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A BRIEF ANALYSIS OF POLICY AND LITIGATION

DOT and DOJ Provide Differing Views on Application by Continental Airlines for Antitrust Immunity

Gloria J. Hurdle & Erica E. Greulich

Gloria J. Hurdle has testified on a number of airline matters. Her airline experience includes mergers, code-share agreements, pricing analysis, predation, and issues related to global distribution systems. Erica E. Greulich specializes in empirical microeconomics, which she has used to analyze antitrust matters and calculate damages in numerous industries.

The Department of Transportation (DOT) recently allowed Continental Airlines to join both the Star Alliance and a new "A++" joint venture with current Star Alliance members United, Air Canada and Lufthansa. The A++ application anticipates that the four airlines will jointly arrange capacity, coordinate sales and marketing, and share revenues in international markets. Both A++'s and the 10-airline Star ATI Alliance's applications for antitrust immunity were granted, subject to "carve-out" exceptions, even though the Department of Justice (DOJ) recommended much more limited immunity.

While DOT has ultimate authority in granting antitrust immunity to international carriers, DOJ also analyzes the competitive effects of granting that immunity. In this case, DOJ defined a market as nonstop service between a city pair. DOJ observed the number of nonstop carriers on each route, considered the likelihood and timeliness of future entry, and estimated price effects of the loss of nonstop competition on certain routes. It recommended retaining existing carve-outs to antitrust immunity and implementing carve-outs in ten concentrated city-pair markets and on U.S.-China routes.

DOT and DOJ both supported their conclusions with empirical analyses, and each agency criticized the methodology used in the other's studies. DOT ultimately disagreed with DOJ that nonstop service for a given city-pair is a relevant market. Nevertheless, DOT did follow DOJ's suggestion to carve out certain routes where the number of non-stop competitors would otherwise decrease from two to one and DOT determined that potential entry would not deter anticompetitive fares. Thus DOT apparently concurred with DOJ's conclusion that a two-to-one reduction could lead to a significant price increase.

DOT and DOJ have disagreed before. As far back as 1996, in the Delta/Swissair/Sabena/Austrian alliance, DOT carved out only three of the seven city pairs requested by DOJ. Even when DOT and DOJ agreed on the city pairs to carve out, DOT made the limitation to antitrust immunity narrower than DOJ had requested. DOJ here requested that the carve-outs apply to all fare categories. DOT disagreed and limited the carve outs so they do not apply to most corporate and group fares, or to promotional, consolidator/wholesaler, and government fares.

Also In This Issue

Secondary Spectrum Markets

Scott J. Wallsten reviews the functioning of secondary markets for spectrum in the United States. These markets have become increasingly important as demand for wireless services continues to increase. Well-functioning secondary markets can ensure that spectrum can shift to new, more efficient uses. Nevertheless, some factors have slowed the development of secondary spectrum markets. Despite these difficulties, secondary spectrum markets are quite active; they embrace a wide variety of different types of transactions and involve a significant volume of spectrum. The FCC has made steady progress towards better facilitating secondary transactions. Nonetheless, some work remains to be done. Certain institutions, such as a robust ownership inventory and trading platforms, must develop to further facilitate the thriving markets that many hope to see.

Class Certification and Rule of Reason Testing of RPM

John M. Gale discusses the implications the combination of the *Leegin* and *Hydrogen Peroxide* decisions may have for the economic analysis and proof required for class certification in resale price maintenance (RPM) cases. In *Leegin*, the Supreme Court mandated a rule-of-reason analysis to determine whether an RPM policy is anti- or pro-competitive. Previously, a proposed methodology to show the impact of an RPM policy through common proof could be limited to price effects. Now, to demonstrate that a viable methodology for showing impact exists, a proposed method must determine the total impact on consumers, including non-price effects. If defendants can demonstrate that plaintiffs' proposed methodology will not work to measure both the anti- and pro-competitive effects of RPM, then plaintiffs will likely not have met the stringent standard that *Hydrogen Peroxide* set for having a class certified.

Secondary Spectrum Markets

Scott J. Wallsten

The Federal Communication Commission's (FCC's) move to use markets to allocate spectrum rights through auctions in the mid-1990s has been a success. Yet regardless of how efficiently initial rights are allocated, changing supply and demand conditions mean that initial allocations can quickly become inefficient. Well-functioning secondary markets can ensure that spectrum can shift to new, more efficient uses.

