

Commission Opinion

IN THE MATTER OF

POLYGRAM HOLDING, INC., ET AL.OPINION OF THE COMMISSION AND FINAL ORDER IN REGARD TO
ALLEGED VIOLATIONS OF SEC. 5 OF THE
FEDERAL TRADE COMMISSION ACT*Docket 9298; File No. 0010231**Complaint, July 30, 2001--Opinion and Final Order, July 24, 2003*

In a unanimous Opinion, the Commission addressed actions taken by Respondent PolyGram Holding, Inc. (a predecessor to Vivendi Universal, S.A.) and Warner Communications Inc. – two of the world’s largest music companies – in connection with a joint venture formed in 1997 to distribute audio and video recordings of the 1998 World Cup concert featuring “The Three Tenors,” Jose Carreras, Placido Domingo, and Luciano Pavarotti. The Commission determined that PolyGram and Warner agreed to restrict price discounting and advertising for recordings of the 1990 and 1994 concerts -- before and after the public release of recordings of the 1998 concert -- in violation of Section 5 of the Federal Trade Commission Act. The Final Order, among other things, prohibits the respondents from soliciting, participating in, entering into, attempting to enter into, implementing, attempting to implement, continuing, attempting to continue, or otherwise facilitating or attempting to facilitate any combination, conspiracy, or agreement, either express or implied, with any Seller (as defined by the Order) (A) to fix, raise, or stabilize prices or price levels in connection with the sale in or into the United States of any prerecorded music in any physical, electronic, or other form or format (“Audio Product”) or of any prerecorded visual or audiovisual product in any physical, electronic, or other form or format (“Video Product”), or (B) to prohibit, restrict, regulate, or otherwise place any limitation on any truthful, nondeceptive advertising or promotion in the United States for any Audio Product or any Video Product.

Participants

For the Commission: *Geoffrey M. Green, John Roberti, Cary Zuk, Melissa Westman-Cherry, Geoffrey D. Oliver, and Richard B. Dagen.*

For the Respondents: *Bradley S. Phillips, Glenn D. Pomerantz, and Stephen E. Morrissey, Munger, Tolles & Olsen.*

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OPINION OF THE COMMISSION

BY MURIS, Chairman, For A Unanimous Commission:

INTRODUCTION

***Nessun Dorma!* – None must sleep!**

This Puccini aria, sung by tenor Luciano Pavarotti in the recording at the heart of our case, announces the edict of the Chinese princess Turandot that no one in Peking may sleep until she solves her problem. The princess has made a bad judgment – agreeing to marry the first suitor who, at peril of death, can answer three riddles. Although this plan once had served her purposes, someone has now answered the riddles, and Turandot is encumbered with a product she neither wants nor can market. She grasps at one last chance to stop the wedding, by guessing the name of the suitor, and will stop at nothing to obtain the information.

Our story takes place not on the opera stage, but in the business world of operatic recordings. The drama is not so stirring, and no one loses his head, at least not literally. The story is troubling, nonetheless. Two recording companies agree to form a joint venture to market a new recording, by three of the world's foremost singers, and to split the costs and profits. By itself, such an agreement, even by competitors, is often beneficial, because it helps bring a new product to market. Here, however, the story turns dark when it becomes apparent that the new recording will repeat much of the repertoire of existing recordings, diminishing its marketing potential and worrying the recording companies. While other businesses might have worked harder to develop an improved or more distinctive product to attract greater consumer interest, our protagonists chose another route. They agreed to restrict their marketing of competing products that they respectively controlled – products that were clearly outside the joint venture they had formed. They imposed a moratorium on discounting and promotion of those recordings that might

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otherwise siphon off sales of the new product. We now consider whether such an agreement unreasonably restrains trade in violation of the antitrust laws. We conclude that it does.

No analytical exercise is more important to U.S. competition policy than defining the bounds of acceptable cooperation between direct rivals. Courts and commentators have written extensively on how Section 1 of the Sherman Act, 15 U.S.C. § 1, and Section 5 of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 45, apply to agreements involving competitors.¹ The Federal Trade Commission (“the FTC” or “the Commission”) also has played a formative role in the evolution of horizontal restraints jurisprudence and policy.² Our opinion in this matter

¹ Comprehensive recent treatments of the relevant case law and commentary appear in ABA Antitrust Section, Monograph No. 23, *The Rule of Reason* (1999); VII Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶ 1500-12 (2d ed. 2003); *Symposium: The Future Course of the Rule of Reason*, 68 Antitrust L.J. 331 (2000).

² Major FTC contributions to horizontal restraints jurisprudence include *Pacific States Paper Trade Ass’n*, 7 F.T.C. 155 (1923) (condemning agreement by trade associations of paper dealers and their members to adhere to price lists issued by the associations), *enforcement denied in part and granted in part*, 4 F.2d 457 (9th Cir. 1925), *rev’d in part and FTC order enforced*, 273 U.S. 52 (1927); *Virginia Excelsior Mills, Inc.*, 54 F.T.C. 455 (1957) (condemning agreement of excelsior producers to establish common sales agent that set prices for all producers and allocated orders according to relative productive capacity of each producer), *aff’d*, 256 F.2d 538 (4th Cir. 1958); *National Macaroni Manufacturers Ass’n*, 65 F.T.C. 583 (1964) (condemning agreement among pasta producers to fix the inputs used to make their products), *aff’d*, 345 F.2d 421 (7th Cir. 1965); *American Medical Ass’n*, 94 F.T.C. 701 (1979) (condemning AMA’s restrictions on truthful advertising and solicitation by its members), *enforced as*

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provides our first adjudicative opportunity to revisit the issue of competitor collaboration since the Supreme Court's decision in *California Dental Ass'n v. Federal Trade Commission*, 526 U.S. 756 (1999) ("CDA"), and the issuance of the Department of Justice and FTC *Collaboration Guidelines*.

modified, 638 F.2d 443 (2d Cir. 1980), *aff'd* by an equally divided Court, 455 U.S. 676 (1982); *Indiana Federation of Dentists*, 101 F.T.C. 57 (1983) (condemning association's efforts to prevent its members from complying with insurers' requests for x-rays with insurance claims), *enforcement denied and order vacated*, 745 F.2d 1124 (7th Cir. 1984), *rev'd and FTC order aff'd*, 476 U.S. 447 (1986); *Superior Court Trial Lawyers Ass'n*, 107 F.T.C. 510 (1986) (condemning boycott designed to help effectuate agreement among attorneys to raise prices), *enforcement denied and remanded*, 856 F.2d 226 (D.C. Cir. 1988), *rev'd and FTC order aff'd*, 493 U.S. 411 (1990); *Massachusetts Board of Registration in Optometry*, 110 F.T.C. 549, 604 (1988) (condemning restrictions on optometrists' price and non-price advertising); *Detroit Auto Dealers Ass'n, Inc.*, 111 F.T.C. 417 (1989) (condemning agreement among Detroit-area automobile dealers to close dealer showrooms on nights and weekends), *aff'd in part and rev'd in part*, 955 F.2d 457 (6th Cir.), *cert. denied*, 506 U.S. 973 (1992). In addition to developing doctrine through adjudication, the FTC has coauthored guidelines to help build the modern analytical framework for horizontal restraints. See Department of Justice and Federal Trade Commission, *Antitrust Guidelines for Collaborations Among Competitors* (Apr. 7, 2000) ("Collaboration Guidelines"); Department of Justice and Federal Trade Commission, *Statements of Antitrust Enforcement Policy in Healthcare* (Aug. 28, 1996); Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* (Apr. 6, 1995).

I. BACKGROUND

The Commission issued its complaint in this matter on July 30, 2001. The complaint charges that the Respondents (hereinafter collectively referred to as “PolyGram”) engaged in unfair methods of competition in violation of Section 5 of the FTC Act by agreeing with competitor Warner Communications Inc. (“Warner”) to restrict price competition and forgo advertising.³ The complaint alleges that, after forming a joint venture (whose establishment the Commission does not challenge here) to collaborate in the distribution of audio and video recordings of a concert by the “Three Tenors” at the 1998 FIFA World Cup for soccer in Paris, PolyGram and Warner entered into a side agreement not to discount or advertise their previous Three Tenors products for a period of time preceding and following the release of the new Three Tenors recording. The complaint alleges that these restrictions had the effect of restraining competition unreasonably, increasing prices, and injuring consumers.

A. PolyGram

PolyGram is a group of vertically integrated companies, affiliated with PolyGram N.V., engaged in the business of producing, marketing, and distributing recorded music and videos in the United States and worldwide. In 1998, PolyGram comprised Respondent PolyGram Holding, Inc. (“PolyGram Holding”); The Decca Record Company Limited (“Decca”) (now

³ On July 31, 2001, when the Commission announced the issuance of the complaint against Polygram, it also announced that it had accepted for public comment a consent agreement with Warner, settling similar allegations against Warner. On September 17, 2001, the Commission issued the final consent order against Warner, enjoining agreements with a competitor to fix prices or limit truthful, non-deceptive advertising or promotion for any audio or video product. *Warner Communications Inc.*, Dkt. No. C-4025 (Sept. 17, 2001).

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Respondent Decca Music Group Limited); PolyGram Records, Inc. (“PolyGram Records”) (predecessor of Respondent UMG Recordings, Inc. (“UMG”)); and PolyGram Group Distribution, Inc. (“PGD”) (predecessor of Respondent Universal Music & Video Distribution Corp. (“UMVD”)). IDF 7-11, 23.⁴ In December 1998, the Seagram Company Ltd. (“Seagram”) acquired PolyGram N.V. Seagram combined the music business of PolyGram N.V. (*i.e.*, PolyGram) with its own music business to form Universal Music Group. Two years later, Seagram merged with Vivendi S.A. and Canal Plus S.A. to form Vivendi Universal S.A. (“Vivendi”). Each Respondent is now a subsidiary of Vivendi. IDF 6, 18.

Decca is a music “label” that develops, acquires, and produces recorded music. In 1998, Decca was part of the PolyGram Classics & Jazz (“PolyGram Classics”) label group, a division of PolyGram Records. At all relevant times, Decca owned the copyright to the master recording of the first Three Tenors concert (“3T1”). IDF 14.

PolyGram Classics was the PolyGram operating company responsible for United States sales of classical music produced by PolyGram. PolyGram Classics was responsible for marketing, promoting, pricing, and advertising 3T1 in the United States. IDF 12, 15. PGD provided the distribution and sales force for

⁴ This opinion uses the following abbreviations:

ID - Initial Decision of the Administrative Law Judge (“ALJ”).
IDF - Numbered Findings of Fact in the ALJ’s Initial Decision
CX - Complaint Counsel’s Exhibit
RX - Respondents’ Exhibit
JX - Joint Exhibits
Tr. - Transcript of Trial before the ALJ

We adopt the ALJ’s findings of fact to the extent such findings are not inconsistent with this opinion.

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PolyGram Classics in the United States and executed PolyGram Classics's marketing strategy at the retailer level. IDF 16.

PolyGram Holding is the parent company of Respondents UMG and UMVD, and provides services to its subsidiaries, including legal, financial, business affairs, and human resources services. PolyGram Holding negotiated the collaboration between PolyGram and Warner with regard to the third Three Tenors World Cup concert ("3T3"). IDF 12-13.

B. Warner

Warner was PolyGram's partner in the Three Tenors joint venture. Two Warner entities principally were involved in the conduct at issue here: Atlantic Recording Corp. ("Atlantic"), a Warner label that operates in the United States, and Warner Music International ("WMI"), which manages the music operations of Warner's operating companies outside the United States. IDF 20-22.

C. Factual Background

The Three Tenors are world-renowned opera singers Jose Carreras, Placido Domingo, and Luciano Pavarotti. IDF 4-5. During the 1990s, the Three Tenors released three paired audio and video recordings derived from live concerts at the FIFA World Cup. PolyGram acquired the rights to distribute audio and video recordings of the first performance of the Three Tenors at the Baths of Caracalla in Rome in 1990.⁵ The trio's first album became the best-selling classical record of all time. IDF 27-29. In 1994, the Three Tenors performed a second World Cup concert at Dodger Stadium in Los Angeles. Warner acquired the rights to

⁵ Since 1990, audio and video recordings of 3T1 have been distributed in the United States by PGD and its successor UMVD. PGD was responsible for deciding the wholesale price and advertising strategy for 3T1 in the United States. IDF 17.

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distribute audio and video recordings derived from the second concert (“3T2”). IDF 30, 32. In 1998, the Three Tenors performed a third World Cup concert in Paris. PolyGram and Warner entered into an agreement to collaborate in the distribution of the audio and video recordings of the third concert, with Warner distributing 3T3 in the United States and PolyGram distributing it in the rest of the world. IDF 59-60.

Upon the release of 3T2 in 1994, and until 1998, PolyGram and Warner competed to sell their respective Three Tenors albums. IDF 34. In 1994, Warner launched an expensive and aggressive marketing campaign to support 3T2 in the United States and internationally. IDF 200-09. PolyGram responded to the release of 3T2 by promoting 3T1 aggressively in the United States and other markets, through advertising and price discounts. IDF 210-21. Sales of 3T1 audio and video products in the second half of 1994 increased over 250% compared with sales in the same period in 1993. JX 12. Despite the competition from 3T1, 3T2 was a business success for Warner. IDF 222. During 1996 and 1997, the Three Tenors held concerts in Tokyo, London, Munich, New York, Johannesburg, and Melbourne. PolyGram and Warner competed with each other throughout the world to capitalize on these concerts as an opportunity to drive sales of their Three Tenors products through various promotional activities. IDF 224-31. 3T1 and 3T2 were both among the best-selling classical recordings in the United States in 1994, 1995, 1996, and 1997. IDF 234.⁶

In 1996, PolyGram and Warner each began to negotiate

⁶ In 1994, 3T2 was the no. 2 and 3T1 was the no. 3 best-selling classical album (CX 587); in 1995, 3T2 was no. 1 and 3T1 was no. 5 (CX 588); in 1996, 3T2 was no. 4 and 3T1 was no. 5 (CX 589); and in 1997, 3T1 was no. 9 and 3T2 was no. 12 (CX 590).

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separately with the concert promoter, Tibor Rudas (“Rudas”),⁷ for the rights to distribute the recordings of the next Three Tenors World Cup concert in 1998. PolyGram did not anticipate collaborating with Warner. IDF 54. Initially, Warner planned to distribute 3T3 without a collaboration with PolyGram: its Atlantic label proposed to distribute 3T3 in the United States, with WMI to distribute 3T3 in the rest of the world. IDF 52. The president of WMI, however, decided to pass on the project because he did not think that another Three Tenors album was a good investment. CX 366; Tr. 407-08.

At that time, Pavarotti was under contract to record exclusively for PolyGram’s Decca label.⁸ In 1997, Warner asked Decca to release Pavarotti from his exclusive contract and permit him to record the 1998 World Cup concert for Warner. Instead, PolyGram proposed that Warner and PolyGram work together on the 3T3 project. Warner accepted this proposal. IDF 55-56.

PolyGram and Warner were very concerned that the new Three Tenors album, scheduled for release in August 1998, would not be as original or commercially appealing as the 1990 and 1994 releases. IDF 73. They recognized that the commercial success of 3T3 would depend largely on having a repertoire that was distinct from that of the earlier Three Tenors recordings. IDF 66, 69. In their negotiations with Rudas, PolyGram and Warner sought the right to approve a significant part of the repertoire for the 1998 concert, but Rudas insisted that he and the artists should control

⁷ Rudas is independent of PolyGram and Warner. *See* CX 380.

⁸ Pavarotti was also under contract to record exclusively for Decca at the time of the 1994 3T2 concert. CX 224. In exchange for certain consideration, Decca agreed to waive its rights and allow Pavarotti to record for Warner. IDF 33.

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the choice of songs. IDF 67-68.⁹ PolyGram and Warner ultimately agreed to forgo approval of the repertoire, and the contract with Rudas provided only that Rudas would consider “in good faith” their suggestions as to repertoire. IDF 68, 71-72.

The collaboration between PolyGram and Warner took the following form: In a series of contracts dated October 14, 1997, in return for an \$18 million advance and other consideration, Rudas licensed to Warner the worldwide audio, video, and home television rights to the 1998 concert. IDF 58. Then, in an agreement dated December 17, 1997, Warner licensed to PolyGram the rights to exploit 3T3 outside of the United States, with Warner (through its affiliate Atlantic) retaining the rights to exploit 3T3 within the United States. The contract provided that PolyGram would reimburse Warner for 50% of the \$18 million advance paid to Rudas, and that Warner and PolyGram would share 50-50 the profits and losses from the 3T3 project. IDF 59-60. The contract also provided that Warner and PolyGram would have the right to market a Greatest Hits album and/or a Boxed Set incorporating the 1990, 1994, and 1998 Three Tenors recordings, but the joint venture agreement did not include the marketing rights to the existing 1990 and 1994 Three Tenors albums. JX-10-F; JX 11 at UMG001790 (*in camera*). The contract also contained a limited covenant not to compete, which stated that neither PolyGram nor Warner would release another Three Tenors recording for four years following the release of 3T3, unless such release was pursuant to this agreement. The contract expressly provided, however, that PolyGram and Warner each could continue to exploit its older Three Tenors products. IDF 62-63. Thus, the relationship of 3T1 and 3T2 to the joint venture was clear: ownership and marketing rights for both were outside the joint venture.

⁹ PolyGram also sought to differentiate the 1998 concert by including a guest performer or original songs to be written by Andrew Lloyd Webber, Elton John, Stevie Wonder, or others, but these suggestions were rejected by the Three Tenors. IDF 75-76.

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The operating companies of both PolyGram and Warner began developing marketing campaigns for 3T1 and 3T2 in early 1998. They planned to capitalize on the upcoming Three Tenors concert and the new album as an opportunity to increase sales of their catalog Three Tenor products. IDF 102-05, 115-18.¹⁰ PolyGram and Warner grew concerned, however, that competition from the catalog Three Tenors recordings would reduce the sales of the new Three Tenors album. As a result, they feared that they would not recoup their \$18 million investment. Tr. 485; JX 9-E; JX 94 at 94, 96; JX 100 at 72-73 (*in camera*); JX 102 at 43; CX 202. In March 1998, executives of PolyGram and Warner met and agreed to refrain from advertising or reducing prices of 3T1 or 3T2 audio or video products in all markets in the weeks surrounding the release of 3T3. They called this agreement the “moratorium” agreement. IDF 90-101, 107-13. Warner’s operating companies, however, continued with plans to launch a discounting campaign for 3T2 scheduled to run through December 1998. IDF 118. When PolyGram learned of this, it informed its operating companies that if Warner discounted 3T2, they were free to retaliate with price discounts on 3T1. IDF 119-21, 128, 130. By June 1998, senior management at both PolyGram and Warner believed that the moratorium agreement was likely to fall apart. IDF 126-27, 129, 131-32.

In June 1998, PolyGram and Warner also learned that – contrary to Rudas’s earlier statement that 3T3 would contain an all-new repertoire – the repertoire would substantially overlap with that of the older Three Tenors concerts. IDF 79-81, 133. This unwelcome news added to PolyGram’s and Warner’s concerns that 3T3 would lose sales to 3T1 and 3T2 and would not be commercially successful. IDF 133-36. Later that month, PolyGram and Warner executives exchanged reassurances that the companies would forgo discounting and advertising of 3T1 and 3T2 during the launch of 3T3. IDF 137-44, 147. PolyGram and

¹⁰ “Catalog” is a music industry term that refers to older albums that a record company continues to offer for sale. IDF 93.

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Warner subsequently issued written instructions to their operating companies worldwide that forbade price discounting and advertising of 3T1 and 3T2 from August 1, 1998 through October 15, 1998. IDF 148-53.

In late July 1998, after the Paris concert but before the release of 3T3, the legal departments of PolyGram and Warner learned of the moratorium agreement. IDF 154. The establishment of the moratorium created evident discomfort for PolyGram's attorneys, who raised concerns with PolyGram's management about the moratorium's legitimacy. CX 459; JX 94 at 170-79; RX 719 at 3-7. Shortly thereafter, PolyGram sent a letter to Warner purporting to disavow the existence of a moratorium; likewise, at the request of its counsel, Warner sent a letter to PolyGram purporting to reject the moratorium agreement. IDF 156-57, 160-63. These letters, however, were mere pretense, and the moratorium agreement remained in effect. IDF 158-59, 163-64. The companies complied with the moratorium. Between August 1, 1998 and October 15, 1998, neither PolyGram nor Warner reduced the prices of or funded advertising for its respective catalog Three Tenors products in the United States. IDF 170-76. The companies substantially complied with the moratorium outside the United States, as well. IDF 177-81.

