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A BRIEF ANALYSIS OF POLICY AND LITIGATION

Statistical Significance at the Supreme Court

John M. Gale

John M. Gale, an EI Vice President, has experience in the statistical analysis of economic data used to estimate damages, determine class certification, and predict price effects with merger simulation. He also has analyzed consumer testing data to gauge the veracity of advertising claims.

A recent Supreme Court decision considered whether information must be "statistically significant" to be relevant. (*Matrixx Initiatives, Inc., et al. v. Siracusano et al.*) While the Court's decision is limited to a narrow context, it sheds light on the importance of significance tests and the weight that should be given to results that fail these tests.

Investors in Matrixx Initiatives Inc. alleged that the company failed to disclose material information when it did not reveal reports that some users of its leading product, Zicam, had lost their sense of smell and that there were pending lawsuits from those affected. When that information was eventually reported, the company's stock price fell. Matrixx argued that the information was not material because the reported results were not statistically significant. The Court ruled unanimously that the case could proceed and that companies could not rely solely on statistical significance to determine what information must be disclosed.

In fields that examine "noisy" data, such as medicine and economics, it is common (and often required) to note whether reported results are statistically significant. "Significant" has a very specific meaning in statistical analysis. Tests of statistical significance are commonly framed as a choice between a base hypothesis (typically that there is no relationship between two variables) and an alternative hypothesis (there is a relationship). A result is statistically significant when the base hypothesis of no relationship is rejected at a given significance level, implying that the alternative hypothesis that there is a relationship is correct. (That level is often, but not always, 5%.) Statistical significance at the 5% level is often misinterpreted to mean, "I am 95% sure there is a relationship." The correct interpretation is that if there were no relationship, there is less than a 5% chance of finding the result shown by the data. Thus the result is very unlikely to be due to chance, so the no-relationship hypothesis is rejected in favor of the hypothesis of a relationship.

The Court found that a result may be relevant, even if it is not statistically significant. The Court noted that both medical experts and the FDA rely on evidence other than statistically significant results and that "courts frequently permit expert testimony on causation based on evidence other than statistical significance." The Court concluded that investors could reasonably rely on results that are not statistically significant.

The Court has recognized that statistical significance is not the sole measure of relevance. Nonetheless, the decision is narrowly tailored to information that might be relevant to an investment decision. Thus, the decision's broader implications may be limited.

Also In This Issue

Remedies in Google's Acquisition of ITA Software

Stuart D. Gurrea and Gloria J. Hurdle provide an overview of Google's acquisition of ITA and the conditions imposed by The U.S. Department of Justice (DOJ) on the transaction. DOJ's primary concern was that the acquisition would give Google the ability and incentive to foreclose competing online travel intermediaries' access to ITA's technology. Nonetheless, DOJ did not block the acquisition, perhaps because it believed that the acquisition might lead to significant consumer benefits. Instead, Google and DOJ agreed to a number of limitations on Google's post-acquisition behavior. Such behavioral remedies are unusual in merger settlements because they require significant oversight on the part of DOJ.

Calculating Awards of Attorney Fees

Laura A. Malowane considers two alternative methods for calculating awards of attorney fees in complex litigation in Washington, DC: the Laffey matrix and the Salazar matrix. The Salazar matrix is largely based on a price index that has several major flaws: it measures price changes in basic, consumer-oriented legal services and not complex federal litigation, it does not routinely take into account reasons why actual collected rates may differ from hourly billing rates, and it is a nationwide average index not specific to the Washington, D.C. area. Moreover, actual hourly billing rates of attorneys in Washington, DC are closer to rates in the Laffey Matrix than in the Salazar Matrix. Thus, for awarding fees in complex federal litigation in Washington, D.C., the Laffey Matrix is superior.

Remedies in Google's Acquisition of ITA Software

Stuart D. Gurrea and Gloria J. Hurdle

The U.S. Department of Justice ("DOJ") recently agreed to allow Google Inc. to acquire ITA Software, Inc. subject to certain conditions. Those conditions, which are set out in a proposed settlement ("Final Judgment") that DOJ, Google, and ITA filed with the court, are unusual because they restrict Google's post acquisition behavior rather than requiring a divestiture of assets. Agencies face a number of significant issues in implementing such behavioral remedies.