The ability of secondary spectrum markets to function well has become increasingly important as demand for wireless services continues to increase. The scarcity of spectrum has led to calls to cap the total amount of spectrum that any given licensee can hold under the belief that it is too difficult for new entrants to acquire spectrum. This debate over spectrum caps, however, is occurring largely in the absence of data on secondary spectrum markets.

Secondary markets are common throughout the economy. Broadly speaking, a secondary market is one in which a seller of a good is not the one who initially sold the good, though there is not always a bright line between transactions better described as wholesale and those better described as secondary. When property rights are defined clearly and information can flow freely, these markets work well and are typically unremarkable—houses and cars are routinely sold in secondary transactions, as are most things sold in garage sales and on eBay.

Nevertheless, some factors have slowed the development of secondary spectrum markets. In particular, property rights to spectrum have been somewhat controversial, in part because license holders own the right to use spectrum but do not technically own the spectrum itself. In addition, those usage rights are often constrained by a wide range of restrictions, including time of use, geographic area, technology allowed, and even the purpose for which the spectrum may be used. Though these factors, plus interference issues, can make defining property rights difficult, they do not make it impossible.

Despite these difficulties, secondary spectrum markets are quite active. For example, the amount of PCS spectrum that has changed hands each year since 2004 is about as much as was newly released in the 2006 Advanced Wireless Services (AWS) auction.

Secondary spectrum markets include a host of economic activities, which range from activities that may be better described as wholesale transactions to true license resale. Sales to mobile resellers, such as Tracfone, straddle the line between wholesale and secondary. These resellers lease network capacity on cellular networks and resell it under their own brand names. The end-user interacts only with the reseller, not with the underlying provider. Resellers serve more than 18 million customers in the United States.

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A related secondary market involves spectrum for use by the so-called machine-to-machine (or "M2M") industry, which supports data communication between remote machines and processes. But most of the M2M market focuses on businesses, which use M2M devices to, for example, track mobile assets, monitor electricity use, and gather telemetry from remote areas. These applications typically rely on specialized devices that work on networks built primarily by large facilities-based cellular wireless carriers. Though this market is new, ABI Research estimates that North America had 22.3 million M2M connections in 2008, and M2M revenues collected by cellular carriers were about $2 billion in 2006. In addition to those markets, there also exists direct spectrum trading.

The FCC has made steady progress towards better facilitating secondary transactions. In 2000 it identified "certain essential elements" for secondary markets to function: "1) clearly defined economic rights; 2) full information on prices and products available to all participants; 3) mechanisms for bringing buyers and sellers together to make transactions with a minimum of administrative costs and delays; 4) easy entry and exit to the market by both buyers and sellers; and 5) effective competition with many buyers and sellers." While the FCC has generally been able to promote these elements, some work remains to be done.

For example, while in direct spectrum trading the rights are defined at least as well as they are specified in the license, information on who owns what and where remains difficult to obtain. The FCC keeps track of this information, but in a database, the Universal Licensing System (ULS), that is extremely difficult to use. Moreover, determining who owns what spectrum rights is becoming more difficult due to the ability of license holders to disaggregate (divide into smaller frequency

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Class Certification and Rule of Reason Testing of RPM

John M. Gale

Two recent high-profile antitrust decisions, *Leegin* and *Hydrogen Peroxide*, brought significant changes to antitrust law. Simply put, *Leegin* removed the per se illegality of resale price maintenance (RPM) policies, while *Hydrogen Peroxide* made it clear that there is a significant evidentiary threshold for certifying a class. Moreover, the interaction between these decisions may have additional significant implications for the standards of economic analysis and proof required in class certification. Together these decisions may reduce significantly the number of RPM cases in which it is possible to certify a class.

In the *Leegin* decision, the Supreme Court struck down the per se illegality of RPM policies. The Court mandated that a rule-of-reason analysis is required to determine whether a particular RPM policy is anti- or pro-competitive. The court recognized that economists have developed models of firm behavior and consumer demand that demonstrate that RPM may have anti-competitive effects, such as cartel enforcement and entry deterrence, and pro-competitive effects, such as output expansion, increased provision of retail services, and increased product choice and availability. Evidence of any adverse price effect must be weighed against evidence of quality- and output-enhancing results of the RPM policy. What the *Leegin* decision means for defendants is that an affirmative defense that empirically demonstrates the pro-competitive effect of an RPM policy can defeat evidence of price effects offered by plaintiffs. The question for the trier of fact is whether the RPM policy ultimately is good or bad for consumers. This question is independent of whether the RPM policy is good for competing manufacturers or retailers. In class actions, the rule-of-reason weighing is not only required in the aggregate to demonstrate harm to competition, but presumably must apply to each individual class member to show class-wide impact.