In the end, 3T3 was unsuccessful. Published reviews were generally unfavorable. IDF 167. Several music reviewers noted the overlap in repertoire between the 1998 Three Tenors album and the earlier Three Tenors recordings. IDF 166. Sales of 3T3 fell far short of the companies' projections in 1997, when they thought 3T3 would feature an all-new repertoire, and PolyGram and Warner lost millions of dollars on the project. Tr. 522-25.

In 1999, Decca agreed to waive its exclusive rights to the recording services of Pavarotti to allow him to record a Three Tenors album for Sony. In October 1999, Sony released the album – which consisted of Christmas songs derived from a performance of the Three Tenors in Vienna – with no restriction on marketing activities by PolyGram or Warner in support of their

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catalog Three Tenors albums. IDF 196-99.

D. The ALJ's Initial Decision

After pretrial discovery, ALJ James P. Timony conducted a one-week trial. Complaint Counsel called four live witnesses: Anthony O'Brien, from Atlantic; Rand Hoffman, from PolyGram Holding; Professor Catherine Moore, the director of the Music Business Program at New York University; and Dr. Stephen Stockum, an economist. Respondents called no live witnesses. Both parties introduced deposition testimony and numerous documents. The record closed on March 20, 2002. Following post-trial motions, Judge Timony issued an initial decision and a proposed order on June 20, 2002. Judge Timony's decision ruled that the moratorium agreement constituted an unfair method of competition in violation of Section 5 of the FTC Act.

The ALJ found that the moratorium agreement – created several months after the joint venture agreement between PolyGram and Warner – was not ancillary to the 3T3 joint venture because it was not an integral part of the joint venture or reasonably necessary to market the joint venture product. ID at 50-53. Instead, the ALJ found that the moratorium was a “naked agreement to fix prices and restrict output” that was properly subject to *per se* condemnation. ID at 54, 68.

The ALJ also evaluated the moratorium under an abbreviated (or “quick look”) rule of reason analysis. He ruled that if the moratorium's anticompetitive effects were “obvious,” the burden would shift to Respondents to show the procompetitive benefits of the restraint. ID at 54-55. Turning first to the agreement not to discount 3T1 and 3T2, the ALJ concluded that this arrangement constituted horizontal price fixing, which, as case law has recognized, “threatens the efficient functioning of a market economy.” ID at 56. The ALJ found that PolyGram and Warner previously had competed by reducing the price of 3T1 and 3T2 – to the benefit of consumers – and that such an agreement to forgo discounting had “obvious anticompetitive potential.” ID at 56-57.

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The ALJ also concluded that the agreement to forgo advertising of 3T1 and 3T2 was presumptively anticompetitive. ID at 57. The ALJ explained that economic theory and empirical research showed that advertising restrictions result in higher prices to consumers, and that the evidence here showed that advertising was an important competitive tool used by PolyGram and Warner in marketing the Three Tenors products, creating additional demand and encouraging price discounting. ID at 57-58. The ALJ found that PolyGram and Warner intended that their advertising ban would conceal the better-value Three Tenors recordings so that consumers instead would purchase the higher-margin 3T3 release. Judge Timony concluded that the potential anticompetitive effect of this strategy was “obvious.” ID at 58.

Turning next to Respondents’ efficiency justifications, the ALJ found that the Respondents failed to meet their burden of identifying legitimate procompetitive justifications. ID at 58-65, 68-69. He found that the parties’ principal motive for the moratorium was to shield 3T3 from competition to protect their profits, which he deemed to be an illegitimate justification. ID at 60. He also rejected Respondents’ other proffered justifications, finding that they were implausible and, even if plausible, were invalid because they were unsupported by the evidence in this case. ID at 61-65.

Finally, the ALJ rejected Respondents’ contention that PolyGram withdrew from the moratorium and thus should not be held liable. ID at 65-66.

The ALJ issued a cease and desist order enjoining Respondents for 20 years from again agreeing with a competitor to fix prices or to restrict advertising in connection with the sale of audio and video products, except under certain specified circumstances related to a joint venture.

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E. Questions Raised by the Appeal

Respondents appeal from the ALJ's determination that their conduct violated Section 5 of the FTC Act. They also challenge the appropriateness of the ALJ's cease and desist order. First, Respondents argue that the ALJ erred in concluding that the moratorium is illegal *per se*. They assert that the moratorium falls outside any well-established category of restraints subject to *per se* condemnation. Rather, they contend, the Commission must analyze the moratorium under the rule of reason because the restrictions at issue were reasonably related to the purpose of a legitimate joint venture.

Second, Respondents argue that, in applying the rule of reason, the ALJ erred by relying on a presumption of anticompetitive effects that shifts the burden to Respondents to show plausible procompetitive justifications. Respondents contend that the Supreme Court's decision in *CDA* requires the FTC to offer proof of actual anticompetitive effect before the burden may be shifted to Respondents to justify the restraints.

Third, Respondents argue that, even if the correct legal standard is that restraints categorized as "inherently suspect" warrant a presumption of anticompetitive effects that shifts the burden to a defendant to show procompetitive justifications, the adoption of the moratorium in the context of a procompetitive joint venture dictates that the moratorium not be considered presumptively anticompetitive.

Fourth, Respondents argue that their identification of "plausible" procompetitive justifications requires an assessment of the moratorium's net competitive effects under a full rule of reason analysis.

Fifth, Respondents argue that a cease and desist order is inappropriate here, because there is no basis for concluding that Respondents are likely to engage in similar conduct again.

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II. LEGAL FRAMEWORK

Courts, enforcement agencies, and commentators long have strived to refine operational principles for applying the Sherman Act's command that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade . . . is declared to be illegal." 15 U.S.C. § 1. Jurisprudence, commentary, and enforcement experience concerning this prohibition provide the basic foundations for the Commission's evaluation of horizontal restraints under Section 5 of the FTC Act.¹¹ In this section we identify major aspects of the development of horizontal restraints doctrine and present the framework we will apply to the challenged restrictions in this matter.

A. The Law of Horizontal Restraints

The seemingly categorical language of Section 1 of the Sherman Act mentions none of the analytical concepts – “per se illegality,” “ancillarity,” “quick look,” or “full-blown rule of reason” – that appear in U.S. horizontal restraints jurisprudence. These concepts have evolved under the antitrust common law that Congress contemplated when it cast the nation's antitrust commands in general terms and entrusted the federal courts and the FTC with developing the operational content for these provisions. Over time, the courts and the FTC have refined that content to account for insights gained from adjudication experience and from developments in economic and legal

¹¹ The Commission's authority under Section 5 of the FTC Act extends to conduct that violates the Sherman Act. *See, e.g., Federal Trade Commission v. Motion Picture Advertising Serv. Co.*, 344 U.S. 392, 394-95 (1953); *Fashion Originators' Guild of America, Inc. v. Federal Trade Commission*, 312 U.S. 457, 463-64 (1941). In the case at hand, our analysis under Section 5 is the same as it would be under Section 1 of the Sherman Act.

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learning.¹²

A number of tensions have marked the evolution of horizontal restraints doctrine and the pursuit of techniques for identifying restrictions that suppress competition. Perhaps most important, adjudicatory tribunals have struggled to attain an appropriate balance between achieving accuracy in individual cases, which generally requires fuller inquiry, and streamlining the law's administration, which usually involves making simplifying assumptions and forgoing elaborate analysis when the conduct at issue ordinarily poses grave competitive dangers.

In *Standard Oil Co. v. United States*, 221 U.S. 1 (1911), the Supreme Court made clear that Section 1 establishes a single, general principle governing trade restraints. The “rule of reason” is the touchstone for evaluating challenged conduct.¹³ As stated in

¹² See *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) (“*State Oil*”) (noting role of courts in antitrust law “in recognizing and adapting to changed circumstances and the lessons of accumulated experience”); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 732 (1988) (use of term “restraint of trade” in Section 1 of Sherman Act “invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890”); *National Society of Professional Engineers v. United States*, 435 U.S. 679, 688 (1978) (in adopting Sherman Act, Congress “expected the courts to give shape to the statute’s broad mandate by drawing on common-law tradition”).

¹³ In *Standard Oil*, the Court explained:

[T]he standard of reason . . . was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which [Sherman Act § 1] provided.

221 U.S. at 60. See also *State Oil*, 522 U.S. at 10 (“Although the Sherman Act, by its terms, prohibits every agreement in ‘restraint

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Standard Oil and reiterated later in the same decade in *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918), the purpose of courts in applying the rule of reason is to evaluate the impact of challenged behavior upon competition.¹⁴

In articulating this principle, *Standard Oil* also endorsed a concept that earlier cases such as *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897), and *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) ("*Addyston Pipe*"), had introduced and that retains vitality today: not all trade restraints require the same degree of fact-gathering and analysis. *Standard Oil*, 221 U.S. at 65. Within the general framework of the rule of reason, certain restraints might be recognized as being so inherently and commonly unreasonable that courts might dispense with an elaborate analysis and condemn them as illegal *per se*. See *id.* (noting that *Trans-Missouri Freight* and other precedent established that the "nature and character" of certain contracts create "a conclusive presumption" that the conduct violates the Sherman Act). Decisions about the appropriate form of inquiry would evolve over time as courts gained experience in evaluating specific business phenomena and accounted for commentary examining the rationale for and effects

of trade,' this Court has long recognized that Congress intended to outlaw only unreasonable restraints.").

¹⁴ In *Chicago Board of Trade*, the Court said:

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.

246 U.S. at 238.

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of various practices.¹⁵

Early decisions also yielded important analytical tools to help courts determine the appropriate form of inquiry for specific restraints. One of the most influential techniques appeared in *Addyston Pipe* in 1898. Seeking to avoid overinclusive application of Section 1, Judge (later Chief Justice) William Howard Taft introduced the concept of ancillarity. *Addyston Pipe*, 85 F. at 281-82. A simple (“naked”) agreement by rivals to set prices, allocate customers, or divide sales territories would be condemned summarily, but the adoption of a uniform pricing schedule as part of the operation of a partnership, which could provide services beyond the capability of any single individual, warranted more tolerant consideration because it was “ancillary” to a legitimate transaction. Even in times when enthusiasm for *per se* rules of liability grew, ancillarity played a crucial role in permitting firms to undertake efficient transactions without Sherman Act condemnation. The willingness of contemporary horizontal restraints jurisprudence to consider efficiency rationales has descended substantially from this ancillarity principle.

Following *Chicago Board of Trade*, particularly from the late 1930s through the early 1970s, the Supreme Court appeared to discern a sharp dichotomy between *per se* and reasonableness analysis – between summary condemnation (in which plaintiffs often prevailed if an agreement was proven) and an abyss of reasonableness analysis (from which defendants routinely

¹⁵ See *State Oil*, 522 U.S. at 21 (“[T]his Court has reconsidered its decisions construing the Sherman Act when the theoretical underpinnings of those decisions are called into serious question.”); see also *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 344 (1982) (“Once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable.”).

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emerged unscathed).¹⁶ The Court's cases in this era reflected little sense that there were manageable alternatives between the poles. For a time, the acceptance of a dichotomy and the perceived absence of intermediate analytical approaches appear to have helped inspire the Court to categorize an ever wider array of conduct as *per se* illegal. By the early 1970s, the Court had found *per se* condemnation appropriate for a broad range of horizontal arrangements affecting prices,¹⁷ the allocation of customers or

¹⁶ For example, in *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958) ("*Northern Pacific*"), the Supreme Court explained that "[t]his principle of *per se* unreasonableness . . . avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable – an inquiry so often wholly fruitless when undertaken." *Id.* at 5. The idea that a conventional rule of reason inquiry entailed a vast analytical undertaking took root in the observation of Justice Brandeis in *Chicago Board of Trade* that a court in a rule of reason case

must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, are all relevant facts.

246 U.S. at 238. This much-quoted formulation is often criticized as too comprehensive and open-ended to be helpful. See VII Areeda & Hovenkamp, *Antitrust Law* ¶ 1502, at 345.

¹⁷ In *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) ("*Socony*"), the Court endorsed a broad conception of horizontal collaboration that would be deemed to constitute *per se*

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territories,¹⁸ and various concerted refusals to deal.¹⁹ The Court's treatment of vertical restraints exhibited similar trends.²⁰

The inability to recognize intermediate approaches posed difficulties in an important category of cases. In some instances, restraints resembled conduct subject to summary condemnation but also appeared to promote the attainment of valuable efficiencies. While declining to surrender the administrability benefits of *per se* tests, courts searched for ways to distinguish unambiguously harmful restraints from conduct that arguably served legitimate ends. Even early Supreme Court decisions that endorsed a literalist reading of Section 1's ban on "every" contract in restraint of trade disavowed any aim to bar all agreements that in some sense limited the commercial freedom of the parties but

illegal price-fixing. The Court said that "[u]nder the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." *Id.* at 223. In a famous footnote, the Court explained that proof of actual anticompetitive effects was not necessary to establish illegality, noting that all price fixing arrangements are "banned because of their actual or potential threat to the central nervous system of the economy." *Id.* at 224 & n. 59.

¹⁸ *United States v. Topco Associates, Inc.*, 405 U.S. 596, 608-10 (1972); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 597-98 (1951).

¹⁹ *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 (1959).

²⁰ *Albrecht v. Herald Co.*, 390 U.S. 145, 152-54 (1968) (maximum resale price maintenance); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967) (vertical territorial restrictions); *Northern Pacific*, 356 U.S. at 5-6 (tying).

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also generated important efficiencies.²¹ As mentioned above, *Addyston Pipe* injected vital flexibility into Section 1 analysis by introducing ancillarity as a means for sorting benign from pernicious restraints.²²

In the mid- to late 1970s, the Court stepped back from the rigid categorical approach to Section 1 analysis that had prevailed since *Socony*. For horizontal restraints, the pivotal modern case was *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979) (“*BMI*”).²³ Although the blanket copyright licenses

²¹ See *United States v. Joint Traffic Ass’n*, 171 U.S. 505, 567-68 (1898) (Sherman Act not intended to proscribe all partnerships or the imposition of non-competition covenants to facilitate the sale of good will in a business).

²² See discussion of *Addyston Pipe* at p. 15-16, *supra*.

²³ The Court foreshadowed *BMI* in *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978) (“*Professional Engineers*”). In *Professional Engineers* the Court’s assessment of restraints contained in a professional association’s code of ethics anticipated themes that *BMI* later emphasized. For example, the analysis in *Professional Engineers* resembles the characterization inquiry endorsed in *BMI*. The Court began by noting that the restriction in question “operates as an absolute ban on competitive bidding” and finding that “no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.” *Id.* at 692. The Court then considered the defendant’s “affirmative defense” that uninhibited competitive bidding “would lead to deceptively low bids, and would thereby tempt individual engineers to do inferior work with consequent risk to public safety and health.” *Id.* at 693. The Court rejected this defense, stating that the possibility that “competition is not entirely conducive to ethical behavior, . . . is not a reason, cognizable under the Sherman Act, for doing away with competition.” *Id.* at 696.

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challenged there were literally agreements to fix prices, the Court recognized that this fact alone did not establish that the practice was “price fixing” subject to the *per se* rule. *Id.* at 8-9. Rather, the Court acknowledged that before a court may condemn collaborative activity as *per se* illegal, it must conduct some assessment of whether the defendant had a legitimate business justification for the collaboration. The Court posed two central questions in attempting to *characterize* the activity: First, is the practice “plainly anticompetitive,” *id.* at 8 (citation omitted), in that it “facially appears to be one that would always or almost always tend to restrict competition and decrease output”? *Id.* at 19-20. And, second, is the practice “designed to increase economic efficiency and render markets more, rather than less, competitive”? *Id.* at 20 (citation omitted).²⁴ *BMI* abandoned the view that posits a sharp dichotomy between rule of reason and *per se* analysis and thus took a major step toward restoring unity to Section 1 analysis.

BMI made explicit and transparent a characterization process that courts performed even during the dichotomy model’s apex. The dichotomy model placed all horizontal restraints in two boxes – one containing *per se* illegal acts and the other containing conduct that warranted a full reasonableness inquiry. To apply this framework in an individual case, the court had to make a threshold decision whether the arrangement at issue belonged in one box or the other. Unless the defendant conceded that its conduct fit exactly within a template of *per se* illegality established in earlier cases, the court was likely to confront arguments that the conduct could not be condemned summarily. To resolve such arguments, courts performed variants of the characterization exercise that *BMI* brought into full view. Under

²⁴ Applying this analysis, the Court concluded that the blanket license was necessary to achieve the efficiencies of integration of sales, monitoring, and enforcement against unauthorized copyright use; thus, a “more discriminating” rule of reason analysis – rather than *per se* condemnation – was required. 441 U.S. at 20-24.

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BMI and its progeny, however, characterization no longer necessarily determines the result of the case.

Five years later, *National Collegiate Athletic Ass’n v. Board of Regents of the University of Oklahoma*, 468 U.S. 85 (1984) (“*NCAA*”), reinforced the teaching of *BMI* that courts must engage in an initial assessment of efficiency rationales before condemning conduct as *per se* illegal. In *NCAA*, the Court recognized that the agreements at issue there constituted horizontal price fixing and restrictions on output – categories of practices ordinarily condemned as *per se* illegal. Nonetheless, the Court declined to invoke the *per se* rule. *Id.* at 100-01. The Court noted that some horizontal restraints were “essential” to make the product (college football) available, *id.* at 101-02, and that a joint selling arrangement may have legitimate procompetitive efficiencies. *Id.* at 103 (citing *BMI*, 441 U.S. at 18-23). The Court held that, under these circumstances, a fair evaluation of the competitive character of the restraints at issue required consideration of the *NCAA*’s claimed justifications. *Id.*²⁵

NCAA also established that, even if summary condemnation under the *per se* rule is inappropriate, full rule of reason analysis is not necessarily the alternative. Full rule of reason analysis often entails defining the market and examining market power, inquiries

²⁵ See also *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 295 (1985) (“*Northwest Wholesale Stationers*”) (Court declined to apply *per se* rule to group boycott by a wholesale purchasing cooperative that expelled one of its members, noting that “such cooperative arrangements would seem to be ‘designed to increase economic efficiency and render markets more, rather than less, competitive’” because “[t]he arrangement permits the participating retailers to achieve economies of scale . . . , and also ensures ready access to a stock of goods that might otherwise be unavailable on short notice”) (quoting *BMI*, 441 U.S. at 20).

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that usually require elaborate analysis.²⁶ Sometimes a restraint's competitive harm is evident after an abbreviated rule of reason analysis, obviating elaborate proof under the full rule of reason.²⁷ In *NCAA*, for example, the Court held that "when there is an agreement not to compete in terms of price or output, 'no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.'" *Id.* at 109 (quoting *Professional Engineers*, 435 U.S. at 692).

Although the Court in *NCAA* went on to consider asserted efficiencies of the association's restrictions, *id.* at 113-17, it did so within the framework of a truncated analysis, without need for a full rule of reason approach. The Court first noted that there was no reason to believe that the restrictions on the product in question

²⁶ When direct evidence of actual effects can be shown, elaborate market definition is unnecessary. *Federal Trade Commission v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986); *Todd v. Exxon Corp.*, 275 F.3d 191, 206 (2d Cir. 2001) ("an actual adverse effect on competition . . . arguably is more direct evidence of market power than calculations of elusive market share figures"); *Re/Max International, Inc. v. Realty One, Inc.*, 173 F.3d 995, 1018 (6th Cir. 1999) ("an antitrust plaintiff is not required to rely on indirect evidence of a defendant's monopoly power, such as high market share within a defined market, when there is direct evidence that the defendant has actually set prices or excluded competition").

²⁷ See William J. Kolasky, Jr., *Counterpoint: The Department of Justice's "Stepwise" Approach Imposes Too Heavy a Burden on Parties to Horizontal Agreements*, 12 *Antitrust* 41, 44-45 (Spring 1998) (the "quick look" approach "is simply an application of the standard rule of reason analysis in circumstances where the effect on competition is apparent and the defendant's procompetitive explanation for it is facially unconvincing, thus allowing the court to end, *i.e.*, truncate, its analysis").