DOJ feared that Google's acquisition of ITA would reduce competition in the market for flight search services. ITA provides technological solutions for organizing and facilitating access to flight information, or as DOJ refers to it, "independent airfare pricing and shopping systems" ("P&S Systems"). ITA offers its services to major airlines, travel meta-search companies (such as Kayak), online travel agents (such as Orbitz), and consumers. Google currently does not offer travel search but plans to develop a travel website that will offer comparative flight search services.

DOJ's main concern was that Google was acquiring a "critical input" to the provision of flight search. After the transaction, Google would compete with travel search providers that depend on the ITA services, and it could foreclose access to those services. DOJ did not address concerns that Google would use its position in general search to gain an unfair advantage in travel search. For example, it has been argued that Google could lower the ranking of unpaid search results from competing providers of travel search, but the Final Judgment does not address that possibility.

DOJ concluded that Google/ITA would have the ability and incentive to foreclose competing online travel intermediaries' (OTIs') access to ITA's technology, and thereby weaken competition because "increased profits from driving customers to its new travel service from rival OTIs will likely outweigh any lost profits from reduced licensing revenues from QPX [ITA's P&S system]." DOJ found that Google could refuse to renew contracts or enter into contracts at less favorable terms, or degrade the speed or quality of the services offered to competitors, and that it had the incentive to do so. That conclusion stemmed in part from DOJ's finding that there are no adequate existing or potential substitutes to the system ITA offers.

DOJ sought to prevent foreclosure with a condition in the Final Judgment that requires Google to license ITA technology to Google's rivals in travel search at commercially reasonable and non-discriminatory rates. Implementation of this type of remedy requires that in the future, DOJ must determine whether the prices of the licenses meet the terms of the Final Judgment. In effect, DOJ must determine what are "reasonable rates," which DOJ in the past had been reluctant to do. The Final Judgment indicates that DOJ will use existing contracts as a starting point for determining reasonableness. Whether the terms in the contracts that Google offers its competitors are fair, reasonable, and nondiscriminatory will largely be determined by comparing them to the terms of licensing agreements with similarly situated OTIs existing as of or subsequent to the date of the Final Judgment.

Stuart D. Gurrea and Gloria J. Hurdle are Vice Presidents at Economists Incorporated. Dr. Gurrea specializes in applied industrial organization and has consulted on airline economics. Dr. Hurdle has testified in a number of airline matters and co-authored a report on airline Global Distribution System rules. A longer version of this article appears in the Spring 2011 issue of Icarus *– the newsletter of the Communications and Digital Technology Industries Committee of the ABA's Section of Antitrust Law.*

Preventing foreclosure also requires DOJ to determine whether Google is licensing its most advanced technology or if Google is disadvantaging its rivals by only allowing them access to inferior technology. Upgrades to ITA's software that take place during the term of the Final Judgment must be offered to competitors at the same price as Google charges to other customers, such as airlines, that license the software. Furthermore, the Final Judgment requires that Google offer the same version of ITA's technology both to its competitors (other travel search companies) and to its other licensors.

The Final Judgment also has conditions that may affect future products. Google must continue to spend at least as much on research and development and maintenance of ITA's system as it did in the prior two years. Certain circumstances may limit this obligation. For example, Google may reduce those expenditures if its third-party licensing revenue from QPX declines. Additional licensing requirements apply to ITA's future InstaSearch product. (This product is still under development, and it may not prove commercially useful.)

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Calculating Awards of Attorney Fees

Laura A. Malowane

When a court awards attorney fees, it must determine the appropriate rate to use in measuring the cost of the attorney's services. Counsel's billing rates often cannot be used because pro bono work, contingency fees, discount rates and other non-traditional forms of billing may render the nominal billing rate meaningless as a tool for measuring the actual value of the attorney's services. Often the court will look to outside sources for estimates of appropriate rates. These sources include fee matrixes, which set out rates that depend on the attorney's years of experience. One such matrix is produced by the United States Attorney's Office (USAO) for the District of Columbia.