In the *Hydrogen Peroxide* decision, the circuit court articulated a stringent evidence-based standard that plaintiffs must meet to have a class certified. The circuit court found that a court must resolve all factual and legal disputes relevant to the class, including issues that touch on the merits of the case. Most commentators seem to agree that plaintiffs' evidentiary burden has increased in that the court is likely to require a rigorous empirical analysis that demonstrates a methodology that can determine impact and damages using common evidence. *Hydrogen Peroxide*

John M. Gale is an antitrust economist who focuses on strategic firm interaction. He has analyzed the competitive effects of RPM policies in a variety of industries and has testified concerning class certification.

invites the defense to present a fact-based refutation of plaintiffs' proposed methodologies for satisfying class requirements. Instead of merely determining that the proposed methodology meets some threshold of plausibility, the court must weigh the arguments to resolve factual disputes and determine if plaintiffs' proposed methodology survives defendants' criticisms.

Where the *Hydrogen Peroxide* and *Leegin* decisions overlap (*i.e.*, where class certification is sought with respect to a rule-of-reason violation such as RPM), the defense may explicitly include evidence of the pro-competitive results of an RPM policy. To determine if class-wide impact can be shown with common proof (which is necessary for certification of the class), a methodology must be developed for determining how the RPM policy affected each consumer in the proposed class, both negatively and positively. Previously it could be assumed that the RPM policy was per se illegal, and the analysis could ignore any consumer impact other than the change in retail prices. Now to demonstrate that a viable methodology exists for showing class-wide impact, both price and non-price effects will likely have to be included in a model of the total impact on consumers. In addition, the proposed methodology will have to account for the differences in how consumers value the estimated price and non-price effects.

An example can illustrate this distinction. Assume that a manufacturer implements an RPM policy and, therefore, the product is sold at the same price by a high-service/high-cost retailer and also by a low-service/low-cost retailer. Plaintiffs may argue that the RPM policy limits discounting by the low-service retailer, so that all consumers paid higher prices because other retailers were not forced to match the discounts. Plaintiffs then may propose a methodology that claims to determine the market price absent the RPM policy. But now that a rule-of-reason analysis is required to show consumer harm, the proposed plaintiffs' analysis may not represent a complete methodology if it examines price in isolation. If all members of the class value only low prices, then determining price

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Secondary Spectrum Markets

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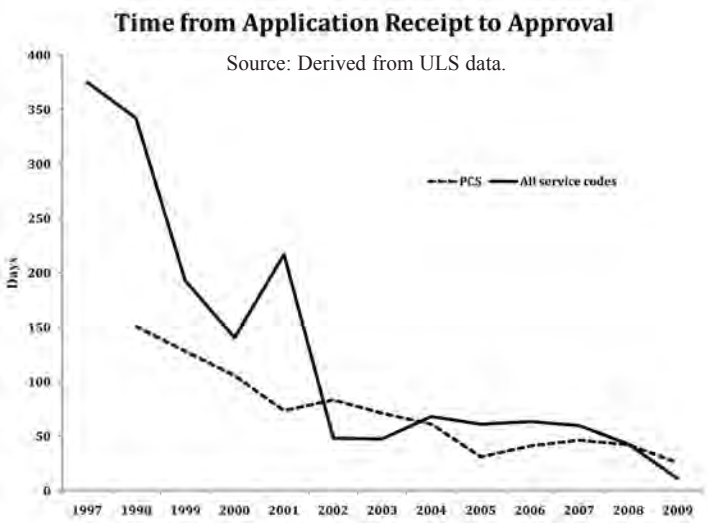
blocks) and partition (divide into smaller geographic areas) licenses. Arguably, the opaqueness of this database constitutes one barrier to a more robust secondary spectrum market.

Nevertheless, careful examination of the ULS database yields some interesting information. The data show that thousands of licenses change hands each year (not including licenses that technically changed hands but only because firms merged or were acquired) and hundreds of others are subleased. These trades represent a large amount of spectrum: between 1999 and 2008 about 10 billion MHz-pops (spectrum bandwidth times the population covered) of Personal Communications Service (PCS) spectrum changed hands each year.

The FCC has significantly reduced the amount of time to approve license transfers, as the figure demonstrates. In the first 6 months of 2009, it took the FCC just over 10 days to approve a license transfer on average across all license types. The decline in approval times shows that the process may be better described as simply notification, rather than approval, though the agency can reject an application under certain circumstances.