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(*i.e.*, television rights to college football games) could bring efficiencies to the sale of that product. *Id.* at 113-15. Next, the Court rejected out of hand arguments that restrictions on one product (television rights) could be justified by the prospect of enhancing sales of *another* product (live attendance tickets). *Id.* at 115-17. While noting that this argument, too, lacked a factual underpinning, the Court held that the “more fundamental reason” for rejecting such an argument is that it is “inconsistent with the basic policy of the Sherman Act” to insulate a product from competition in this manner. *Id.* at 116-17. In other words, such an argument is not cognizable as a matter of law.

The *NCAA* Court also made clear that a proffered justification for an otherwise unlawful restraint must be reasonably “tailored” to serve the asserted procompetitive interests. In rejecting the *NCAA*’s arguments that the challenged restrictions could help to preserve competitive balance among amateur teams, the Court emphasized that a variety of less restrictive alternatives were available that would have served that goal at least as well. *Id.* at 119. *See also Collaboration Guidelines, supra* note 2, at § 3.36(b) (“[I]f the participants could have achieved or could achieve similar efficiencies by practical, significantly less restrictive means, then the Agencies conclude that the relevant agreement is not reasonably necessary to their achievement.”); XI Herbert Hovenkamp, *Antitrust Law* ¶ 1913 (1998).

Similarly, in *Federal Trade Commission v. Indiana Federation of Dentists*, 476 U.S. 447 (1986) (“*IFD*”), the Court did not require extensive market analysis to ascertain the competitive harm resulting from practices that it considered obviously anticompetitive, but instead focused on whether there was an efficiency justification for such practices. There, the Court found that “no elaborate industry analysis is required to demonstrate the anticompetitive nature of” an agreement among dentists to withhold from their customers a desired service (providing x-rays to insurers in conjunction with insurance claim forms); accordingly, “[a]bsent some countervailing procompetitive virtue – such as, for example, the creation of efficiencies in the operation

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of a market or the provision of goods and services, . . . – such an agreement limiting consumer choice by impeding the ‘ordinary give and take of the market place,’ . . . cannot be sustained under the Rule of Reason.” *Id.* at 459 (quoting *Professional Engineers*, 435 U.S. at 692).

Turning to IFD’s justification – that allowing insurance companies to make coverage decisions on the basis of x-rays would harm the quality of care provided to patients – the Court found this argument legally and factually flawed:

The argument is, in essence, that an unrestrained market in which consumers are given access to the information they believe to be relevant to their choices will lead them to make unwise or even dangerous choices. Such an argument amounts to ‘nothing less than a frontal assault on the basic policy of the Sherman Act.’ [*Professional Engineers*, 435 U.S. at 695.] Moreover, there is no particular reason to believe that the provision of information will be more harmful to consumers in the market for dental services than in other markets.

476 U.S. at 463. Because IFD’s justification did not withstand scrutiny, the Court concluded that the challenged practice was unlawful. *Id.* at 465-66.

BMI, *NCAA*, and *IFD* indicated that the evaluation of horizontal restraints takes place along an analytical continuum in which a challenged practice is examined in the detail necessary to understand its competitive effect. Nevertheless, these cases did not provide a clear structure for the required analysis.

In 1988, the Commission itself sought to provide a structured framework in *Massachusetts Board of Registration in Optometry*, 110 F.T.C. 549 (1988) (“*Mass. Board*”):

First, we ask whether the restraint is “inherently suspect.” In other words, is the practice the kind that appears likely,

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absent an efficiency justification, to “restrict competition and decrease output”? . . . If the restraint is not inherently suspect, then the traditional rule of reason, with attendant issues of market definition and power, must be employed. But if it is inherently suspect, we must pose a *second* question: Is there a plausible efficiency justification for the practice? That is, does the practice seem capable of creating or enhancing competition (*e.g.*, by reducing the costs of producing or marketing the product, creating a new product, or improving the operation of the market)? Such an efficiency defense is plausible if it cannot be rejected without extensive factual inquiry. If it is not plausible, then the restraint can be quickly condemned. But if the efficiency justification is plausible, further inquiry – a *third inquiry* – is needed to determine whether the justification is really valid. If it is, it must be assessed under the full balancing test of the rule of reason. But if the justification is, on examination, not valid, then the practice is unreasonable and unlawful under the rule of reason without further inquiry – there are no likely benefits to offset the threat to competition.²⁸

²⁸ 110 F.T.C. at 604 (emphasis in original). The Commission applied the *Mass. Board* framework the following year in *Detroit Auto Dealers Ass’n*, 111 F.T.C. 417, 492-501 (1989), and ruled that an agreement among Detroit automobile dealers to close dealer showrooms on nights and weekends unreasonably restrained trade. The Sixth Circuit rejected the Commission’s conclusion that the restraint was “inherently suspect” as an improper application of the *per se* rule. *Detroit Auto Dealers Ass’n, Inc. v. Federal Trade Commission*, 955 F.2d 457, 470-71 (6th Cir. 1992). In particular, the court criticized the Commission’s reliance on Robert Bork’s argument (in his treatise, *The Antitrust Paradox* (1978)) that there is no economic difference between an agreement to limit shopping hours and an agreement to increase price. 955 F.2d at 470. The Commission’s analysis, however, rested upon more than citations to Judge

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See also VII Areeda & Hovenkamp, *Antitrust Law* ¶ 1511c.

The Commission later retreated from the *Mass. Board* approach in *California Dental Ass'n*, 121 F.T.C. 190 (1996), applying a *per se* rule and the rule of reason as “separate categories” of analysis. *Id.* at 299. The Commission reasoned that the Supreme Court had returned to such a categorical approach in two 1990 cases finding *per se* violations, *Federal Trade Commission v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990) (“SCTLA”), and *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (“*Palmer*”).²⁹ 121 F.T.C. at 299. Thus, the

Bork’s book. The Commission found ample record evidence demonstrating that showroom hours are an important basis on which dealers compete for customers. For example, it was undisputed that Detroit was the only metropolitan area in the country in which almost all dealers were closed on weekends. 111 F.T.C. at 497-98. Although it disagreed with the Commission’s “inherently suspect” categorization, the court upheld the Commission’s ruling that the limitation of showroom hours was an unreasonable restraint of trade, because hours of operation are a basis of competition among automobile dealers, and because respondents failed to advance valid justifications for the restraint. 955 F. 2d at 471-72.

²⁹ These cases are better understood as being consistent with the view of Sherman Act Section 1 analysis articulated in *NCAA*, *IFD*, and *Mass. Board* – that the court must consider proffered efficiencies before condemning a particular restraint. In *SCTLA*, the Court considered and rejected claimed efficiencies and other justifications before concluding that the challenged conduct (a boycott to force an increase in the compensation of court-appointed counsel) was a naked restraint on price and output falling within the *per se* category. 493 U.S. at 423-24. In *Palmer*, the Court held that an agreement between competitors to divide markets and share revenues was *per se* illegal. The *Palmer* defendants did not argue that the agreement yielded

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Commission held that the dental association's ethical rules restricting price advertising (which precluded, *e.g.*, advertising that characterized a dentist's fees as low or reasonable) were *per se* illegal. *Id.* at 307.³⁰ The Ninth Circuit disagreed with the Commission's *per se* approach and held that the advertising restrictions were properly condemned under an abbreviated rule of reason analysis, because they were facially anticompetitive and because CDA's purported procompetitive justifications, although plausible, lacked evidentiary support. *California Dental Ass'n v. Federal Trade Commission*, 128 F.3d 720 (9th Cir. 1997). While the Supreme Court rejected the Ninth Circuit's analysis as too abbreviated, the Court's opinion leaves no doubt that it views Section 1 analysis as a continuum, rather than a series of distinct boxes (*per se*, quick look, full rule of reason). *California Dental Ass'n v. Federal Trade Commission*, 526 U.S. 756 (1999).³¹

procompetitive efficiencies or a new product. Instead, they tried to avoid liability by contending that the traditional ban on horizontal agreements to allocate sales territories did not apply if a firm agreed with a rival not to enter a market that it previously had not served. In such circumstances, the Supreme Court had little difficulty condemning the agreement outright. 498 U.S. at 49-50.

³⁰ Alternatively, the Commission found the restraints on price advertising illegal under an abbreviated rule of reason analysis. The Commission also found the association's restraints on non-price advertising illegal under an abbreviated rule of reason analysis. 121 F.T.C. at 320-21.

³¹ *CDA* was the first case since *BMI* in which the Court found that the evidence was insufficient to condemn a basic horizontal restraint. In the eleven years following *BMI*, the Court issued six consecutive opinions finding the evidence sufficient to condemn the restraint. *See Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980) (*per curiam*) ("*Catalano*"); *Maricopa*, 457 U.S. 332; *NCAA*, 468 U.S. 85; *IFD*, 476 U.S. 447; *SCTLA*, 493 U.S. 411; *Palmer*, 498 U.S. 46. In each of these cases, except for *NCAA*, the

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In *CDA*, the Court explicitly acknowledged, for the first time, that its prior cases support an abbreviated or “quick look” rule of reason analysis. *Id.* at 770-71. The Court recognized that advertising restrictions normally harm competition and consumers, but noted that CDA had advanced a number of reasons why its restrictions might nonetheless have served procompetitive purposes in light of the circumstances and context. *Id.* at 773. The restrictions did not ban advertising completely, *id.*, and were designed on their face to avoid false or deceptive advertising and therefore “might plausibly be thought to have a net procompetitive effect, or possibly no effect at all on competition.” *Id.* at 771. Thus, the Court found that the anticompetitive effect of the restrictions on professional advertising was not obvious. *Id.* at 771, 778. The Court emphasized the professional context of the case before it, questioning whether market forces “normally” found in the commercial world apply to *professional* advertising, especially given that the market at issue was “characterized by striking disparities between the information available to the professional and the patient.” *Id.* at 771-74.³² The Court concluded that, under these circumstances, and in the absence of any empirical evidence supporting the theoretical basis for a presumption of anticompetitive effects, CDA’s identification of plausible procompetitive justifications precluded the “indulgently abbreviated” review of the Ninth Circuit. *Id.* at 774-78.³³

Court reversed the court of appeals. *But see Northwest Wholesale Stationers*, 472 U.S. 284 (Court reversed circuit court’s ruling that wholesale cooperative’s expulsion of member warranted condemnation as *per se* illegal group boycott).

³² The majority opinion used the word “professional” more than 20 times. Respondents’ attempt to downplay the professional setting of *CDA* ignores this striking fact.

³³ Although the Court criticized the Ninth Circuit for prematurely shifting the evidentiary burden to CDA to “adduce hard evidence of the procompetitive nature of its policy,” 526 U.S.

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The Court remanded for a more extended examination of the

at 776, the Supreme Court's own discussion repeatedly reflects the premise that CDA had identified potential justifications that not only were plausible in theory but also had some grounding in actual experience. *See id.* at 771 ("The restrictions on both discount and nondiscount advertising are, at least on their face, designed to avoid false or deceptive advertising in a market characterized by striking disparities between the information available to the professional and the patient."); *id.* at 772 ("In a market for professional services, in which advertising is relatively rare and the comparability of service packages not easily established, the difficulty for customers or potential competitors to get and verify information about the price and availability of services magnifies the dangers to competition associated with misleading advertising."); *id.* at 773 ("The existence of such significant challenges to informed decision making by the customer for professional services immediately suggests that advertising restrictions arguably protecting patients from misleading or irrelevant advertising call for more than cursory treatment as obviously comparable to classic horizontal agreements to limit output or price competition."); *id.* at 773-74 ("[T]he particular restrictions on professional advertising could have different effects from those 'normally' found in the commercial world, even to the point of promoting competition by reducing the occurrence of unverifiable and misleading across-the-board discount advertising."); *id.* at 774 ("[T]he discipline of specific examples may well be a necessary condition of plausibility for professional claims that for all practical purposes defy comparison shopping."); *id.* at 775 ("It might be, too, that across-the-board discount advertisements would continue to attract business indefinitely, but might work precisely because they were misleading customers . . ."); *id.* at 778 (the Ninth Circuit "failed to explain why it gave no weight to the countervailing, and at least equally plausible, suggestion that restricting difficult-to-verify claims about quality or patient comfort would have a procompetitive effect by preventing misleading or false claims that distort the market").

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“tendency of these professional advertising restrictions.” *Id.* at 781. The Court specified that this did not necessarily call for the fullest market analysis. *Id.* at 780. “The truth,” said the Court, “is that our categories of analysis of anticompetitive effect are less fixed than terms like ‘*per se*,’ ‘quick look,’ and ‘rule of reason’ tend to make them appear.” *Id.* at 779. Rather, the Court indicated that rule of reason analysis should be flexible:

As the circumstances here demonstrate, there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.

Id. at 780-81.³⁴

CDA stops short of providing a complete analytical framework for the rule of reason inquiry, but gives important guidance about how abbreviated rule of reason analysis is to be conducted. Notably, *CDA* does not require a showing of actual

³⁴ On remand before the Ninth Circuit, the Commission argued that citations in the *CDA* record to a small fraction of the economic evidence relevant to the effects of the advertising restrictions provided an adequate basis to condemn the restraints at issue, and alternatively sought a remand to the FTC to develop a fuller record. The Ninth Circuit concluded that such evidence was not adequate to establish the likelihood of anticompetitive effects in this context, and declined to allow the Commission a “second bite at the apple” by remanding. *California Dental Ass’n v. Federal Trade Commission*, 224 F.3d 942, 950-52, 958 (9th Cir. 2000). In contrast to *CDA*, the record in the instant case contains a full discussion of the relevant economic literature. *See infra* note 52 and accompanying text.

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anticompetitive effects or proof of market power.³⁵ Its principal lesson is that rule of reason analysis must be sensitive to context and distinct characteristics of particular markets, particularly those involving professional services, in evaluating whether general rules of economic theory can be expected to apply. When, as in that case, the defendant articulates plausible reasons why its restrictions may *not* result in competitive harm and may result in cognizable procompetitive benefits, then the plaintiff's showing of likely anticompetitive effects should have an "empirical" foundation, whether based on evidence specific to a particular

³⁵ The Court focused on the restraint itself, identifying "the *likelihood* of anticompetitive effects" as that which must be examined under an abbreviated rule of reason analysis, 526 U.S. at 771 (emphasis added), and thus belied any claim that a showing of actual anticompetitive effect is required. Before each tribunal in *CDA*, including the Supreme Court, the dentists had argued that their restraints could not be condemned without proof that the dentists exercised power in appropriately defined markets. *See, e.g.*, Brief of Petitioner California Dental Association, 28, 42-43 (Nov. 10, 1998). The Supreme Court's *CDA* opinion contains no hint that the error below was failure to conduct a plenary analysis of market power. Indeed, the Court's description of quick look analysis as that by which "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets," 526 U.S. at 770, reveals that proof of market power is not a necessary element of this analysis. *See also* Stephen Calkins, *California Dental Association: Not a Quick Look But Not the Full Monty*, 67 Antitrust L.J. 495, 496 (2000) ("The most important lesson of *CDA* is that the defendant's principal argument throughout the proceeding – that the Commission could prohibit its restraints only through elaborate, formal proof of market power – was rejected.").

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case or in empirical studies of similar markets. *Id.* at 775 n. 12.³⁶ Even in such cases, however, the plaintiff need not necessarily address the full range of issues regarding market conditions, if an “enquiry meet for the case” permits “a confident conclusion about the principal tendency of a restriction.” *Id.* at 781. *CDA* does not preclude – indeed, it is consistent with – the Commission’s approach in *Mass. Board*, and it provides guidance about how that approach should be pursued.

B. Synthesis

As embodied most recently in *CDA* and in our *Collaboration Guidelines*, the development of modern horizontal restraints jurisprudence suggests an analytic framework that proceeds by several identifiable steps. These steps reflect the general principle that antitrust law proscribes only conduct that is likely to harm consumers. In most cases, conduct cannot be adjudged illegal without an analysis of its market context to determine whether those engaged in the conduct or restraint are likely to have sufficient power to harm consumers. In a smaller but significant category of cases, scrutiny of the restraint itself is sufficient to find liability without consideration of market power.³⁷

A plaintiff may avoid full rule of reason analysis, including the pleading and proof of market power, if it demonstrates that the conduct at issue is inherently suspect owing to its likely tendency to suppress competition. Such conduct ordinarily encompasses behavior that past judicial experience and current economic

³⁶ Because the Court relied on literature concerning professions other than dentistry, 526 U.S. at 771-73, the Court presumably would allow evidence concerning analogous professional markets.

³⁷ This synthesis addresses the analytical steps when the plaintiff seeks to avoid pleading and proving market power. It does not address the analysis when market power is at issue.

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learning have shown to warrant summary condemnation. If the plaintiff makes such an initial showing, and the defendant makes no effort to advance any competitive justification for its practices, then the case is at an end and the practices are condemned.

If the challenged restrictions are of a sort that generally pose significant competitive hazards and thus can be called inherently suspect, then the defendant can avoid summary condemnation only by advancing a legitimate justification for those practices. Such justifications may consist of plausible reasons why practices that are competitively suspect as a general matter may not be expected to have adverse consequences in the context of the particular market in question; or they may consist of reasons why the practices are likely to have beneficial effects for consumers.

At this early stage of the analysis, the defendant need only articulate a legitimate justification. *See CDA*, 526 U.S. at 775 & n. 12. While the defendant at this point is not obligated to prove competitive benefits, *id.*, the proffered justifications must be both cognizable under the antitrust laws and at least facially plausible. The first element, cognizability, allows the deciding tribunal to reject proffered justifications that, as a matter of law, are incompatible with the goal of antitrust law to further competition.³⁸ Cognizable justifications ordinarily explain how

³⁸ Although it has earlier roots, the concept of cognizability as a principle limiting the types of justifications has been clearly articulated at least since *Professional Engineers*, where the Supreme Court endorsed the view that certain types of defenses or justifications did not warrant consideration:

We are faced with a contention that a total ban on competitive bidding is necessary because otherwise engineers will be tempted to submit deceptively low bids. Certainly, the problem of professional deception is a proper subject of an ethical canon. But, once again, the equation of competition with deception, like the similar equation with

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specific restrictions enable the defendants to increase output or improve product quality, service, or innovation. By contrast, courts since the earliest decades of the Sherman Act have identified classes of justifications that, because they contradict the procompetition aims of the antitrust laws, will not save restraints from condemnation. For example, a defendant cannot defend restraints of trade on the ground that the prices the conspirators set were reasonable,³⁹ that competition itself is unreasonable or leads

safety hazards, is simply too broad; we may assume that competition is not entirely conducive to ethical behavior, but that is not a reason, cognizable under the Sherman Act, for doing away with competition.

435 U.S. at 696. *See also IFD*, 476 U.S. at 463 (citing *Professional Engineers* in rejecting claim that competition would lead to “dangerous choices” because “there is no particular reason to believe” that consumers cannot digest the information competition provides); *Collaboration Guidelines*, *supra* note 2, at § 3.2 (“Some claims – such as those premised on the notion that competition itself is unreasonable – are insufficient as a matter of law”); compare Thomas G. Krattenmaker, *Per Se Violations in Antitrust Law: Confusing Offenses With Defenses*, 77 Geo. L.J. 165 (1988) (cases considered to identify “*per se*” offenses in antitrust analysis are best interpreted as identifying defenses that cannot redeem challenged behavior).

³⁹ *See, e.g., Socony*, 310 U.S. at 224 & n. 59 (“Whatever economic justification particular price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness.”); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397-98 (1927) (“The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. . . . [I]n the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend on so uncertain a test as whether prices

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to socially undesirable results,⁴⁰ or that price increases resulting from a trade restraint would attract new entry.⁴¹ Of particular relevance here, the Supreme Court has recognized that a defendant cannot justify curbing access to a more-desired product to induce consumers to purchase larger amounts of a less-desired product. *See NCAA*, 468 U.S. at 116-17. Such justifications are not cognizable and require no further analysis.

The second necessary element of legitimacy is plausibility. To be legitimate, a justification must plausibly create or improve competition. A justification is plausible if it cannot be rejected without extensive factual inquiry. The defendant, however, must do more than merely assert that its purported justification benefits consumers. Although the defendant need not produce detailed evidence at this stage, it must articulate the specific link between the challenged restraint and the purported justification to merit a more searching inquiry into whether the restraint may advance procompetitive goals, even though it facially appears of the type likely to suppress competition.⁴²

are reasonable . . .”).

