMISSIONER AZCUENAGA: I don't think it necessarily is a bad thing either. I would say one quick comment that any concerns about the Interpreters case, at least we have moved back more toward a traditional view, away from CDA, so perhaps the direction is the right direction.

I don't want to monopolize the questions but I will ask one more and it is a procedural one. Would you recommend, if we prepare guidelines, that we put them out for public comment before adopting them?

MR. RILL: My views come around on this. I had a battle with Ernie Gellhorn and others about public comment on the Merger Guidelines. I am sort of -- I think it was done the right way then, but I notice the public comment was asked for in the international, the '95 International Guidelines, and I think in the interest of openness that probably public comment is a good idea.

COMMISSIONER AZCUENAGA: Thank you.

COMMISSIONER STEIGER: Steve?

MR. CALKINS: The problem, of course, with saying that if it is a joint venture, it is not per se, as you know, and I really raised something that you already know to give you a chance to speak on it, is that good lawyers are able to categorize things to their clients' advantage.

I can imagine that a good lawyer in the Palmer or the BRG case could have said where efficiently aligning our clients interests and making sure the marketing is not inefficient of our respective bargaining courses in a variety of ways, so that's a joint venture.

In *Blackburn v. Sweeney*, a Seventh Circuit opinion, where some law firms had an alignment of interest and agreed not to advertise in each other's areas, that could have been characterized as a joint

venture. And yet the Seventh Circuit and Supreme Court had no trouble with either one of those cases, saying that it was per se illegal.

So also you were kind enough to wonder about how a marketing arrangement ever could be per se illegal and, of course, the answer would be that you could imagine some things which a lawyer could call a joint venture marketing arrangement, which at least traditional case law, even recent case law would have said would have been per se illegal.

So I guess my suggestion to you is if indeed one is going to put a whole lot of weight on the word joint venture, as from the per se rule, the antitrust system will have to be pretty good at defining what it is that is a joint venture because whatever he wants, any good lawyer will do.

Either you need to help us come up with a good definition or give us other reasons why we should not in general worry about not abandoning the per se rule.

MR. RILL: Well, I sort of anticipated the question, I guess. I think the labels aren't dispositive. And there are a number of joint ventures labeled joint ventures which would fall properly under the per se rule as I suggested. I just don't think I can identify a situation where the per se rule is appropriate

that wouldn't justify criminal prosecution.

COMMISSIONER STEIGER: As a follow-up to that, though, your comment, don't follow the EC on this matter, would dropping the per se rule leave us in a limbo that would create the dichotomy that they tried to create in the '94 and are not happy with, concentrative?

MR. RILL: I don't think so. It would be a very limiting rule. And then everything else would be subject to a form of rule of reason analysis. I don't think it helps much to say quick-look or truncated.

The rule of reason analysis can flow efficiently over various issues. And at certain points along the analysis -- and this is where I am sort of beguiled by Sal on his paper in this hearing, not to be overly expansive of -- never mind, but at certain points along the way you pretty well know where the decision is going to come out on a rule of reason analysis, and you can reach that decision with some level of confidence.

So I think it is a very limiting nonlabel approach I had. I have to give you an anecdote of a client who shall go nameless who wanted to do a joint venture and I said: What are the efficiency justifications? And the anonymous client said: Well, if I don't do it, I am going to have to compete with him and that's not very efficient. The deal wasn't done.

(Laughter)

COMMISSIONER STEIGER: Well, to all of our participants, our thanks for your contributions to our record. And I hope you will bear with us patiently. I have a feeling the Commission will call on you again as this process goes forward.

MR. RILL: It has been an honor. Thank you.

COMMISSIONER STEIGER: Thank you.

(Whereupon, at 4:40 p.m., the hearing was adjourned.)

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

CASE TITLE: JOINT VENTURE PROJECTHEARING DATE: July 1, 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

KAREN BRYNTESON

C E R T I F I C A T E 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.

DIANE QUADE