The significant volume of activity and rapid approvals of transfers show the FCC has made progress in promoting secondary spectrum markets. The data do not, however, by themselves demonstrate that secondary markets are working as well as they could be. For example, as the FCC noted, these markets require full information to function well. That information is not easily obtainable. In part because of the high investment required to use the ULS database, it is difficult to learn who owns which spectrum. In addition, while licenses can be traded, no robust platform exists to facilitate this trading, though at least one company, Spectrum Bridge, is attempting to become that platform.



In sum, secondary spectrum trades are far more common than many realize, but certain institutions, such as a robust ownership inventory and trading platforms, must develop to further facilitate the thriving markets that many hope to see.

Class Certification

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might be sufficient. But when some consumers value the services provided by the high-service retailer and would have bought the product there even if the same product was available elsewhere at a lower price, then non-price benefits must be included to determine impact on particular members of the proposed class. If the lower prices that plaintiffs claim would have occurred absent the RPM policy also induced some retailers to curtail services or to discontinue the products (as some procompetitive explanations for RPM predict), then the elimination of RPM may harm some members of the proposed class. As a result, plaintiffs must identify a method of measuring the non-price benefits to consumers and offsetting those benefits against the predicted lower prices to demonstrate that both price-only buyers and price-and-service buyers within the proposed class were harmed by the RPM policy or they must propose a methodology that would (through common proof) identify price-only consumers that are appropriately in the class.

A combination of these two recent decisions appears to require that plaintiffs seeking a class in an RPM case demonstrate a method of estimating any pro-competitive benefits to consumers and determining which individual consumers value these benefits. Even if identifying and documenting procompetitive effects is the burden of the defendant at the merits stage, plaintiffs still cannot ignore these effects at the class certification stage. Plaintiffs cannot now claim to have a viable method of showing class-wide impact without demonstrating that their methodology could reliably show the individualized impact of both the price and non-price effects of RPM on each consumer. Based on the circuit court's decision in *Hydrogen Peroxide*, the proposed methodology must also be empirically grounded in the facts of the case. In addition the proposed methodology is now open to refutation by a fact-based demonstration by defendants. If defendants can demonstrate that plaintiffs' proposed methodology will not accurately measure both the anti- and procompetitive effects of RPM, as required by the *Leegin* decision, then plaintiffs will not have met their burden under the *Hydrogen Peroxide* decision.

EI News and Notes

Verdi Valley Medical Center Wins Summary Judgment

Barry C. Harris, Principal and Board Chairman of Economists Incorporated (EI), was the expert economist and testified at deposition on behalf of defendant Verdi Valley Medical Center. Plaintiffs alleged that the defendants engaged in a variety of anticompetitive actions to eliminate competition for cardiology services in the Verdi Valley area of Arizona. Dr. Harris's analysis showed that competition had not been eliminated and that the appropriate antitrust geographic market was broader than the Verdi Valley area. Defendants won on summary judgment. The defendants were represented by David Ettinger of Honigman Miller Schwartz & Cohn LLP. Dr. Harris was assisted by EI Corporate Vice President David Argue.

Gannett Wins Injunction

Gannett Co., Inc. and Lee Enterprises, Inc. published the Tucson Citizen and the Arizona Daily Star newspapers as part of a joint operating agreement. When Gannett announced that it would discontinue printing the Citizen, the Arizona Attorney General asked a Federal Court for an injunction to require continued publication. EI Senior Vice President Kent Mikkelsen submitted a declaration showing that the Citizen cost more to produce than the incremental revenue it brought in. The court found that the Citizen would qualify under the failing company test and denied the injunction. The Attorney General subsequently withdrew the suit. Gannett and Lee were represented by Nixon Peabody and K&L Gates, respectively.

Raytheon Wins in Defamation Trial

EI Vice President Laura A. Malowane testified before the Fairfax Circuit Court of Virginia on behalf of defendants Raytheon Company, *et al.* Her testimony concerned damages stemming from alleged defamation of a former employee. Plaintiff claimed the defamation resulted in her termination and caused her $6.5 million in damages. Dr. Malowane showed that the plaintiff suffered no economic damages. The jury found for the defendants. The defendants were represented by Hunton & Williams and Willkie Farr & Gallagher. Dr. Malowane was assisted by EI Senior Vice President Jeffry Davis and Senior Economist Allison Holt.

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