⁴⁰ *See IFD*, 467 U.S. at 463-64 (confirming that, even in markets for professional services such as dentistry and engineering, there is no reason to believe that informed consumers will make unwise tradeoffs between quality and price); *Professional Engineers*, 435 U.S. at 696 (“[T]he Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.”).

⁴¹ *See Catalano*, 446 U.S. at 649 (refusing to recognize defense based on argument that limits on credit terms would promote new entry by raising price of product).

⁴² As a practical matter, many of the claimed efficiencies likely will involve claims of “ancillarity.” *See supra* note 22 and accompanying text, *supra* Part II. A (describing development of

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When the defendant advances such cognizable and plausible justifications, the plaintiff must make a more detailed showing that the restraints at issue are indeed likely, in the particular context, to harm competition.⁴³ Such a showing still need not prove actual anticompetitive effects or entail “the fullest market analysis.” *CDA*, 526 U.S. at 779. Depending upon the circumstances of the cases and the degree to which antitrust tribunals have experience with restraints in particular markets, such a showing may or may not require evidence about the particular market at issue, but at a minimum must entail the identification of the theoretical basis for the alleged

ancillarity concept in antitrust analysis as tool for identifying restraints that increase efficiency). Although post-*BMI* cases generally speak of “efficiency,” the ancillary restraints doctrine retains its vitality in evaluating efficiency claims. The concept of ancillarity is implicit in our *Collaboration Guidelines*, see *supra* note 2, which recognize that restraints that otherwise might be considered illegal *per se* warrant more elaborate analysis when they are reasonably related to, and reasonably necessary for the achievement of, procompetitive benefits. *Collaboration Guidelines*, at § 1.2. Moreover, whether or not expressed in terms of ancillarity, the link between defendant’s “plausible” justification and a cognizable benefit must be clear. Unless it leads to a cognizable benefit, a proffered justification is irrelevant to the analysis.

⁴³ Although this stage and the preceding inquiry could be combined, we think it analytically superior and consistent with the relevant case law to first screen the purported justification for legitimacy before engaging in a more extensive, and therefore longer and more resource-intensive, inquiry whether detailed analysis supports or refutes the justification. Antitrust courts have long held that preliminary analysis of purported justifications is appropriate. See, e.g., *supra* Part II.A. (discussing *NCAA* and *IFD*) and notes 38-39 and accompanying text (citing relevant cases).

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anticompetitive effects and a showing that the effects are indeed likely to be anticompetitive. *See id.* at 775 n.12. Such a showing may, for example, be based on a more detailed analysis of economic learning about the likely competitive effects of a particular restraint, in markets with characteristics comparable to the one at issue. The plaintiff may also show that the proffered procompetitive effects could be achieved through means less restrictive of competition. The defendant, of course, can introduce evidence to refute the plaintiff's arguments or to show that detailed evidence supports its proffered justification. Applying a flexible analysis "meet for the case," the tribunal at this stage must ascertain whether it can draw "a confident conclusion about the principal tendency of a restriction" regarding competition. *Id.* at 781.⁴⁴

The plaintiff has the burden of persuasion overall, but not necessarily the burden with respect to each step of this analysis. If the plaintiff satisfies its initial burden of showing that the practices in question are inherently suspect, then the defendant

⁴⁴ In *CDA*, the partial restraints on professional advertising at issue could not be condemned without more evidence than the FTC provided. According to the Supreme Court, the court of appeals failed to test the dentists' proposed justification to determine whether the restraints themselves had "a net procompetitive effect, or possibly no effect at all on competition." 526 U.S. at 771. In terms of the synthesis outlined here, the dentists prevailed either because (1) it was incorrect, without more evidence, to assume that restraints inherently suspect in "normal" (*id.* at 773) markets were similarly suspect in a professional setting, or (2) the restraints at issue had a plausible and cognizable justification that, given the complex nature of professional advertising, could not be rebutted by assumption alone. In either case, the burden on the Commission was the same: it was required to show why the presumption of likely anticompetitive effects that applies in non-professional markets also applied in the professional setting of *CDA*.

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must come forward with a substantial reason why there are offsetting procompetitive benefits. If the defendant articulates a legitimate (*i.e.*, cognizable and plausible) justification, then the plaintiff must address the justification, and provide the tribunal with sufficient evidence to show that anticompetitive effects are in fact likely, before the evidentiary burden shifts to the defendant.⁴⁵ At this stage, the defendant's burden to respond will likely depend in individual cases upon the quality and amount of evidence that the plaintiff has produced to illuminate the competitive dangers of the defendant's conduct.⁴⁶ The defendant also has the burden of producing factual evidence in support of its contentions, including documents within its control.

The existence of a joint venture or other collaboration is simply one circumstance to be considered in assessing the competitive effects of a challenged restraint.⁴⁷ If a joint venture results in

⁴⁵ See, *e.g.*, *IFD*, 476 U.S. at 459 (once plaintiff has met burden of showing likely anticompetitive effects, defendant must show "countervailing procompetitive virtue"); *Law v. National Collegiate Athletic Assn*, 134 F.3d 1010, 1019 (10th Cir.) ("*Law*") (discussing shifting burdens of proof in rule of reason cases), *cert. denied*, 525 U.S. 822 (1998).

⁴⁶ *Cf. United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990) (applying this principle in merger case).

⁴⁷ The DOJ/FTC *Collaboration Guidelines*, *supra* note 2, draw upon the case law discussed above in providing an analytical structure for evaluating joint venture activity. The Agencies' analysis "begins with an examination of the nature of the relevant agreement." *Collaboration Guidelines*, at § 1.2. First, the Agencies ask whether the agreement is potentially *per se* illegal – *i.e.*, is "of a type that always or almost always tends to raise price or reduce output." *Id.* at § 3.2. If the answer is yes, then the Agencies consider proffered justifications. An agreement will escape *per se* challenge if it "is reasonably related to [efficiency-

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competitive benefits, such as the introduction of innovative products or the achievement of production efficiencies, then such benefits are a proper part of the antitrust analysis. But proffered justifications still must be analyzed under the framework stated above, and will entitle the defendant to a fuller review only if they are cognizable and are factually supported to the degree necessary in light of the plaintiff's demonstration of likely anticompetitive effects.

Our intended contribution in this synthesis is to specify more fully the analytical principles that we perceive to be embedded in the case law and our own guidelines and to refine the methodology for applying those principles in practice. Our

enhancing] integration and reasonably necessary to achieve its procompetitive benefits.” *Id.* The *Collaboration Guidelines* explain that before accepting proffered justifications, the Agencies undertake a limited factual inquiry to determine whether claimed justifications that are plausible in theory are plausible in the context of a particular collaboration, and that “[s]ome claims – such as those premised on the notion that competition itself is unreasonable – are insufficient as a matter of law.” *Id.*

Following *CDA*, the *Collaboration Guidelines* specify that rule of reason analysis “entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances.” *Id.* at § 3.3 (citations omitted). The *Collaboration Guidelines* also recognize that full rule of reason analysis may not be required: “[W]here the likelihood of anticompetitive harm is evident from the nature of the agreement, . . . then, absent overriding benefits that could offset the competitive harm, the Agencies challenge such agreements without a detailed market analysis.” *Id.* (citations omitted). The *Collaboration Guidelines* indicate that the underlying issue is the extent to which a challenged restraint in fact likely assists the parties in achieving efficiencies in the market circumstances at issue. *Id.* at § 3.36.

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synthesis thus responds to the need in modern competition policy to devise analytical tests that are sound in substance, transparent in revealing their operational criteria, and administrable in the routine analysis of antitrust disputes.

III. ANALYSIS OF THE CHALLENGED RESTRAINTS

Respondents argue that because the moratorium was “ancillary to a procompetitive joint venture, that agreement cannot be deemed ‘presumptively anticompetitive,’” Respondents’ Opening Brief at 41, and their practices cannot be held illegal without evidence of actual anticompetitive effect. *Id.* at 32. Respondents also argue that their identification of plausible procompetitive justifications means that their practices cannot be held illegal unless the actual, net effect of the restraint is proven to be anticompetitive. *Id.* at 42-44. In terms of the synthesis of horizontal restraints jurisprudence just discussed, Respondents appear to argue that this case falls toward the fuller end of the rule of reason spectrum – if not in fact requiring the fullest, or “plenary,” review. To decide whether Respondents are correct, we first must determine whether the agreement between PolyGram and Warner to forgo discounting and advertising of 3T1 and 3T2 falls within the category of restraints that are likely, absent countervailing procompetitive justifications, to have anticompetitive effects – *i.e.*, to lead to higher prices or reduced output. In making this assessment, we consider what judicial experience and economic learning tell us about the likely competitive effects of such restrictions.⁴⁸

⁴⁸ The Supreme Court has indicated that both sources of insight – the results of case-by-case adjudication and commentary – are relevant as antitrust tribunals form judgments about the competitive significance of observed behavior. *State Oil*, 522 U.S. at 15.

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A. The Likely Anticompetitive Effects of the Moratorium

In keeping with the analytical structure detailed above, we start with an inquiry into whether the restraints at issue here – the agreement not to discount and the agreement not to advertise – are inherently suspect under the antitrust laws, in that they fall within a category of restraints that warrant summary condemnation because of their likely harm to competition. We find ample basis for concluding that they are.

1. The Agreement Not To Discount

The anticompetitive nature of the agreement not to discount is obvious. As the ALJ correctly observed, this is simply a form of price fixing, and is presumptively anticompetitive. *See Catalano*, 446 U.S. at 648 (agreement to terminate the availability of free credit in connection with purchase of good is “tantamount to an agreement to eliminate discounts, and thus falls squarely within the traditional *per se* rule against price fixing”); *NCAA*, 468 U.S. at 100 (horizontal price fixing is “perhaps the paradigm of an unreasonable restraint of trade”).⁴⁹

Antitrust law’s hostility to price fixing is rooted in uncontroversial economic analysis. As Complaint Counsel’s economic expert, Dr. Stockum, testified, an agreement between competitors not to discount is likely to result in higher prices to consumers, restriction of output, and reduced allocative efficiency. Tr. 583-85; JX 104-B. Dr. Stockum therefore concluded that, absent an efficiency justification, the agreement between PolyGram and Warner not to discount their catalog Three Tenors products was very likely to have had anticompetitive effects. Tr. 583-85. Respondents’ own economic expert, Dr. Ordoover, agreed that a naked agreement between competitors to restrict price

⁴⁹ As the Supreme Court said in *Socony*, “the machinery employed by a combination for price fixing is immaterial.” 310 U.S. at 223.

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competition has “clearly pernicious effects on competition and consumers.” RX 716 at ¶ 61.⁵⁰

Moreover, it does not matter that, as Respondents argue, the moratorium applied “only” to two products and “only” for a period of ten weeks.⁵¹ It is patently an elimination of a basic form of rivalry between competitors, and properly triggers an obligation by Respondents to come forward with some showing of countervailing procompetitive justification.

2. The Agreement Not To Advertise

We also find that the agreement between PolyGram and Warner not to advertise their earlier Three Tenors products is presumptively anticompetitive. The Supreme Court in *CDA* indicated that, in ordinary commercial markets – like the one at issue here – complete bans on truthful advertising normally are likely to cause competitive harm. 526 U.S. at 773. Indeed, the Court repeatedly has recognized that advertising facilitates competition. By informing consumers of the nature and prices of the goods or services available in a market, and thus creating an incentive for suppliers of the products and services to compete along these dimensions, advertising “performs an indispensable role in the allocation of resources in a free enterprise system.” *Bates v. State Bar of Arizona*, 433 U.S. 350, 364 (1977); *see also Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 388 (1992). Restrictions on truthful and nondeceptive advertising harm

⁵⁰ Respondents’ expert witnesses did not testify at trial, and thus were not subject to cross-examination. Our references to the statements of Respondents’ experts are to their expert reports and deposition testimony.

⁵¹ As the Supreme Court stated in *Socony*, “the amount of interstate or foreign trade involved is not material . . . , since § 1 of the [Sherman] Act brands as illegal the character of the restraint not the amount of commerce affected.” 310 U.S. at 224 n. 59.

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competition, because they make it more difficult for consumers to discover information about the price and quality of goods or services, thereby reducing competitors' incentives to compete with each other with respect to such features. *See CDA*, 526 U.S. at 773 ("restrictions on the ability to advertise prices normally make it more difficult for consumers to find a lower price and for [suppliers] to compete on the basis of price"); *see also Morales*, 504 U.S. at 388; *Bates*, 433 U.S. at 377-78. These principles apply not just to price advertising, but also to information about qualitative aspects of goods and services. "[A]ll elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers." *Professional Engineers*, 435 U.S. at 695.

Complaint Counsel's economic expert testified that an agreement among competitors not to advertise is likely to harm consumers and competition by raising consumers' search costs and reducing sellers' incentives to lower prices. Tr. 587-92; JX 104-C. One reason a restriction on advertising may reduce a seller's incentives to lower prices is that, absent an ability to advertise, lower per-unit prices may not be sufficiently offset by higher volume. Tr. 589-90; JX 105-I ¶ 41; JX 90 at 49-50. Dr. Stockum relied on several empirical studies that have found that advertising restrictions result in consumers' paying higher prices. Tr. 592-600; JX 104-D (citing studies).⁵²

⁵² The studies relied on by Dr. Stockum, as well as other empirical literature concerning the impact of advertising restrictions, are in the record at Appendix A to Complaint Counsel's Findings of Fact, Conclusions of Law, Memorandum of Law in Support Thereof and Order. *See* Lee Benham, *The Effect of Advertising on the Price of Eyeglasses*, 15 J.L. & Econ. 337 (1972) (restricting the advertising of eyeglasses raised the average retail price by \$7.48); Lee Benham & Alexandra Benham, *Regulating Through the Professions: A Perspective on Information Control*, 18 J.L. & Econ. 421 (1975) (prices were 25-

40% higher in markets with greater professional information controls, including advertising restrictions); Ronald S. Bond et al., *Staff Report on Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry* (Executive Summary), Bureau of Economics, Federal Trade Commission (Sept. 1980) (price for combined eye exam and glasses was \$29 less in cities with least restrictive advertising regimes); John F. Cady, *An Estimate of the Price Effects of Restrictions on Drug Price Advertising*, 14 Econ. Inquiry 493 (1976) (states restricting the advertising of prescription drugs have prices that are 2.9% higher than states that do not restrict advertising); Steven R. Cox et al., *Consumer Information and the Pricing of Legal Services*, 30 J. Indus. Econ. 305 (1982) (attorneys who advertised had lower fees than those who did not advertise); Roger Feldman & James W. Begun, *The Welfare Cost of Quality Changes Due to Professional Regulation*, 34 J. Indus. Econ. 17 (1985) (total loss of consumer welfare from state regulations governing optometrists that, *inter alia*, banned price advertising was \$156 million); Roger Feldman & James W. Begun, *Does Advertising of Prices Reduce the Mean and Variance of Prices?*, 18 Econ. Inquiry 487 (1980) (ban on advertising by optometrists and opticians increased prices by 11%); Roger Feldman & James W. Begun, *The Effects of Advertising: Lessons from Optometry*, 13 J. Hum. Resources 247 (1978) (price is 16% higher in states that ban optometric and optician price advertising); Amihai Glazer, *Advertising, Information and Prices – A Case Study*, 19 Econ. Inquiry 661 (1981) (grocery prices rose because of newspaper strike in Queens County, NY, that eliminated large amounts of supermarket advertising, and fell after the strike ended); Deborah Haas-Wilson, *The Effect of Commercial Practice Restrictions: The Case of Optometry*, 29 J.L. & Econ. 165 (1986) (prices were 26-33% lower in markets in which price and non-price media advertising by optometrists occurred); William W. Jacobs et al., *Staff Report on Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising* (Executive

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One of these studies, for example, showed that even a short-lived restraint on advertising can lead to higher prices. Tr. 599-600; IDF 247. On the basis of economic theory and empirical studies, Dr. Stockum concluded that, absent an efficiency justification, Respondents' agreement not to advertise or promote the catalog Three Tenors albums is very likely to be anticompetitive. Tr. 587-92, 616-17; JX 104-D. Dr. Ordovery, Respondents' economic expert, agreed in his deposition that a naked agreement among competitors not to advertise is likely to cause consumer harm. JX 90 at 46-47. This testimony reinforces the general proposition

Summary), Bureau of Economics, Federal Trade Commission (Nov. 1984) (restrictions on attorney advertising resulted in prices that were 5-10% higher); John E. Kwoka, Jr., *Advertising and the Price and Quality of Optometric Services*, 74 Am. Econ. Rev. 211 (Mar. 1984) (prices of eye exams were \$11-\$12 lower in markets with advertising than in markets with advertising restrictions); James H. Love & Frank H. Stephen, *Advertising, Price and Quality in Self-Regulating Professions: A Survey*, 3 Int'l. J. Econ. Bus. 227 (1996) (reviewed 17 studies and found that restrictions on advertising generally have the effect of raising prices paid by consumers); Alex R. Maurizi et al., *Competing for Professional Control: Professional Mix in the Eyeglasses Industry*, 24 J.L. & Econ. 351 (1981) (advertisers charged approximately \$7 less than non-advertisers); Robert H. Porter, *The Impact of Government Policy on the U.S. Cigarette Industry*, in *Empirical Approaches to Consumer Protection Economics* 446 (Pauline M. Ippolito & David T. Scheffman eds., 1986) (demand fell by 7.5% as result of 1971 ban on television and radio advertising in the cigarette industry; during the ban, prices increased from 3-6%); John R. Schroeter et al., *Advertising and Competition in Routine Legal Service Markets: An Empirical Investigation*, 36 J. Indus. Econ. 49 (1987) (advertising made demand more elastic, meaning that consumers were more responsive to price differences); Robert L. Steiner, *Does Advertising Lower Consumer Prices?*, 37 J. Marketing 19 (Oct. 1973) (advertising resulted in lower toy prices to the consumer).

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that restrictions on advertising, such as those imposed here, are likely to reduce competition and harm consumers.

B. Respondents' Justifications

Having concluded that both elements of Respondents' moratorium agreement were indeed inherently suspect restraints of trade because of their likely harm to competition, we turn to Respondents' proffered justifications. Respondents' sole argument in this regard is that the moratorium served a plausible procompetitive interest by preventing the PolyGram and Warner operating companies from using the promotional opportunity created by the 1998 Paris concert and the release of the new album to "free ride" on the joint venture.⁵³ In particular, Respondents assert that PolyGram and Warner were concerned that aggressive promotion of 3T1 or 3T2 during the 3T3 release period would divert sales from 3T3, and that the prospect of such diversion could induce them to withhold promotional efforts in support of 3T3. They further assert that lack of success with 3T3 could have undermined the success of subsequent joint venture products – *i.e.*, a proposed "Greatest Hits" album and a Boxed Set.⁵⁴

⁵³ In contrast to the situation in *CDA*, Respondents here make no argument that the particular industry context renders normal economic conclusions about the competitive impact of price and advertising restrictions inapplicable. This failure is unsurprising, because the present case arises in a conventional *commercial* context, rather than the professional context that so influenced the Supreme Court's approach to *CDA*. See note 32 and accompanying text, *supra*. In any event, as discussed in Part III.C, *infra*, the present record amply shows the likely anticompetitive effects of such restraints in the particular context of the recording industry.

⁵⁴ Respondents also assert, in passing, that the moratorium prevented the PolyGram and Warner operating companies from using "confidential marketing plans developed by the joint venture

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We reject these arguments as a matter of law because they go far beyond the range of justifications that are cognizable under the antitrust laws.⁵⁵ Respondents are not asserting that restraints on the joint venture activities are reasonably necessary to achieve efficiencies in its operations, nor even that expansion of the joint venture is reasonably necessary to achieve such efficiencies. Rather, they are arguing that competitors may agree to restrict competition by products wholly *outside* a joint venture, to increase profits for the products of the joint venture itself. Such a claim is “nothing less than a frontal assault on the basic policy of the Sherman Act,” *Professional Engineers*, 435 U.S. at 695, for it displaces market-based outcomes regarding the mix of products to be offered with collusive determinations that certain new products will be offered under a shield from direct competition.