The USAO's matrix was first introduced by the U.S. District Court for the District of Columbia to determine reasonable attorney's fees for work performed in *Laffey v. Northwest Airlines, Inc.* The attorney fees awarded in that case were for work done primarily in 1981 and 1982. To determine reasonable attorney rates for later periods, the USAO adjusted these original rates in accordance with changes in the Bureau of Labor Statistics Consumer Price Index for All Urban Consumers for the Washington-Baltimore area ("CPI-Washington"). The USAO continues annually to update this matrix to produce a table that provides hourly rates, based on years of experience, for attorneys, paralegals and law clerks in the Washington, D.C. area. This table is known as the USAO Laffey Matrix.

An alternative to the USAO Laffey Matrix is the Salazar Matrix, named after the case that first accepted it (*Salazar v. District of Columbia*). The Salazar Matrix begins with a 1989 template of hourly billing rates for legal services and then proposes to use a national index, the U.S. City Average of the Consumer Price Index for Legal Services ("US Legal Index"), to update these hourly billing rates. Several court decisions have accepted the Salazar Matrix as a basis for determining attorney fees, and its proponents claim this matrix has significant advantages, particularly its more recent base year and its use of an inflation index specific to legal services. Nevertheless, in cases involving complex federal litigation in the D.C. area, the USAO Laffey Matrix is the superior matrix to use to determine attorney fees.

The purpose of using a matrix for determining attorney fees is to approximate the actual hourly rates collected in the local community by attorneys with similar qualifications working on comparable cases, (i.e., the "market rate"). The Salazar Matrix falls short of this goal when assessing attorney fees in complex federal litigation in DC. The Salazar matrix, and its use of the US Legal Index, have several major flaws: a) the US Legal Index measures price changes in basic, consumer-oriented legal services and not complex federal litigation; b) the US Legal Index does not routinely take into account reasons why actual collected rates may differ from hourly billing rates, such as discount rates and contingency fees; c) the US Legal Index is a nationwide average index and not specific to the Washington, D.C. metropolitan region; and d) actual hourly billing rates of attorneys in the Washington, D.C. area are, according to published survey data, closer to rates outlined in the USAO Laffey Matrix than those in the Salazar Matrix.

Laura A. Malowane, an EI Vice President, has extensive experience in analyzing and testifying on issues relating to the awarding of attorney fees. She also specializes in assessing damages in commercial and personal litigation matters, including wrongful termination, defamation and loss of business opportunity.

Because the US Legal Index is based on the prices for some legal services, proponents of the Salazar Matrix assume that is the appropriate price index to use when adjusting legal fees. But given the nature of the services whose prices are considered when computing the US Legal Index, this assumption is incorrect. The US Legal Index measures price changes for personal legal services used by household consumers, such as basic wills, uncontested divorces, powers of attorney, and traffic violations. It does not include hourly billing rates for complex litigation. The demand for personal legal services is independent of the demand for complex litigation legal services. Moreover, because of legal specialization and differences in the skills necessary to supply specific legal services, the lawyers who provide personal legal services generally are different from those who engage in complex litigation. Thus, there is no advantage in using the US Legal Index, rather than the CPI, to measure price changes for legal services in complex litigation.

Moreover, the US Legal Index cannot reliably track changes in the fees charged in complex litigation, because those fees are often structured very differently from the fees for personal legal services. The US Legal Index is based on standard flat-fee rates, which are commonly charged for basic, personal legal services but are much less common in complex litigation. The US Legal Index excludes contingency fees, as they are not generally relevant to personal legal services.

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Google's Acquisition of ITA Software

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The Final Judgment also provides for arbitration of disputes, requires Google to develop a website with forms for submitting complaints, prohibits Google from entering into an agreement with an airline that restricts the airline's right to share information with other parties unless the airline enters into such an agreement with other OTIs, prevents tying of ITA's system to other Google products, and requires a firewall to protect confidential data that it receives from OTIs in the course of servicing a QPX agreement.

The optimal terms of a behavioral remedy, including scope and duration, depend on the conditions in the market. DOJ limited the remedy's duration to 5 years, which suggests that DOJ expects alternatives to ITA's software to be available within that time period. If competitive issues continue to exist after that period, however, the Final Judgment will not address them.