Preventing free-riding can be a legitimate efficiency. The most widely recognized application in antitrust of this efficiency is, as Respondents suggest, limiting intrabrand competition to improve interbrand competition. *See Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-55 (1977). In such cases, the scope of the restraint is necessarily limited to products that are within the control (at least initially) of the entity that owns the restricted brand. Here, despite Respondents’ invocation of a Three Tenors “brand,” there is obviously no such thing, because one entity did not legally control all Three Tenors products. The marketing rights to 3T1 and 3T2 were held not by the joint venture but, rather, independently by the parties to the venture. RX 716 ¶ 31.

partners.” Respondents’ Opening Brief at 44. However, Respondents do not develop this argument further and cite to no record evidence indicating that the moratorium was intended to protect against the misuse of confidential marketing plans.

⁵⁵ Although Respondents state their justification for the moratorium in various ways, their arguments all amount to the same thing: that restraining competition from 3T1 and 3T2 enhanced the marketing of the new joint venture product.

See supra Part I.C.⁵⁶

Respondents draw our attention to cases in which courts have declined to condemn restrictions that co-venturers have imposed upon each other when the restrictions were justified, at least in part, as reasonable means to control free-riding by the co-venturers. These cases are readily distinguishable from the case at hand. The restraints upheld in the “free-riding” cases Respondents rely upon were limited to the products of the joint venture or other single economic entity involved. For example, in *Polk Bros., Inc. v. Forest City Enterprises, Inc.*, 776 F.2d 185 (7th Cir. 1985), two retail chains whose offerings were largely complementary, but which were at least potential competitors, agreed to open a new store offering, side by side, the full range of their goods. To protect their respective economic interests and make the new venture possible, they agreed to refrain from carrying competing goods *at that location*. 776 F.2d at 187. The venturers did not agree to restrict competition between their other stores. *Id.*

In *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) (“*Rothery*”), *cert. denied*, 479 U.S. 1033 (1987), Atlas, a national van line that contracted with numerous local agent-carriers, altered its previously more flexible arrangement by generally requiring that any moving company doing business as its agent cease interstate carriage on its own account and provide such carriage exclusively in conjunction with Atlas (although competition by wholly independent affiliates was allowed in some circumstances). 792 F.2d at 213, 217. Atlas’s restriction simply required agent-carriers to bring within the

⁵⁶ Had this case involved a merger to create a single entity with rights to market all Three Tenors products, a different analysis would have been required – *i.e.*, one that would weigh potential anticompetitive effects against the prospect of integrative and other efficiencies, under the standards of Section 7 of the Clayton Act, 15 U.S.C. § 18.

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integrated joint venture all of their interstate carriage that used Atlas's equipment, uniforms, services, or other assets of the Atlas network. Because Atlas demonstrated that this restraint was reasonably necessary to eliminate free-riding and thus preserve the efficiencies of the joint venture and because Atlas had only a small percentage of the overall national market, the court upheld the restraints under the rule of reason. *Id.* at 229.

In the present case, however, Respondents and Warner did not bring all of their Three Tenors products into a single, integrated joint venture; indeed, the joint venture agreement expressly provided that PolyGram and Warner could continue to exploit 3T1 and 3T2. JX 10-V. Nor did Respondents and Warner limit the restrictive effects of the moratorium to the product within the joint venture – *i.e.*, 3T3. Rather, they left each of the three Three Tenors products in the hands of an independent economic entity, yet agreed to restrict competition by two of those entities – Respondents with respect to the marketing of 3T1 and Warner with respect to the marketing of 3T2.⁵⁷ Thus, the issue here is whether a joint venture can claim the “efficiency” of limiting “free-riding” from competing products the joint venture neither owns nor otherwise legally controls.

The sort of behavior that Respondents disparage as “free-riding” – *i.e.*, taking advantage of the interest in competing products that promotional efforts for one product may induce – is

⁵⁷ Prior to the moratorium agreement, these independent entities had planned to conduct marketing campaigns for 3T1 and 3T2 during the release of 3T3. IDF 102-05, 115-18. Moreover, Respondents were concerned that it would be difficult for PolyGram and Warner to implement the moratorium consistently on a worldwide basis, because they did not have complete control over the prices for 3T1 and 3T2 charged by their operating companies. IDF 126. Ultimately, however, PolyGram and Warner succeeded in enforcing the moratorium. *See supra* Part I.C.

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an essential part of the process of competition that occurs daily throughout our economy. For example, when General Motors (“GM”) creates a new sport utility vehicle (“SUV”) and promotes it, through price discounts, advertising, or both, other SUVs can “free ride” on the fact that GM’s promotion inevitably stimulates consumer interest, not just in GM’s SUV, but in the SUV category itself.⁵⁸ Our antitrust laws exist to protect this response, because it is in reality the competition that drives a market economy to benefit consumers. There is no doubt that GM’s SUV will likely be more profitable if its competitors do not respond. Promoting profitability, however, is not now, nor has it ever been, recognized as a basis to restrain interbrand competition under the antitrust laws. *See Catalano*, 446 U.S. at 649;⁵⁹ *Law*, 134 F.3d at 1023 (“mere profitability or cost savings have not qualified as a defense under the antitrust laws”); *Chicago Prof’l Sports Ltd. Partnership v. National Basketball Ass’n*, 754 F. Supp. 1336, 1359 (N.D. Ill. 1991), *aff’d*, 961 F.2d 667 (7th Cir. 1992).

⁵⁸ As discussed in Part III.C.3., *infra*, the record reveals that this phenomenon is common in the music industry. JX 91 at 126-27; JX 97 at 46; CX 609 at 71-73, 83-84; CX 610 at 52-54. It is common in many other industries, as well.

⁵⁹ The *Catalano* Court stated:

[I]n any case in which competitors are able to increase the price level or to curtail production by agreement, it could be argued that the agreement has the effect of making the market more attractive to potential new entrants. If that potential justifies horizontal agreements among competitors . . . it would seem to follow that the more successful an agreement is in raising the price level, the safer it is from antitrust attack. Nothing could be more inconsistent with our cases.

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During the oral argument, Respondents in effect conceded this flaw in their argument in their response to a hypothetical positing that Sony had received the rights for 3T3 and then Sony had entered into the same moratorium agreement with Warner and PolyGram restricting price discounting and advertising of 3T1 and 3T2 during the 3T3 release period.⁶⁰ This hypothetical assumes that the same benefits to the Three Tenor “brand” exist that Respondents assert exist in their joint venture. Respondents conceded that for Sony to enter into such an agreement with Warner and PolyGram would be *per se* illegal,⁶¹ even if it might maximize the value of the Three Tenors “brand” in the long term. Transcript of Nov. 4, 2002 Oral Argument at 74-75. Although Respondents claim that the Sony hypothetical is inapposite because the parties here were engaged in a joint venture and own the competitive products, they provided no principled reason why this distinction should make a difference. In each, three products are offered, by three different and independent economic entities. In each, the competitive efforts on behalf of two products are restricted to shield a third product from competition. In each, there is a blatant departure from the principles of free competition on which our antitrust laws are based.

Nor does the fact that the shielded product is a new introduction to the market justify such market manipulation. Suppose, to return to our SUV example, that GM and one of its rivals enter into a joint venture to produce a new SUV, and the parties restrict the competition from their existing, non-joint-

⁶⁰ As mentioned above, *see supra* Part I.C., Sony released a Three Tenors Christmas album in 1999.

⁶¹ The transcript of the oral argument reads “*per se* legal” (Transcript of Nov. 4, 2002 Oral Argument at 74:24), but it is clear from the surrounding discussion of the Sony hypothetical that Respondents’ counsel actually said (or meant) “*per se* illegal.”

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venture SUVs to protect the market for the new SUV.⁶² Any argument that such a stifling of competition is “necessary” to bring the new product to market would face the same fundamental problem that condemns Respondents’ arguments here. Although the antitrust laws favor product innovation, the very concept of a free market is that competitive forces themselves will induce the production of new products that consumers desire and whose availability will enhance consumer welfare. “Antitrust law presumes that competitive markets offer sufficient incentives and resources for innovation, and that cartel pricing leads not to a dedication of newfound wealth to the public good but to complacency and stagnation.” *Freeman v. San Diego Ass’n of Realtors*, 322 F.3d 1133, 1152 (9th Cir. 2003). If a “new” product can succeed in a free marketplace only if it is shielded from competitive forces by a facially anticompetitive agreement between existing competitors, then it is likely no loss to consumers if it is not introduced. To allow such an “efficiency” to justify an agreement between competitors to restrict promotion of competing products is to displace market forces with collusive decisions by competitors regarding what new products consumers

⁶² The Commission’s decision in 1984 to permit General Motors and Toyota to engage in a production joint venture provides an instructive point of comparison. *General Motors Corp.*, 103 F.T.C. 374 (1984). No feature of the GM-Toyota joint venture, either as proposed by the parties or as ultimately approved by the Commission, restricted competition between the two firms concerning existing automobile models that they previously had developed independently. This is a critical distinction between that case and the present one. As a leading commentator noted, “[w]hat excuses the GM-Toyota venture from charges of per se unlawful price fixing is that the venturers did not enter into any agreement to fix the price of their nonventure output.” XI Hovenkamp, *Antitrust Law* ¶ 1908e, at 237-38.

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ought to be offered.⁶³

Indeed, the argument Respondents advance here is remarkably similar to a justification that the *NCAA* Court considered and rejected as antithetical to the antitrust laws. There, addressing the NCAA's argument that restrictions on television broadcasts of

⁶³ Respondents' reliance on Example 10 in Section 3.36(b) of the *Collaboration Guidelines* is misguided. That example addresses the analysis of restrictions imposed by co-venturers in the development of new word processing software products – including, potentially, the cessation of sales of preexisting, competing products. The example makes clear, however, that such restraints may be justified only if they achieve “*cognizable* efficiency goals.” *Id.* (emphasis added). Specifically, the example indicates that such restrictions might be justified if they were necessary for the activities of the joint venture itself, as for monitoring the venturers' contributions of assets or preventing one participant from misappropriating assets the other contributed. The example does not support the notion that a restraint on the marketing of non-venture products can be justified simply because it would increase sales opportunities for the joint venture product. On the contrary, the *Guidelines* make clear that claims “premised on the notion that competition itself is unreasonable . . . are insufficient as a matter of law.” *Collaboration Guidelines*, at § 3.2. Moreover, as discussed in Example 9 of the *Guidelines*, cost savings from depriving consumers of information useful to their decision making (like the advertising restrictions at issue here) amounts to a service reduction, not a cognizable efficiency.

Further, unlike the joint venture in Example 10, the collaboration at issue here was merely a marketing venture. PolyGram and Warner did not create a novel product. They did not produce the 1998 Three Tenors concert; that was done independently by concert promoter Rudas. Instead, PolyGram and Warner merely collaborated to distribute the audio and video recordings of the 1998 concert. *See supra* Part I.C.

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college football games were necessary to protect live attendance at games, the Court stated:

At bottom the NCAA's position is that ticket sales for most college games are unable to compete in a free market. The television plan protects ticket sales by limiting output – just as any monopolist increases revenues by reducing output. By seeking to insulate live ticket sales from the full spectrum of competition because of its assumption that the product itself is insufficiently attractive to consumers, petitioner forwards a justification that is inconsistent with the basic policy of the Sherman Act.

NCAA, 468 U.S. at 116-17. *See also Professional Engineers*, 435 U.S. at 696 (“[T]he Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable. Such a view of the Rule would create the ‘sea of doubt’ on which Judge Taft refused to embark in *Addyston*, 85 F. at 284, and which this Court has firmly avoided ever since.”).

Another way of analyzing this issue is that the restraints here are not “ancillary” to the production of efficiencies in the sense that Sherman Act cases have employed that concept, even assuming (contrary to our conclusion in Part III.C.3, *infra*) that, as a factual matter, restricting the marketing of 3T1 and 3T2 was reasonably necessary to ensure the vigorous marketing of 3T3. To qualify as an “ancillary” restraint, “an agreement eliminating competition must be subordinate and collateral to a separate, legitimate transaction,” and it must also “be related to the efficiency sought to be achieved.” *Rothery*, 792 F.2d at 224. A determination of ancillarity includes, of course, the factual inquiry whether a particular restraint was indeed reasonably necessary to permit the parties to achieve a particular efficiency. *See infra* Part III.C.3. But that factual inquiry is not the only pertinent consideration. Suppose, for example, General Motors and Toyota asserted that, to provide incentives for marketing of a new solar-powered car, they would eliminate price promotions on their

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conventional vehicles. Such an argument would be rejected because it is not sufficiently “related to” the efficiency to be furthered.

Cases in which defendants successfully invoked the doctrine of ancillary restraints consistently have involved restraints that affect the joint venture at issue, but not products outside its scope. This was true in both *Rothery* and *Polk Brothers*, as discussed above. Similarly, in *BMI*, the Court upheld the joint setting of prices for the joint venture product (blanket music licenses) because it “accompanie[d] the integration of sales, monitoring, and enforcement against unauthorized copyright use.” 441 U.S. at 20. Significantly, the pricing arrangement approved in *BMI* did not include products outside the joint venture – *i.e.*, licenses on individual compositions – which remained available and were not subject to restraints. *Id.* at 23-24; *see* XI Hovenkamp, *Antitrust Law* ¶ 1908e, at 237-38. Respondents have not cited any cases, nor are we aware of any, in which restraints on the sales of non-joint-venture products have been upheld as “ancillary” to the production of efficiencies by the joint venture itself. On the contrary, the Commission has long recognized that restraints on activities “outside the ambit of the joint venture” cannot be hidden under its cloak. *See Brunswick Corp.*, 94 F.T.C. 1174, 1277 (1979), *aff’d sub nom. Yamaha Motor Co., Ltd. v. Federal Trade Commission*, 657 F.2d 971, 981 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982).

In the present case, Respondents and Warner chose to retain control over their respective existing Three Tenors products and to form a joint venture limited to 3T3 and specified follow-on products (*i.e.*, a possible “Greatest Hits” recording and a Boxed Set). They cannot claim the integrative efficiencies that could conceivably have been brought about by combining the production and marketing of all Three Tenors products. Accordingly, the restrictions on the marketing of 3T1 and 3T2 cannot be considered “ancillary” to the present joint venture, *as a matter of law*, because they are not related to the efficiencies the

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joint venture was created to produce.⁶⁴

Thus, we hold that the Respondents' "free-riding" argument is simply an attempt to shield themselves from legitimate interbrand competition. As such, the proffered justification is not cognizable under antitrust law.⁶⁵ This conclusion, together with our previous conclusion that the restraints at issue are of the sort that are likely to harm competition, provides us with ample ground to condemn Respondents' actions as unlawful under Section 1, without further analysis. Arguably, this conclusion could be characterized as a finding of "*per se* illegality" in that we conclude that the restraints at issue are "naked" restraints on competition because they lack a cognizable justification. Yet our mode of analysis, in which we evaluate the proffered justifications at some length and ultimately reject them as not cognizable in an antitrust analysis, closely tracks that of the Supreme Court in *Professional Engineers* and *NCAA* – both cases that the Court described as applying the rule of reason.⁶⁶ In the end, the label matters less than the substance of

⁶⁴ As discussed in Part III.C.3, *infra*, the restraints on the marketing of 3T1 and 3T2 also fail to qualify as ancillary *as a matter of fact*, in that the record shows that such restrictions were not actually necessary to ensure the introduction and vigorous promotion of 3T3 and any covered follow-on products.

⁶⁵ Accordingly, we have no need to determine whether Respondents' proffered justification is "plausible" in a purely factual sense. Because it is not cognizable under antitrust law, it has no relevance to our analysis. *See* note 42, *supra*. In any event, as we determine in Part III.C.3, *infra*, Respondents' attempted defense also fails factually.

⁶⁶ *See* discussion of *NCAA*, at p. 19-21, *supra*; *see also Professional Engineers*, 435 US at 688 ("to evaluate this argument it is necessary to identify the contours of the Rule of Reason and to discuss its application to the kind of justification asserted by petitioner") and at 435 U.S. at 695 ("It is this restraint

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the analysis, the purpose of which remains “to form a judgment about the competitive significance of the restraint.” *Professional Engineers*, 435 U.S. at 692. Here, we have no doubt that the restraints before us harm competition and must be condemned.

C. A More Detailed Factual Analysis

Our analysis could properly end at this point. Respondents’ only proffered justification is not cognizable as a matter of law, and therefore triggers no need to go beyond the analysis presented above. Even if we concluded, however, that Respondents had offered a cognizable and plausible justification and that a more elaborate analysis were therefore needed, analysis of the facts here would only reconfirm our ultimate conclusion. The extensive factual record regarding practices in the recording industry and Respondents’ own prior course of conduct establishes that the harm to competition not only is inferable from the nature of the conduct but is established as a matter of fact. And the record likewise shows that Respondents’ proffered justification regarding free riding and the supposed need to ensure the vigorous promotion of 3T3 would fail as a factual matter, even if it were legally cognizable.

that must be justified under the Rule of Reason . . .”). Of course, even this type of analysis is unnecessary in cases with no possible arguments that restraints are needed to achieve beneficial results, and a more traditional *per se* approach remains appropriate. *See, e.g., United States v. Andreas*, 39 F. Supp. 2d 1048, 1058-61 (N.D. Ill. 1998) (rejecting arguments that rule of reason can apply to criminal case charging price fixing and volume allocation imposed to restrict output), *aff’d*, 216 F.3d 645, 666-68 (7th Cir. 2000). Such matters are commonly the subject of criminal prosecution and are appropriately deemed *per se* illegal, as are other restraints for which the proffered justifications can likewise be dismissed summarily. *See also Palmer*, 498 U.S. at 49-50; *SCTLA*, 493 U.S. at 424; *Catalano*, 446 U.S. at 649-50.

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1. Competitive Effect of Respondents' Discounting Restrictions

The record evidence shows that the moratorium's price restraint not only was inherently suspect, but also actually harmed competition and consumers. In the sale of recorded music, as in other industries, price discounting is an important dimension of competition. IDF 238-42. Executives from PolyGram and Warner testified that their companies commonly offer price discounts to retailers, on catalog products as well as new releases, and that such discounts increase sales. IDF 239. PolyGram and Warner also commonly provide retailers with cooperative advertising funds, which function as a discount from the wholesale price.⁶⁷ IDF 217-18; CX 603-Z-18 (*in camera*). These wholesale discounts encourage retailers to sell the product to consumers at reduced retail prices. IDF 220; JX 100 at 91-92 (*in camera*).

⁶⁷ Cooperative advertising is a monetary commitment that the record label makes to retailers to support both out-of-store advertising (*e.g.*, print, radio, and television advertising) and in-store promotion (*e.g.*, posters and floor displays). Out-of-store advertising is intended to draw customers into the store by informing them where a recording may be purchased and at what price. In-store advertising is designed to increase the likelihood that, once inside the store, the consumer buys a specific recording. JX 105-F; Tr. 48-54, 58-60, 194-96. When PolyGram provides cooperative advertising funds, the retailer provides the advertising and then deducts the value of the cooperative advertising from the amount it pays for the product it purchases from PolyGram. Cooperative advertising thus functions as a price discount. IDF 217-18. Indeed, industry participants recognize that cooperative advertising funds are a form of discount, because they represent the partial assumption by the recording company of expenses that retailers would otherwise bear. *See* CX 603-P (*in camera*) (discussion by Warner of cooperative advertising).

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Prior to the moratorium, Respondents discounted prices as part of the marketing strategy for their respective Three Tenors products. In 1994, PolyGram responded to the release of 3T2 by launching an aggressive marketing campaign for 3T1 worldwide, with price discounting in many markets. JX 29 (“PolyGram were able to sell an additional one million copies of their 1990 album on the back of our new record in 1994. This was achieved through aggressive TV advertising, print advertising, extensive rack exposure of their record at retail *and a price reduction.*”) (emphasis added); JX 12 (in the U.S., 3T1 audio sales in 1994 increased 274% over 1993 sales as a result of marketing campaign); IDF 214-21. In the United States, for example, PolyGram provided cooperative advertising funds to retailers to increase sales and encourage lower retail prices for 3T1. IDF 219-20. In 1996 and 1997, during the Three Tenors’ world concert tours, PolyGram again offered 3T1 at a discounted price in many markets. IDF 224-25, 241; CX 299 at 3TEN00005903 (“You can be certain Decca will be planning to exploit this concert tour with pricing campaigns . . .”). In early 1998, many PolyGram and Warner operating companies planned to reduce the price of 3T1 and 3T2 as part of aggressive marketing campaigns, including promotional activities planned for the weeks surrounding the release of 3T3. IDF 102-05, 115-18. As a result of the moratorium agreement, however, 3T1 and 3T2 ultimately were sold only at full price during the release of 3T3. IDF 170-81.

Respondents argue there is no evidence that the pricing (or advertising) of 3T1 or 3T2 in the United States would have been different without the moratorium. In particular, Respondents assert that in 1994 PolyGram did not discount 3T1 in the United States, and that evidence cited by the ALJ regarding PolyGram’s and Warner’s plans in 1998 to discount 3T1 and 3T2 related solely to operating companies outside of the United States. Respondents’ Opening Brief at 16-17. Respondents appear, however, to hold an artificially narrow view of what constitutes price discounting. Although one method of price discounting, called a “mid-price campaign,” is not used in the United States, Tr. 184-86, the evidence shows that record companies in the

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United States – including PolyGram and Warner – routinely use other forms of price discounting, such as wholesale discounts offered to retailers on new releases or restocking campaigns for catalog products. JX 100 at 91-92 (*in camera*); CX 609 at 49-50; Tr. 44-45. Record companies in the United States – again, including PolyGram and Warner – also use cooperative advertising to achieve what is effectively a discount in the wholesale price, without actually lowering the suggested list price. Tr. 66-68, 187, 808; IDF 217-18, 220.⁶⁸ Moreover, the moratorium applied worldwide, not merely to foreign markets. As Dr. Stockum explained, when direct competitors form an agreement not to discount, “it is a safe economic inference to draw that they intend to stop discounting that would otherwise have occurred.” JX 85 at 45-46. This inference is particularly safe where it appears that the parties’ counsel cautioned them about the legal risks of a moratorium on discounts. *See* p. 9, *supra*.

On this record, we find that the agreement by PolyGram and Warner not to discount 3T1 and 3T2 in the period surrounding the release of 3T3 not only is presumptively anticompetitive, but also eliminated actual price discounting that had occurred previously in the industry, including competition between 3T1 and 3T2 upon the release of 3T2.

2. Competitive Effect of Respondents’ Advertising Restrictions

Here, in contrast to *CDA*, Respondents made no effort to articulate any reason why the market in question (the sale of

⁶⁸ The evidence is clear that PolyGram employed cooperative advertising for 3T1 in 1994 in the United States. For example, in September 1994 – the first full month after the release of 3T2 – PolyGram returned to retailers through 3T1 cooperative advertising programs approximately 9% of the money generated from 3T1 sales. IDF 219.

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recorded music) falls outside the “general rule” that advertising restrictions tend to have anticompetitive effects. *See* 526 U.S. at 771. Nevertheless, the record evidence confirms that such principles indeed apply fully to the recorded music industry, and that the advertising restrictions imposed here were harmful to competition. *See* Tr. 601-03. The record shows that advertising is an important basis of competition in this industry. JX 105-F-G. Record companies spend considerable sums of money advertising their products. CX 609 at 57-59; JX 101 at 12-13. Such advertising serves to inform consumers about the availability of alternatives, sales locations, prices, and quality differences among competing products. Tr. 53-54, 58-59, 62-64. Complaint Counsel’s music industry marketing expert, Dr. Moore, explained that a record company’s decisions regarding advertising and wholesale price are linked, and if there is no advertising, there is less incentive for the company to offer the recording at a significantly reduced price. JX 105-I ¶ 41. Dr. Moore further testified – and Respondents’ executives confirmed – that record companies advertise to increase their sales, and that such advertising generally results in lower retail prices for consumers. Tr. 58-59, 64-67; JX 87 at 79-80, 90; CX 609 at 59; CX 610 at 50.

Furthermore, before the moratorium, advertising was an important part of competition between 3T1 and 3T2. In 1994, when 3T2 was released, PolyGram advertised to inform consumers that 3T1 was the “original” Three Tenors recording, was still widely available, and indeed was often available at a discounted price. IDF 210-20. Largely as a result of its marketing campaign, PolyGram sold almost one million audio and video recordings of 3T1 in the second half of 1994, as compared with 377,000 in the same period in 1993. JX 12. In turn, Warner used advertising to create a distinct identity for 3T2, suggesting to consumers that the newer release was the superior product. IDF 201-09.⁶⁹ PolyGram and Warner again used advertising to

⁶⁹ For example, Warner’s 1994 marketing plan for 3T2 stated:

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highlight the advantages of their respective Three Tenors products during the Three Tenors' world concert tours in 1996 and 1997. IDF 224-34.

In 1998, PolyGram and Warner operating companies began to plan advertising campaigns for their respective catalog Three Tenors products in connection with the upcoming Paris concert. IDF 102-03, 105, 115-18, 255-58. PolyGram and Warner subsequently instructed their operating companies that, because of the moratorium agreement, advertising of 3T1 and 3T2 had to end before 3T3 was released. IDF 107, 147-49. The ban on advertising was intended to protect sales of 3T3 by withholding information from consumers about the nature and price of competing products. As one Warner executive explained at trial, the companies did not want consumers to "start comparing the repertoire along with the price and make a determination that, you know, the '94 concert is just fine for a few dollars less." Tr. 487. We agree with the ALJ that the anticompetitive effect of this strategy is obvious. IDF 224-34.

3. Inadequacy of Respondents' Free-Rider Defense

The foregoing analysis shows that the price and advertising restrictions Respondents imposed were inherently suspect as a matter of economic theory and also were demonstrably anticompetitive in the particular industry context in which they were imposed. Although we have found it unnecessary to engage in "the fullest market analysis," *CDA*, 526 U.S. at 779, we have

In order to counter the perceived threat of competitive imitation products which will aim to satisfy demand in the period directly around the concert using similar repertoire and perceptually identical artists, the concept of the genuine or "real thing" will underpin all local implementation of the [marketing strategy].

CX 259 at 3TEN00011109.

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examined evidence of industry practice and the past practices of the very participants in the present scheme, as well as the consistent economic literature regarding the likely effects of such practices. By any standard, this is an enquiry “meet for the case,” allowing us to arrive at a “confident conclusion” about the anticompetitive nature of these restraints. *Id.* at 781. An antitrust defendant can avoid liability in these circumstances only by making a concrete showing of “countervailing procompetitive virtue.” *See IFD*, 476 U.S. at 459. Respondents have failed to make such a showing.

As discussed above, Respondents’ only proffered justification is impermissible as a matter of law, because the supposed “efficiency” of restraining competition in the offering of products outside of a joint venture to enhance market opportunities for a new joint venture product is not cognizable under the antitrust laws. Nevertheless, in this section we examine the record evidence on these restraints and conclude that, *even if* Respondents could properly defend on the basis that restricting the marketing of 3T1 and 3T2 was reasonably necessary to ensure the vigorous marketing of 3T3, the record simply does not support that argument as a factual matter.

The joint venture unquestionably would have proceeded and the new product would have been brought to market without the moratorium. Initially, Warner planned to market and distribute 3T3 on its own, without any collaboration from PolyGram. IDF 52. Furthermore, PolyGram and Warner were contractually committed to the formation of the joint venture and the creation of 3T3 months before discussions of the moratorium began. IDF 263. Although the timing of the moratorium is not dispositive, it is certainly relevant to an assessment of whether the moratorium was reasonably necessary to achieve the procompetitive benefits of the collaboration. At trial, a Warner executive testified that even if PolyGram and Warner had not agreed to the moratorium, Warner was committed to distribute 3T3 in the United States. Tr. 446-47. Moreover, the fact that the joint venture agreement itself expressly contemplated that PolyGram and Warner would remain

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free to exploit the earlier Three Tenors albums strongly suggests that the parties did not view a ban on competition from these products as important to the efficient operation of the joint venture. JX-10-J-K.

The evidence in this case shows that the prospect that PolyGram and Warner operating companies would discount and advertise 3T1 and 3T2 during the 3T3 release period did not diminish Warner's incentives to promote 3T3 in the United States. Respondents' marketing expert, Dr. Wind, acknowledged in his deposition that firms commonly capitalize on the promotional activities of their competitors, and sellers generally respond to this challenge by using advertising and other marketing tools to create a distinct identity for the target product. JX 91 at 125-29, 133-34; IDF 277-79. In particular, within the recorded music industry, the diversion of sales identified by Respondents is commonplace, and advertising intended to benefit one album often leads to sales of competing albums, including catalog albums by the same artist. IDF 280; Tr. 87-88, 264-65; JX 89 at 33-35; JX 87 at 69-72; JX 101 at 183-84; JX 102 at 114-15; JX 609 at 71-73. As the president of WMI wrote when informed that the moratorium agreement would prevent his operating companies from implementing their plans to promote and discount 3T2 when 3T3 was released:

There is nothing sinister nor underhanded in marketing catalog on the back of a significant related event or new release. In fact, as you well know, this is the normal and traditional practice of our industry.

JX 8.⁷⁰

⁷⁰ In economic terms, one reason for this practice is that, for certain consumers, prior recordings are apparently complements, not substitutes. That is, for these consumers a new recording can increase the attractiveness of previous recordings.

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Complaint Counsel's music industry marketing expert testified, and the parties' executives confirmed, that the prospect of a new album's losing sales to competing catalog products typically does not lead record companies to curtail their marketing of a new album. Tr. 88-90; JX 105-H; CX 610 at 54-55; CX 609 at 71-80, 85-86. For example, when Warner released 3T2 in 1994, it anticipated that PolyGram would take advantage of the promotional opportunity arising from the release of 3T2 to advertise and discount 3T1. IDF 202. But Warner did not cut back on its marketing of 3T2. To the contrary, it launched an aggressive and expensive international marketing campaign in support of 3T2, competing by creating a distinct identity for 3T2. Tr. 89-98; IDF 201, 203-09.

The evidence here shows that marketing activities in support of 3T3 would not have been curtailed on account of the promotion of 3T1 and 3T2. IDF 288-91. Witnesses representing both Warner and PolyGram testified that 3T3 would have been appropriately promoted without the moratorium, and that the moratorium had no effect on the resources for advertising and promoting 3T3. Tr. 490; JX 94 at 87-89; JX 95 at 89-90; JX 101 at 85-86; IDF 288-91. Indeed, in June 1998, when it appeared that the moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. IDF 129.

Respondents fail to point to any convincing countervailing evidence that "opportunistic" behavior by PolyGram and Warner operating companies would have led Warner to reduce its level of marketing of 3T3 in the United States. Even Respondents' economic expert, Dr. Ordoover, was unable to conclude that promotion of 3T1 and 3T2 was a significant concern in the United States; rather, he found that the moratorium was motivated by concerns about promotion of 3T1 and 3T2 in Europe. JX 90 at 36-37; IDF 294-96. Even if the evidence supported a conclusion that promotional activities by the operating companies in Europe were a concern, this would not justify a ban on discounting and advertising in the United States. *See Rothery*, 792 F.2d at 224 ("If [a restraint] is so broad that part of the restraint suppresses

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competition without creating efficiency, the restraint is, to that extent, not ancillary.”). Moreover, although Dr. Ordovery opined that the moratorium was “reasonably necessary” to avoid free-riding, he defined “reasonably necessary” as meaning not obviously pretextual. IDF 297-98. This meaning of “reasonably necessary” is contrary to the case law. *See Rothery*, 792 F.2d at 224 (restraint “must be subordinate and collateral to a separate, legal transaction” *and* “related to the efficiency sought to be achieved”). Dr. Wind, Respondents’ marketing expert, opined that the moratorium plausibly benefitted consumers because it provided incentives for PolyGram and Warner to produce 3T3 and invest in promoting the album, but he could not identify any record evidence that supported his opinion. JX 91 at 111-15, 117-18. Accordingly, we agree with the ALJ that the opinions of Respondents’ experts are entitled to little weight. ID at 58-59, n. 25.

Respondents also fail to point to any convincing evidence to support their contention that the moratorium increased the likelihood that the parties would release a Three Tenors Boxed Set and a Greatest Hits album. Although aggressive promotion of 3T1 and 3T2 during the launch of 3T3 might have diverted some sales of 3T3 to the other products (with consumers benefitting from lower prices), presumably there would have been at least as many total units sold during that period. This scenario may well have been less profitable for the joint venture, but it is not apparent that the parties’ possible decision in the future to release these additional Three Tenors products would have depended on achieving greater sales of 3T3, as opposed to sales of 3T1 or 3T2. A Warner executive testified that the decision whether to release a Greatest Hits album was not related to a moratorium on price discounting, and that, as of early 2001, the disappointing sales of 3T3 had not dissuaded Warner and PolyGram from planning to release a Three Tenors Boxed Set or a Greatest Hits album. JX 101 at 76, 110-11, 113-15. *See also* JX 24 (“PolyGram has insisted . . . on having these box set and ‘greatest hits’ rights in order to ‘hedge their bets’ and give us an additional source of income in case the 1998 album does not perform up to

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expectations.”).

At most, Respondents’ record citations suggest that some PolyGram and Warner executives harbored vague concerns that discounting and advertising of 3T1 and 3T2 during the launch of 3T3 might have “devalued” the Three Tenors “brand” (jeopardizing future demand for Three Tenors products) or resulted in customer confusion (leading customers to purchase a different album than intended or perhaps not purchase anything at all). JX 89 at 57-58; JX 94 at 80-82. Respondents, however, offer no evidence indicating that these are valid concerns.⁷¹ In 1994, PolyGram responded to the release of 3T2 by discounting and aggressively promoting 3T1; and during the Three Tenors world tours in 1996 and 1997, both companies mounted promotional campaigns, which included discounting in many markets. *See supra* Part I.C. There is no evidence that any of these promotional activities “devalued” the Three Tenors “brand,” unduly confused consumers, or otherwise threatened Three Tenors output.

IV. REMEDY

Having found a violation of Section 5 of the FTC Act, the Commission is empowered to enter an appropriate order to prevent a recurrence of the violation. The Commission has wide discretion in its choice of a remedy. *Federal Trade Commission v. National Lead Co.*, 352 U.S. 419, 428 (1957); *Jacob Siegel Co. v. Federal Trade Commission*, 327 U.S. 608, 611 (1946). “[T]he Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past,” but “must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity.”

⁷¹ Respondents’ argument about consumer confusion – that eliminating the “clutter and confusion” of competing products was “in the customer’s best interest,” JX 94 at 80 (Saintilan Dep.) – is similar to a justification that the Supreme Court rejected in *IFD*. *See* p. 22, *supra*.

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Federal Trade Commission v. Ruberoid Co., 343 U.S. 470, 473 (1952). The remedy selected, however, must be reasonably related to the violation found to exist. *Id.*; *Jacob Siegel*, 327 U.S. at 613.

The order we issue narrowly prohibits the Respondents from engaging in the conduct that we have concluded was unlawful without impeding their ability to engage in legitimate joint venture activity. Paragraph II of the order requires Respondents to cease and desist from entering into an agreement with a competitor to fix prices of, or restrict truthful or “nondeceptive” advertising for any audio or video product in the United States. Paragraphs III.A. and III.B. specifically provide that the order does not prohibit Respondents from entering into a written agreement to set prices of or restrict the advertising for any audio or video product if the agreement is reasonably related to a lawful joint venture and reasonably necessary to achieve its procompetitive benefits. Paragraphs III.C. and III.D. provide that the order does not prohibit Respondents from entering into a written agreement to set prices of or restrict the advertising for any jointly produced audio or video product. Paragraph III.E. provides that Respondents are not prohibited from complying with an industry code or ethical standard intended to restrict the marketing to children of audio and video products rated with a parental advisory. Paragraph III.F. provides that, in any action by the Commission alleging a violation of this order, the burden is on the Respondents to show that the challenged conduct satisfies the conditions of Paragraphs III. A-E.⁷² These provisions are clearly related to the law violation found to exist and no broader than necessary to prevent a

⁷² Respondents claim, without citing authority for the proposition, that this provision improperly reverses the substantive and procedural burdens under the antitrust laws. We disagree. Requiring Respondents to demonstrate a justification for conduct that is inherently suspect is consistent with the analytical framework set forth in the relevant cases and followed in this opinion.

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recurrence of the violation.

Paragraphs IV, V, VI, VII, and VIII set forth Respondents' compliance obligations under the order. We have altered the ALJ's proposed order by shortening Respondents' reporting obligations under Paragraph IV.B. from nine to five years. These provisions are designed to assist the Commission in monitoring compliance with the order, and they impose a small burden on Respondents.

Respondents argue that a cease and desist order is not supported in this case because there is no threat that similar conduct will recur. We disagree. The marketing challenge that gave rise to the Three Tenors moratorium – *i.e.*, the fear that a new release by one of Respondents' recording artists may lose sales to the artist's older albums owned by a competitor – is not unique to the Three Tenors. As one PolyGram executive explained:

For every major release in any record company there is always an element of anxiety because of big investment, because of big expectations, to make sure that everything is set up to deliver the quantities we need to make money on that project. There was not any difference on this one.

JX 97 at 42-43.

Recording artists often release material on more than one record label during their careers. Music labels often release an exclusive artist to a competing company for a particular project. Thus, many artists have catalog albums that appear on a label different from the label that releases the artist's new record. IDF 331-32. In addition, a music label may release an artist from an exclusive recording contract in return for a royalty on the artist's first album on a new label, giving the companies a shared financial interest in the success of a particular album. IDF 333. In such circumstances, Respondents will likely have the same incentives and opportunity to restrict the pricing or advertising of

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the artist's catalog albums that led PolyGram and Warner to enter into the Three Tenors moratorium agreement.

Respondent UMG is presently engaged in other joint venture activity – including a joint venture with Sony to distribute music over the Internet – that may provide similar incentives and opportunity to restrain competition. UMG, Sony, and other music companies will provide music to the joint venture on a non-exclusive basis, meaning that music products marketed by the joint venture may also be marketed through traditional retail outlets. Absent a cease and desist order, UMG and Sony may find it profitable to fix prices on product sold to retail stores so as to enhance the joint venture's sales. IDF 334.

We find that, under these circumstances, there is a reasonable risk that Respondents will repeat the unlawful conduct absent an order to cease and desist. *See United States v. W.T. Grant Co.*, 345 U.S. 629, 632 (1953); *Marlene's, Inc. v. Federal Trade Commission*, 216 F.2d 556, 560 (7th Cir. 1954); *Superior Court Trial Lawyers Ass'n*, 107 F.T.C. 510, 602 (1986).

V. CONCLUSION

At the conclusion of *Turandot*, the Princess – overcome by the power of love – has a dramatic change of heart. She gladly weds the new suitor and presumably becomes a more kindly ruler. Because we hardly expect those in the business world to act on the basis of such sentiments, we rely on laws and institutions to ensure that businesses adhere to the principles of free competition that keep our economy vigorous and maximize the welfare of consumers. The process of adjudication is vital to those laws, in that it serves to clarify the acceptable bounds of business conduct.

In this case, we find that the moratorium agreement between PolyGram and Warner unreasonably restrained trade and constitutes an unfair method of competition. Respondents' restraints on price discounting and advertising are inherently suspect, because experience and economic learning consistently

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show that restraints of this sort dampen competition and harm consumers. Respondents' only proffered justification is not cognizable because it represents a collusive determination that consumers should be deprived of the vigorous competitive offering of certain products to induce them to choose others. Competing businesses contemplating such strategies should be aware that they are antithetical to the fundamental policies of our antitrust laws and will not be countenanced.

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FINAL ORDER

The Commission has heard this matter on Respondents' appeal from the Initial Decision and on briefs and oral argument in support of and in opposition to the appeal. For the reasons stated in the accompanying Opinion of the Commission, the Commission has determined to affirm the Initial Decision and enter the following order. Accordingly,

I.

IT IS ORDERED that, as used in this order, the following definitions shall apply:

1. "PolyGram Holding" means PolyGram Holding, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by PolyGram Holding, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

2. "Decca Music" means Decca Music Group Limited, its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Decca Music Group Limited; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

3. "UMG" means UMG Recordings, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by UMG Recordings, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

4. "UMVD" means Universal Music & Video Distribution Corp., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and

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affiliates controlled by Universal Music & Video Distribution Corp.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

5. “Respondents” means PolyGram Holding, Decca Music, UMG, and UMVD, individually and collectively.

6. “Commission” means the Federal Trade Commission.

7. “Audio Product” means any prerecorded music in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any compact disc, magnetic recording tape, audio DVD, audio cassette, album, audiotape, digital audio tape, phonograph record, electronic recording, or digital audio file (*i.e.*, digital files delivered to the consumer electronically to be stored on the consumer’s hard drive or other storage device).