DOJ's reasons for accepting a behavioral remedy rather than attempting to block the transaction are unclear. DOJ's complaint, settlement, and competitive impact statements failed to explicitly discuss any potential benefits to consumers associated with the transaction that might offset competitive harm. Nonetheless, potential benefits may exist. Combining Google's technology and ITA's software may result in better ways to access ITA's data and improve overall travel-related searches. For example, being acquired by Google might hasten ITA's development of a hotel-search capability. If the transaction facilitates or improves consumers' travel searches and increases the volume of online bookings, and if ITA's customers, such as travel search and airline sites, have access at competitive prices to any improved technology, then ITA's customers likely would favor the transaction. Furthermore, if Google offers an integrated search service, consumers could benefit from more transparent fare offerings, which could allow them to find lower prices or enhanced service. Google has stated that it does not plan to sell tickets but would direct consumers to airline or online travel sites to make a purchase. Thus, Google's entry into travel search could benefit consumers by increasing competition to meta-search companies. These benefits may have ultimately justified the application of remedies to preserve the transaction.

Calculating Awards

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Moreover, the US Legal Index ignores discounts from standard fees unless the attorney routinely gives a discount for a specific service. Surveys of law firms reveal that contingency fees and other alternative fee arrangements are common practice in complex litigation. There is no basis for assuming that changes in flat-fee legal services, as measured by the US Legal Index, accurately capture changes in fees under these alternative billing mechanisms.

The USAO Laffey Matrix is superior to the Salazar Matrix in its geographic focus. The USAO Laffey Matrix uses the CPI-Washington (a regional, Washington area, price index) to adjust for changes in attorney fees in the Washington area. In contrast, the Salazar Matrix uses a nationwide index that is not specific to the region at issue. Due to the importance of local laws and regulations as well as the need for many clients to have local counsel, the demand and supply of legal services differ across areas. Nevertheless, the US Legal Index, and thus the Salazar Matrix, ignores the regional variation in attorney fees.

Finally, survey data support the use of the USAO Laffey Matrix over the Salazar Matrix. These data show that Laffey Matrix rates are approximately the same or slightly lower than the actual billing rates of firms in the greater D.C. area, while Salazar Matrix rates are consistently higher than these billing rates. Given the limitations of the Salazar Matrix, it is not surprising that actual attorney rates are more closely mirrored by the USAO Laffey Matrix.

Two matrixes have been proposed for use in awarding attorney fees. The Salazar Matrix fails to properly address the types of legal services, alternative billing methods, and geographic features applicable to complex federal litigation in Washington, D.C. The USAO Laffey Matrix is the superior matrix to use to determine attorney fees in such cases.

EI News and Notes

Technology Royalty Rates

Thomas R. Varner, an EI Vice President, published a paper in the September 2010 issue of *les Nouvelles* (the Journal of the Licensing Executives Society International). The paper, "Technology Royalty Rates in SEC Filings," presents findings from his research on royalty rates collected from thousands of technology licenses disclosed to the U.S. Securities & Exchange Commission from 1994 to 2009. This unique dataset collected by Dr. Varner includes a large number of agreements he obtained in unredacted form under the Freedom of Information Act.

Mirant Corporation and RRI Energy Inc. Merge to Form GenOn Energy

The Department of Justice has closed its investigation of the merger of Mirant Corporation and RRI Energy. EI Principal John R. Morris assisted in the antitrust defense of this merger. Dr. Morris has consulted on several merger filings at the Department of Justice, the Federal Energy Regulatory Commission and other agencies. In this matter, he was assisted by EI Senior Vice President Richard Shin and EI Senior Economists Lona Fowdur, Allison Holt, Su Sun, Gale Mosteller and Clarissa Yeap. RRI was represented by Skadden, Arps, and Mirant was represented by King & Spalding LLP.

Proposed Rulemaking Regarding Position Limits For Derivatives

The Commodity Futures Trading Commission recently implemented a Notice of Proposed Rulemaking regarding position limits pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. EI Principal John R. Morris and EI Senior Economist Lona Fowdur submitted comments concerning the proposed amendments to the definition of the bona fide hedge exemption and addressed the relevance of some of the proposed rules. They noted that certain changes are needed to allow entities to hedge. As written, the rules may place more restrictions on end-users than are necessary to meet the Act's goal of restricting excessive speculation.

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