8. “Video Product” means any prerecorded visual or audiovisual product in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any videocassette, videotape, videogram, videodisc, compact disc, electronic recording, or digital video file (*i.e.*, digital files delivered to the consumer electronically to be stored on the consumer’s hard drive or other storage device).

9. “Seller” means any Person other than a Respondent that produces or sells at wholesale any Audio Product or Video Product.

10. “Joint Venture Agreement” means a written agreement between a Respondent and a Seller that provides that the parties to the agreement shall collaborate in the production or distribution of Audio Products or Video Products (including, without limitation, through the licensing of intellectual property).

11. An Audio Product or Video Product is “Jointly Produced” by a Respondent and a Seller when, pursuant to a written

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agreement between such Respondent and such Seller, each contributes significant assets to the production or distribution of the Audio Product or Video Product (including, without limitation, personal artistic services, intellectual property, technology, manufacturing facilities, or distribution networks) to achieve procompetitive benefits. For example and without limitation, an Audio Product or Video Product is “Jointly Produced” by a Respondent and a Seller when (1) such product is manufactured or packaged by such Seller and sold at wholesale by such Respondent, or (2) such product is manufactured or packaged by such Respondent and sold at wholesale by such Seller.

12. “Person” means both natural persons and artificial persons, including, but not limited to, corporations, partnerships, and unincorporated entities.

13. “Officer, Director, or Employee” means any officer or director or management employee of any Respondent with responsibility for the pricing, marketing, or sale in the United States of Audio Products or Video Products.

14. “United States” means the fifty states, the District of Columbia, the Commonwealth of Puerto Rico, and all territories, dependencies, and possessions of the United States of America.

II.

IT IS FURTHER ORDERED that Respondents shall cease and desist from, directly or indirectly or through any corporate or other device, in or affecting commerce (as “commerce” is defined in the Federal Trade Commission Act), soliciting, participating in, entering into, attempting to enter into, implementing, attempting to implement, continuing, attempting to continue, or otherwise facilitating or attempting to facilitate any combination, conspiracy, or agreement, either express or implied, with any Seller:

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A. To fix, raise, or stabilize prices or price levels in connection with the sale in or into the United States of any Audio Product or any Video Product; or

B. To prohibit, restrict, regulate, or otherwise place any limitation on any truthful, nondeceptive advertising or promotion in the United States for any Audio Product or any Video Product.

III.

IT IS FURTHER ORDERED that:

A. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement to set the prices or price levels for any Audio Product or Video Product when such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

B. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio Product or Video Product when such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

C. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement to set the prices or price levels for any Audio Product or Video Product that is Jointly Produced by such Respondent and such Seller.

D. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio

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Product or Video Product that is Jointly Produced by such Respondent and such Seller.

E. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement, industry code, or industry ethical standard that is: (1) intended to prevent or discourage the advertising, marketing, promotion, or sale to children of Audio Products or Video Products labeled or rated with a parental advisory or cautionary statement as to content, and (2) reasonably tailored to such objective.

F. In any action by the Commission alleging violations of this Order, each Respondent shall bear the burden of proof in demonstrating that its conduct satisfies the conditions of Paragraph(s) III.A., III.B., III.C., III.D. and III.E. of this Order.

IV.

IT IS FURTHER ORDERED that:

A. Within sixty (60) days after the date this Order becomes final, each Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which the Respondent has complied and is complying with this Order.

B. One (1) year after the date this Order becomes final, annually for the next four (4) years on the anniversary of the date this Order becomes final, and at other times as the Commission may require, each Respondent shall file with the Commission a verified written report:

- (1) Setting forth in detail the manner and form in which it has complied and is complying with this Order; and
- (2) Identifying the title, date, parties, term, and subject matter of each agreement between any Respondent and any Seller, entered into or amended on or after the date this

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Order becomes final, that: (a) fixes, raises, or stabilizes prices or price levels in connection with the sale in or into the United States of any Audio Product or Video Product, or (b) prohibits, restricts, regulates, or otherwise places any limitation on any truthful, non-deceptive advertising or promotion in the United States for any Audio Product or any Video Product, other than those Audio Products and Video Products that are Jointly Produced.

PROVIDED, HOWEVER, that Respondents shall not be required to identify in their reports to the Commission any agreement that: (i) was previously identified to the Commission pursuant to Paragraph IV.B.2., and (ii) was not amended following such previous identification.

C. Each Respondent shall retain copies of all written agreements identified pursuant to Paragraph IV.B.2. above; and shall file with the Commission, within ten (10) days' notice to the Respondent, any such written agreements as the Commission may require.

V.

IT IS FURTHER ORDERED that each Respondent shall notify the Commission at least thirty (30) days prior to any proposed change in the Respondent such as dissolution, assignment, sale resulting in the emergence of a successor corporation, or the creation or dissolution of subsidiaries or any other change in the corporation that may affect compliance obligations arising out of the Order.

VI.

IT IS FURTHER ORDERED that, for the purpose of determining or securing compliance with this Order, upon written request, each Respondent shall permit any duly authorized representative of the Commission:

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A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of the Respondent relating to any matters contained in this Order; and

B. Upon five (5) days' notice to the Respondent and without restraint or interference from it, to interview officers, directors, or employees of the Respondent.

VII.

IT IS FURTHER ORDERED that each Respondent shall:

A. Within thirty (30) days after the date on which this Order becomes final, send a copy of this Order by first class mail to each of its Officers, Directors, and Employees;

B. Mail a copy of this Order by first class mail to each person who becomes an Officer, Director, or Employee, no later than (30) days after the commencement of such person's employment or affiliation with the Respondent; and

C. Require each Officer, Director, or Employee to sign and submit to the Respondent within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the Order; (2) represents that the undersigned has read and understands the Order; and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the Order may subject the Respondent to penalties for violation of the Order.

VIII.

IT IS FURTHER ORDERED that this Order shall terminate twenty (20) years after the date on which the Order becomes final.

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COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission ("Commission"), having reason to believe that PolyGram Holding, Inc., a corporation, Decca Music Group Limited, a corporation, UMG Recordings, Inc., a corporation, and Universal Music & Video Distribution Corp., a corporation, hereinafter sometimes collectively referred to as "respondents," have violated the provisions of said Act, and it appearing to the Commission that a proceeding in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

1. Respondent PolyGram Holding, Inc. ("PolyGram Holding") is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware with its office and principal place of business located at 825 Eighth Avenue, New York, New York 10019.
2. Respondent Decca Music Group Limited ("Decca Music") is a corporation organized, existing and doing business under and by virtue of the laws of the United Kingdom, with its office and principal place of business located at 347-353 Chiswick High Road, London, England W4 4HS. Decca Music is successor to, and was formerly named, The Decca Record Company Limited ("Decca Records").
3. Respondent UMG Recordings, Inc. ("UMG") is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 2220 Colorado Avenue, Santa Monica, California 90404. UMG is successor to, and was formerly named, PolyGram Records, Inc. ("PolyGram Records").
4. Respondent Universal Music & Video Distribution Corp. ("UMVD") is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware,

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with its office and principal place of business located at 10 Universal City Plaza, Universal City, California 91608. UMVD became the successor corporation to PolyGram Group Distribution, Inc. ("PolyGram Distribution") when PolyGram Distribution merged with UMVD on May 1, 2000. PolyGram Holding, Decca Music, UMG, and UMVD are all subsidiaries or affiliates of Vivendi Universal S.A., a French corporation.

5. Warner Communications Inc. ("Warner") is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 75 Rockefeller Plaza, New York, New York 10019. Warner is a subsidiary of AOL Time Warner Inc.

6. Warner, acting directly and through certain subsidiaries (collectively, "Warner Music Group"), has for many years been engaged in the business of producing, marketing, and distributing pre-recorded music and videos in the United States and worldwide.

7. PolyGram N.V. ("PolyGram"), a Netherlands corporation, acting directly and through certain subsidiaries (collectively, "PolyGram Music Group"), was for many years engaged in the business of producing, marketing, and distributing pre-recorded music and videos in the United States and worldwide. Among the firms composing the PolyGram Music Group were PolyGram Holding, Decca Records, PolyGram Records, and PolyGram Distribution. In December 1998, PolyGram was acquired by The Seagram Company Ltd., a Canadian corporation. Two years later, The Seagram Company Ltd. merged with Vivendi S.A. and Canal Plus S.A., to form Vivendi Universal S.A.

8. The acts and practices of Warner, PolyGram Holding, Decca Records (predecessor to Decca Music), PolyGram Records (predecessor to UMG), and PolyGram Distribution (predecessor to UMVD), including the acts and practices alleged herein, are in commerce or affect commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

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9. The Three Tenors is a musical joint venture consisting of renowned opera singers Luciano Pavarotti, Placido Domingo, and Jose Carreras. Beginning in 1990, The Three Tenors have come together every four years at the site of the World Cup soccer finals for a combination live concert and recording session. The concert promoter is responsible for producing the master recordings. Prior to each performance, the concert promoter selects one (or more) of the major music/video distribution companies to distribute compact discs, cassettes, videocassettes, and videodiscs derived from the master recordings.

10. Distribution rights to the original 1990 Three Tenors performance, entitled *The Three Tenors*, were acquired by PolyGram Music Group. Distribution rights to the follow-up performance, *The Three Tenors in Concert 1994*, were acquired by Warner Music Group.

11. In a contract dated December 19, 1997, Warner Music Group and PolyGram Music Group agreed to collaborate in the distribution of audio and video products derived from the next Three Tenors World Cup concert, scheduled for Paris on July 10, 1998. Among the important undertakings of the parties were the following:

- (a) Warner Music Group would secure from the concert promoter worldwide audio, home video, and television broadcast rights to the 1998 Three Tenors concert (the "Rights");
- (b) Warner Music Group would exploit the Rights within the United States;
- (c) Warner Music Group would license to PolyGram Music Group the right to exploit the Rights outside of the United States;
- (d) Warner Music Group and PolyGram Music Group would each be entitled to 50 percent of the net profits and net

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losses derived from the worldwide exploitation of the Rights (as well as from the production of a Greatest Hits album and/or a Box Set incorporating the 1990, 1994, and 1998 Three Tenors albums);

- (e) PolyGram Music Group would reimburse Warner Music Group for 50 percent of any advance paid to the concert promoter; and
- (f) other expenses incurred by either Warner Music Group or PolyGram Music Group in the exploitation of the Rights (*e.g.*, manufacture, advertising, marketing, and distribution) would be deducted from revenues for purposes of calculating net profits (losses).

12. Warner Music Group and PolyGram Music Group were concerned that the audio and video products that would be derived from the upcoming Three Tenors concert in Paris would be neither as original nor as commercially appealing as the earlier Three Tenors releases.

13. In 1998, Warner and certain other members of Warner Music Group, and PolyGram Holding, Decca Records, PolyGram Records, and PolyGram Distribution, entered into an agreement not to compete. PolyGram Holding, Decca Records, PolyGram Records, and PolyGram Distribution agreed not to discount and not to advertise the 1990 Three Tenors album and video from August 1, 1998 through October 15, 1998. In return, Warner and certain other members of Warner Music Group agreed not to discount and not to advertise the 1994 Three Tenors album and video from August 1, 1998 through October 15, 1998. The parties referred to their agreement not to compete worldwide during this period as the “moratorium.”

14. The third Three Tenors album and video, entitled *The Three Tenors -- Paris 1998*, were released in the United States on August 18, 1998, and were distributed in the United States by Warner Music Group. During the moratorium period, August 1

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through October 15, PolyGram Holding, Decca Records, PolyGram Records, and PolyGram Distribution refrained from discounting or advertising the 1990 Three Tenors album and video in the United States. During this period, Warner and Warner Music Group likewise refrained from discounting or advertising the 1994 Three Tenors album and video in the United States.

15. The moratorium agreement was not reasonably necessary to the formation or to the efficient operation of the joint venture between Warner Music Group and PolyGram Music Group.

16. The effect of the moratorium agreement among Warner, certain other members of Warner Music Group, PolyGram Holding, Decca Records, PolyGram Records, and PolyGram Distribution, as alleged herein, was to restrain competition unreasonably, to increase prices, and to injure consumers.

Violations Alleged

17. As set forth in Paragraph 13 above, Warner, PolyGram Holding, Decca Records (predecessor to Decca Music), PolyGram Records (predecessor to UMG), and PolyGram Distribution (predecessor to UMVD) agreed to restrict price competition, in violation of Section 5 of the Federal Trade Commission Act, as amended.

18. As set forth in Paragraph 13 above, Warner, PolyGram Holding, Decca Records (predecessor to Decca Music), PolyGram Records (predecessor to UMG), and PolyGram Distribution (predecessor to UMVD) agreed to forgo advertising, in violation of Section 5 of the Federal Trade Commission Act, as amended.

19. The acts and practices of respondents, as alleged herein, constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45. Such acts and practices, or the effects thereof, will continue or recur in the absence of appropriate relief.

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NOTICE

Proceedings on the charges asserted against you in this complaint will be held before an Administrative Law Judge (ALJ) of the Federal Trade Commission, under Part 3 of the Commission's Rules of Practice, 16 C.F.R. Part 3. A copy of Part 3 of the Rules is enclosed with this complaint.

You may file an answer to this complaint. Any such answer must be filed within 20 days after service of the complaint on you. If you contest the complaint's allegations of fact, your answer must concisely state the facts constituting each ground of defense, and must specifically admit, deny, explain, or disclaim knowledge of each fact alleged in the complaint. You will be deemed to have admitted any allegations of the complaint that you do not so answer.

If you elect not to contest the allegations of fact set forth in the complaint, your answer shall state that you admit all of the material allegations to be true. Such an answer will constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the ALJ will file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. Such an answer may, however, reserve the right to submit proposed findings and conclusions and the right to appeal the initial decision to the Commission under Section 3.52 of the Commission's Rules of Practice.

If you do not answer within the specified time, you waive your right to appear and contest the allegations of the complaint. The ALJ is then authorized, without further notice to you, to find that the facts are as alleged in the complaint and to enter an initial decision and a cease and desist order.

The ALJ will schedule an initial prehearing scheduling conference to be held not later than 14 days after the last answer is filed by any party named as a respondent in the complaint. Unless

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otherwise directed by the ALJ, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

A hearing on the complaint will begin on October 29, 2001, at 10:00 A.M. in Room 532, or such other date as determined by the ALJ. At the hearing, you will have the right to contest the allegations of the complaint and to show cause why a cease and desist order should not be entered against you.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceeding in this matter that the respondents are in violation of Section 5 of the Federal Trade Commission Act, as amended, as alleged in the complaint, the Commission may order such relief as is supported by the record and is necessary and appropriate, including, but not limited to, an order that requires the following:

1. Each respondent shall cease and desist, either directly or indirectly, from entering into, seeking to enter into, continuing, or implementing any agreement to fix, raise, or stabilize prices or price levels, or to engage in any other pricing action in connection with the sale of any audio product or any video product.
2. Each respondent shall cease and desist, either directly or indirectly, from entering into, seeking to enter into, continuing, or implementing any agreement that prohibits, restricts, impedes, or places limitations on any truthful, non-deceptive advertising or promotion for any audio product or any video product.

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3. Each respondent shall mail a copy of the Commission's complaint and order in this matter, along with a letter from such respondent's chief executive officer stating that it will abide by the terms of this order, to each of its directors, officers, and employees.
4. Each respondent shall file periodic compliance reports with the Commission.
5. Each respondent shall take such other measures as are appropriate to correct or remedy, or to prevent the recurrence of, the anticompetitive practices engaged in by respondents.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this thirtieth day of July, 2001, issues its complaint against said respondents.

By the Commission.

Initial Decision

INITIAL DECISION

By James P. Timony, Administrative Law Judge

FINDINGS OF FACT

I. BACKGROUND

A. History

1. The Federal Trade Commission ("FTC") issued a complaint on July 31, 2001, alleging that Respondents PolyGram Holding, Inc. ("PolyGram Holding"), Decca Music Group Limited ("Decca MGL"), UMG Recordings, Inc. ("UMG"), and Universal Music & Video Distribution Corp. ("UMVD") agreed with competitor Warner Communications Inc. ("Warner Communications"): (a) to restrict price competition, and (b) to forgo advertising, violating Section 5 of the Federal Trade Commission Act.

2. On September 17, 2001, the Commission accepted a consent agreement with Warner Communications enjoining agreements with a competitor to fix prices or limit truthful, non-deceptive advertising or promotion. (Warner Communications Inc., C-4025 (Sept. 17, 2001)).

3. A trial of this matter commenced on March 5, 2002. Complaint Counsel called four witnesses. Anthony O'Brien, from Atlantic Recording Corp. (an affiliate of Warner Communications); Rand Hoffman, from PolyGram Holding; Professor Catherine Moore, the director of the Music Business Program at New York University; and Dr. Stephen Stockum, an economist. Respondents rested without calling any witnesses. Both sides introduced numerous documents and deposition testimony of 20 witnesses.

B. Three Tenors

4. The Three Tenors are opera singers Jose Carreras, Placido Domingo, and Luciano Pavarotti. Stip. P2. Since 1990, they sang

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every four years at the site of the World Cup soccer finals n1 for a live concert and recording session. Stip. P84.

n1 The World Cup is an international soccer tournament. The World Cup final match was located in Rome in 1990, in Los Angeles in 1994, and in Paris in 1998. Stip. P83.

5. The Three Tenors recorded three albums of arias and songs. The first album, The Three Tenors ("3T1"), was released in 1990 by PolyGram. The second album, Three Tenors in Concert 1994 ("3T2"), was released in 1994 by Warner. The third album, The Three Tenors--Paris 1998 ("3T3"), was released in 1998 by PolyGram and Warner. Stip. P85.

C. Respondents

6. Each of the four Respondents is a subsidiary of Vivendi Universal S.A., a French corporation. Stip. P5. Respondents UMG and UMVD are subsidiaries of Respondent PolyGram Holding. Stip. P14.

7. Respondent PolyGram Holding is a Delaware corporation with its office and principal place of business located in New York, NY. Stip. P6.

8. Respondent Decca MGL is a United Kingdom corporation with its office and principal place of business located in London, England. Decca MGL was formerly named, The Decca Record Company Limited ("Decca"). Stip. P7.

9. Respondent UMG is a Delaware corporation with its office and principal place of business located in Santa Monica, CA. UMG was formerly named, PolyGram Records, Inc. ("PolyGram Records"). Stip. P8.

10. Respondent UMVD is a Delaware corporation with its office and principal place of business located in Universal City, CA. UMVD is successor to PolyGram Group Distribution, Inc. ("PGD"). Stip. P9.

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11. PolyGram is a group of firms--affiliated with PolyGram N.V.--engaged in the producing, marketing, and distributing recorded music and videos in the United States and worldwide. Comprising Polygram in 1998 were PolyGram Holding, PolyGram Records, PGD, and Decca, all subsidiaries of PolyGram N.V. Stip. PP13, 15.

12. In 1998, Decca owned 3T1 and marketed the album. Stip. P95; F. 102-07. PolyGram Classics & Jazz ("PolyGram Classics"), a division of PolyGram Records, also had marketing responsibilities for 3T1. Stip. PP79, 132. PGD distributed 3T1 in the United States. Stip. P134. PolyGram Holding negotiated the collaboration between PolyGram and Warner with regard to 3T3. Hoffman, Tr. 406-07, 479; F. 65.

13. During 1998, PolyGram Holding provided services to its subsidiaries, including legal, financial, business affairs, and human resources services. Stip. P16; Hoffman, Tr. 287.

14. Decca was a music "label." Decca develops, acquires, and produces recorded music. Stip. P74. From 1990 to 1998, Decca owned the copyright to the master recording of 3T1. Stip. P95. Decca did business in the United States under the name London Records. Stip. P96.

15. In 1998, PolyGram Classics was a division of PolyGram Records. Stip. P17. PolyGram Classics was a "label group," assisting PolyGram labels, including Decca, Philips Classics, Deutsche Grammophon, and Verve. PolyGram Classics engaged in marketing, promoting, pricing and advertising 3T1 in the United States. Stip. PP79, 132.

16. In 1998, PGD distributed and sold audio and video products in the United States. Stip. P82. PGD serviced all of the PolyGram labels and joint ventures. Caparro Dep. (CX 609) at 12. During the 1990s, PGD executed PolyGram Classics' marketing strategy as it related to retailers. Caparro Dep. (CX609) at 25-26.

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17. Since 1990, compact disc, audio cassette, and video cassette versions of 3T1 were distributed in the United States by PGD, and by its successor UMVD. Stip. P91. PGD decided the wholesale price and the advertising strategy for audio and video versions of 3T1 sold in the United States. Stip. P133.

18. In December 1998, PolyGram N.V. was acquired by The Seagram Company Ltd. ("Seagram"). The music businesses of PolyGram N.V. (i.e., Polygram) combined with the music businesses of Seagram to form Universal Music Group ("Universal"). Two years later, Seagram merged with Vivendi S.A. and Canal Plus S.A., to form Vivendi Universal S.A. Stip. P18.

19. Most of the PolyGram employees in this case were with Universal after the merger, including: Chris Roberts, former President of PolyGram Classics; Rand Hoffman, the former Senior Vice President of Business Affairs for PolyGram Holding; Bert Cloeckert, the former Vice President for PolyGram in Continental Europe; and Kevin Gore, the former Senior Vice President and General Manager of PolyGram Classics. Stip. PP24, 26, 29, 32; Roberts Dep. Vol. 1 (JX 92) at 5-6, 8; Hoffman Dep. (JX 99) 6-7; Cloeckert Dep. Vol. 1 (JX 97) at 5-7; Gore Dep. (JX 87) at 6-7.

D. Warner

20. Warner Communications, a subsidiary of AOL Time Warner Inc., is a Delaware corporation with its office and principal place of business located in New York, NY. Stip. P19. Warner Music Group ("Warner") refers to a group of firms--affiliated with Warner Communications--engaged in the business of producing, marketing, and distributing recorded music and videos in the United States and worldwide. Among the firms comprising Warner are Atlantic Recording Corp. ("Atlantic") and Warner Music International ("WMI"). Stip. P20.

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21. Atlantic is a label engaged in the business of developing, acquiring, and producing recorded music. Atlantic operates primarily in the United States. Stip. P75.

22. WMI manages and coordinates the music operations of Warner operating companies located outside of the United States. Stip. P21.

E. Interstate Commerce

23. PolyGram and Warner are each vertically integrated producers and distributors of recorded music. Answer PP6-7. PolyGram and Warner distribute their products through operating companies ("opcos")--responsible for sales in a particular country. Stip. P148. In 1998, PolyGram Classics was the "opco" for the United States for classical music produced by PolyGram. Greene Dep. at 40.

24. Respondent PolyGram Holding, PolyGram Records (the predecessor to Respondent UMG) and PGD (the predecessor to Respondent UMVD) all engage in, or engaged in, acts and practices that affect commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44. Stip. PP10-12.

25. In 1998, recorded music products produced by Decca, including 3T1, were distributed throughout the United States, primarily by PGD. Stip. PP76, 134; Caparro Dep. (CX 609) at 24-25. In 1998, PGD distributed recorded music and videos, including 3T1, to retailers in each of the fifty states and in the District of Columbia, and maintained a warehouse facility in Indiana from which it distributed recorded music and videos. Stip. P135; Caparro Dep. (CX 609) at 15, 24-25. Today, recorded music products produced by Decca MGL (including 3T1) are distributed throughout the United States, primarily by UMVD. Stip. P77.

26. Warner distributed 3T2 and 3T3 in the United States since 1994. O'Brien, Tr. 402-03; O'Brien Dep. (JX 100) at 19.

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PolyGram and Warner negotiated the Three Tenors moratorium agreement in the United States, including in a meeting in New York, NY in March 1998. F. 90; CX 382.

II. OLDER THREE TENORS RECORDINGS**A. The 1990 Three Tenors Concert**

27. The Three Tenors first performed together at the Baths of Caracalla in Rome, on the eve of the 1990 World Cup final match in July 1990. Stip. P86.

28. PolyGram acquired from the concert promoter distribution rights to recordings from the 1990 Three Tenors performance in Rome. CX 213; CX 215; Stip. P89. Compact disc, audio cassette, and video cassette versions of 3T1 were released by PolyGram in August 1990. Stip. P90.

29. 3T1 became the best-selling classical album of all time. Stip. P100. More than twelve million audio units, and three million video units of 3T1 have been sold worldwide. Stip. PP101-102. 3T1 was the number one classical album in the United States for 1991 and 1992, and was the third highest selling classical album for 1993. CX 584; CX 585; CX 586.

B. The 1994 Three Tenors Concert

30. On July 16, 1994, the Three Tenors performed at Dodger Stadium in Los Angeles, on the eve of the final match of the World Cup. Stip. P103. The 1994 Three Tenors concert was organized by concert promoter Tibor Rudas. CX 246 at 3TEN0007695. All of the major music companies, including PolyGram and Warner, vied to acquire distribution rights for products to be derived from the 1994 Three Tenors concert. CX 247 at 3TEN00011271.

31. During 1993, PolyGram negotiated with Rudas to acquire the right to distribute audio and video recordings of the 1994 Three Tenors concert. Stip. P104. PolyGram and Rudas were

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unable to agree upon the final terms of a contract. Kronfeld Dep. (JX 86) at 21-23; CX 228; CX 230; CX 231; Constant Dep. (JX 96) at 80-81.

32. Warner acquired from Rudas the right to distribute audio and video recordings of the 1994 Three Tenors concert. Stip. P105.

33. At the time of the 1994 concert, Pavarotti was obligated by contract to record exclusively for Decca. Stip. P108. In 1994, Decca agreed, in exchange for certain considerations, to waive its rights to the exclusive services of Pavarotti as a recording artist, thereby permitting Pavarotti to perform on an audio and video product distributed by Warner. Stip. P109.

34. Upon the release of 3T2 in 1994 and until 1998, PolyGram (3T1) and Warner (3T2) competed to sell their Three Tenors albums. F. 200-34.

35. Warner considered 3T2 to be a business success. F. 222; O'Brien, Tr. 406.

III. THE MORATORIUM AGREEMENT

36. In 1997, Warner and PolyGram agreed to collaborate on the distribution of products derived from the 1998 Three Tenors concert. Warner would distribute 3T3 in the United States, and PolyGram would distribute 3T3 outside of the United States. F. 59.

37. PolyGram and Warner were concerned that 3T3 would lose sales to 3T1 and 3T2. F. 234-35, 239, 268-73.

38. PolyGram and Warner agreed to a "moratorium" on the discounting and advertising of their older Three Tenors products in the weeks surrounding the release of 3T3. They agreed at a meeting in March 1998, in oral and written communications between PolyGram and Warner representatives in late June/early

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July 1998. F. 137-53. The agreement was approved by senior executives at PolyGram and Warner. F. 83, 95, 123, 152.

A. Agreement to Restrict Discounting and Advertising

39. PolyGram and Warner executives admit that there was an agreement to restrict discounting and advertising. F. 40-42.

40. In 1998, Anthony O'Brien was Executive Vice President and Chief Financial Officer of Atlantic Records, and Warner's principal contact with PolyGram for the 3T3 project. Stip. PP49, 50. O'Brien testified at trial that PolyGram and Warner agreed to restrict the discounting and advertising of 3T1 and 3T2 during 1998 in the United States and worldwide. O'Brien, Tr. 390.

41. Rand Hoffman, Senior Vice President for Business Affairs for PolyGram Holding during 1998, also acknowledged the existence of the moratorium agreement. Hoffman, Tr. 280.

42. Paul Saintilan, the Senior Marketing Director for Decca/PolyGram, acknowledged that PolyGram and Warner agreed to restrict the marketing of 3T1 and 3T2. Saintilan Dep. (JX 94) at 47-48.

43. Contemporaneous internal Warner and PolyGram business documents acknowledge that PolyGram and Warner agreed to limit the discounting and advertising of 3T1 and 3T2 for a period of time around the release of 3T3. JX 1; JX 2; JX 3; JX 4; JX 5 at UMG001527; JX 6; JX 9; JX 28 at UMG001487; JX 40; JX 42; JX 43 at UMG00479-80; JX 48; JX 62 at 3TEN00003536-38; JX 63; JX 64; JX 66; JX 72; JX 74; CX 204; CX 404; CX 429.

B. General Terms

44. PolyGram and Warner agreed to forgo discounts and promotions for the older Three Tenors products for the period from August 1, 1998 through October 15, 1998 (the "moratorium period"). O'Brien, Tr. 390, 443-44; Hoffman, Tr. 311-12; JX 4 at UMG000208; CX 202; JX 9-A.

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45. PolyGram and Warner agreed not to "aggressively" discount 3T1 or 3T2 during the moratorium period. Neither party would offer the older ("catalogue") Three Tenors products at a price that would provide an incentive to retailers to sell the product at a price below suggested retail price, or prominently to position the product in the store. O'Brien, Tr. 442-43; Hoffman, Tr. 311-12; JX 3; JX 9-A.

46. PolyGram and Warner agreed not to advertise or promote 3T1 or 3T2 during the moratorium. O'Brien, Tr. 390, 436; JX 1-A; JX 4 at UMG000208.

47. PolyGram and Warner agreed that the moratorium would apply to audio and video products. O'Brien, Tr. 446; Hoffman, Tr. 326; JX 4 at UMG000208; JX 9-A; CX 202; CX 203 at UMG004911.

48. PolyGram and Warner agreed that the moratorium would apply to the marketing of 3T1 and 3T2. O'Brien, Tr. 390; Hoffman, Tr. 312; JX 9-A.

49. PolyGram and Warner understood that, outside of the United States, there might be some discounting of catalogue Three Tenors products during the moratorium period. JX 74 at UMG000203.

50. PolyGram asked Anthony O'Brien that Atlantic not "overstock" retailers with 3T2 in the period prior to August 1, 1998. PolyGram did not want product sold by Atlantic prior to August 1 to be offered by retailers at a discount price after August 1, 1998. O'Brien instructed Atlantic's sales department not to overstock retailers in the United States in the period leading up to August 1, 1998. O'Brien, Tr. 444-45.

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IV. NEGOTIATION OF THE MORATORIUM

A. PolyGram and Warner Agree to Collaborate

51. During 1996, concert promoter Tibor Rudas approached Warner to discuss the next Three Tenors project: a huge open-air concert in front of the Eiffel Tower scheduled to coincide with the World Cup finals in Paris in July 1998. CX 319 at UMG004205; O'Brien, Tr. 407.

52. Initially, Warner considered distributing the 3T3 products without a collaboration with PolyGram. O'Brien, Tr. 550-51; CX 317; CX 321 at 3TEN00004277; **CX 322** (in camera).

53. During the negotiation with Rudas, Warner was concerned that Rudas might make a deal for 3T3 with another music company. CX 354 at 3TEN00002271; **CX 355 at 3TEN00003298** (in camera).

54. During 1996, Rudas also discussed with PolyGram the possibility of PolyGram acquiring the rights to the 1998 Three Tenors concert. Stip. P122; CX 315. In November 1996, Decca/PolyGram executives negotiated with Rudas and requested PolyGram's senior executives' approval to make an offer for the rights to the 3T3 project; PolyGram did not anticipate collaboration with Warner. CX 327.

55. In 1998, as in 1994, Pavarotti was under exclusive contract to record for PolyGram. Stip. P125. In the spring of 1997, Ahmet Ertegun, the Chairman of Atlantic (a Warner subsidiary based in the United States) met with Alain Levy, his counterpart at PolyGram, "to ask that PolyGram allow Luciano Pavarotti to record the project for [Warner]." CX 366 at 3TEN00007334.

56. At the meeting, PolyGram's counter-offer was that Warner and PolyGram should "be partners for the 1998 concert project and all derivative product[s]." CX 366 at 3TEN00007334. See also JX 22 at UMG001342; CX 345 at UMG001635.

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57. Warner calculated that, on the conservative assumption that the third Three Tenors album sold only 60 percent as well as 3T2, then Warner and PolyGram would each make over \$ 5.5 million. CX 366 at 3TEN00007334. If the profits had been projected to be only \$ 3 million, Warner still would have gone ahead with the deal. O'Brien, Tr. 412.

B. PolyGram and Warner Negotiate

58. By a series of contracts dated October 14, 1997, in return for an \$ 18 million advance and other consideration, Rudas licensed to Warner the worldwide audio, video, and home television rights to the 1998 Three Tenors concert and a box set and greatest hit albums from 3T1, 3T2 and 3T3 (the "3T3 Rights"). Stip. P126; **JX 11** (in camera); **CX 205** (in camera); **CX 206** (in camera).

1. Specific terms of the collaboration

59. Pursuant to the Concert/License Agreement dated December 19, 1997, Warner and PolyGram agreed to collaborate on the distribution of products derived from the 1998 Three Tenors World Cup concert. The contract is formally between Warner Benelux B.V. and PolyGram S.A. Stip. P127; JX 10.

60. The contract between PolyGram and Warner provides that:

- a. Atlantic, a Warner affiliate, is responsible for exploiting the 3T3 Rights within the United States. JX 10-N. n2
- b. Warner licenses to PolyGram the right to exploit the 3T3 Rights outside of the United States. JX 10-N-O.
- c. Warner and PolyGram are separately responsible for developing and implementing marketing plans for their respective territories. Neither party has the right

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to approve or disapprove the other's marketing plans. JX 10-P, T. However, Warner and PolyGram agree to "consult and coordinate" with respect to marketing and promotion activities in connection with the exploitation of the 3T3 Rights. JX 10-P.

d. Warner and PolyGram are each entitled to 50 percent of the net profits and net losses derived from the worldwide exploitation of the 3T3 Rights (as well as from the production of a Greatest Hits album and/or a Box Set incorporating the 1990, 1994, and 1998 Three Tenors albums). JX 10-Q.

e. PolyGram agrees to reimburse Warner for 50 percent of the \$ 18 million advance paid to Rudas. JX 10-S.

f. Other expenses incurred by either Warner or PolyGram in the exploitation of the 3T3 Rights are to be deducted from revenues for purposes of calculating net profits (losses). JX 10-Q-S.

n2 To "exploit" a recording is a music industry term that encompasses selling, advertising, marketing, and promoting the album. O'Brien 422:6-11.

2. Limited covenant not to compete

61. In negotiating the terms of the 1998 Three Tenors project, PolyGram and Warner discussed the scope of a covenant not to compete. Several iterations of this contract provision were exchanged over a one month period. **CX 357** (in camera); **CX 359** (in camera); **CX 361** (in camera).

62. PolyGram and Warner decided that for four years following the release of 3T3, neither PolyGram nor Warner would release a new Three Tenors album. However, the contract provides that PolyGram shall be free to exploit 3T1, and that Warner shall be free to exploit 3T2.

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- a. The original draft of the Concert/License Agreement, prepared by PolyGram and forwarded to Warner on November 19, 1997, contained no covenant not to compete. **CX 357** (in camera); **Hoffman, Tr. 374** (in camera).
- b. On December 8, 1997, Warner requested that the draft Concert/License Agreement be modified to include a provision restricting both PolyGram and Warner from releasing a new Three Tenors album. **CX 358** at 3TEN00002443 (in camera). Warner was concerned that a new Three Tenors album would capture sales from 3T3 and diminish the profitability of the venture. O'Brien, Tr. 420.
- c. PolyGram was also concerned that a new Three Tenors album may interfere with sales of 3T3 and diminish its profitability. Hoffman, Tr. 305. PolyGram forwarded to Warner a second draft of the Concert/License Agreement. The second draft, dated December 15, 1997, includes a provision captioned "Holdback on Future Three Tenors Products." The Holdback Provision provides that neither PolyGram nor Warner shall release a Three Tenors album until June 2002. **CX 359 at 3TEN00002410** (in camera).
- d. On December 14, 1997, Warner communicated to PolyGram its request that the Holdback Provision be amended: **[redacted] [redacted] CX 359 at 3TEN00002410** (in camera).
- e. On December 15, 1997, PolyGram forwarded to Warner a revised version of the Contract/License Agreement. PolyGram amended the Holdback Provision so as to exclude any restriction on the exploitation of 3T1 and 3T2. **CX361 at 3TEN00002400** (in camera); O'Brien, Tr. 421.

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f. On December 18, 1997, Warner requested an additional modification to the Holdback Provision. **[redacted] [redacted] [redacted]** Thus, the draft contract was amended to prohibit--for a four year period--the repackaging of either 3T1 (by PolyGram) or 3T2 (by Warner). **CX 362 at 3TEN00002316** (in camera).

63. The parties' non-compete obligation is contained in Paragraph 9 of the final, executed Concert/License Agreement:

Holdback on Future "Three Tenors" Products:
Neither Warner nor PolyGram (nor any of their respective parents or affiliates) shall release any phonograph record or audiovisual device embodying the joint performances of all of the Artists (whether pre-existing or newly recorded), anywhere in the world, until June 1, 2002, unless such release is pursuant to this agreement. Nothing contained in this paragraph 9 shall be construed to prohibit (a) Warner from continuing to exploit the 1994 Album or (b) PolyGram from continuing to exploit the 1990 Album (as defined in the Rights Agreements).

JX 10-U-V at UMG001076-77.

64. As of the date the Concert/License Agreement was entered into, PolyGram did not know Warner's plans for the exploitation of 3T2 upon the release of 3T3. Hoffman, Tr. 305. As of the date the Concert/License Agreement was entered into, Warner did not know PolyGram's plans for the exploitation of 3T1 upon the release of 3T3. O'Brien, Tr. 501, 548.

65. Although the Concert/License Agreement is formally between Warner Benelux B.V. and PolyGram S.A., the Holdback Provision was understood by both parties to apply to all Warner affiliates and to all PolyGram affiliates. Hoffman, Tr. 305-07; O'Brien, Tr. 421-22. Rand Hoffman, the PolyGram Holding executive who negotiated the Concert/License Agreement,

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understood his role in these negotiations as representing all of PolyGram, and not just the French company (PolyGram S.A.) that ultimately executed the agreement. Hoffman, Tr. 307; Stip. P29.

3. Repertoire

66. Warner, Polygram and Rudas negotiated who would control the repertoire for the 1998 Three Tenors concert and recordings. Warner and PolyGram recognized that the success of the new Three Tenors album was tied to the repertoire. The music companies wanted to be sure that the repertoire on 3T3 would be "distinctive," and that it would not repeat selections from the earlier Three Tenors recordings. Roberts Dep. (JX 92) at 12-16; Hoffman, Tr. 300; O'Brien, Tr. 410; CX 331; CX 343; CX 402; CX 330 at UMG000512.

67. Warner and PolyGram proposed to Rudas that they should have the right to approve a significant part of the repertoire to be performed and recorded at the 1998 Three Tenors concert. **CX 322 at 3TEN00006987** (in camera); CX 337; CX 340 at 3TEN00000523; CX 349 at 3TEN00000520; CX 354 at 3TEN0002272; O'Brien, Tr. 410.

68. Rudas insisted that he and the artists should control the choice of songs. CX 334; O'Brien, Tr. 410.

69. In 1997, Phil Wild was Executive Vice President for Atlantic/Warner. In a memo to senior management, dated November 7, 1997, Wild identified the repertoire issue as one of the most significant business risks presented by the Three Tenors transaction. CX 354 at 3TEN00002272; see also CX 356 at 3TEN00002249; O'Brien, Tr. 418.

70. Wild's memo identifies and discusses several other "significant business risks" associated with the 3T3 transaction. Wild does not identify as a problem free-riding, consumer confusion, or difficulties in developing an effective marketing strategy for 3T3. CX 354 at 3TEN00002271-00002273.

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71. PolyGram and Warner agreed to forgo the right to approve the repertoire for the 1998 concert. CX 356 at 3TEN00002249; JX 22 at UMG001342; O'Brien, Tr. 418.

72. [redacted] [redacted] [redacted] [redacted] [redacted]
[redacted]

**C. PolyGram and Warner Consider Ways to Distinguish
3T3**

73. In 1996 and 1997, prior to agreeing to distribute 3T3, both PolyGram and Warner were concerned that the 1998 Three Tenors album would be neither as original nor as commercially appealing as the 1990 and 1994 releases. CX 318 at UMG004146, UMG004150; CX 321 at 3TEN000004277; CX 424 at UMG003563.

**1. PolyGram and Warner seek to develop a unique identity
for 3T3**

74. PolyGram and Warner considered marketing strategies aimed at creating a unique identity for the 1998 album, distinct from the previous Three Tenors recordings. Saintilan Dep. (JX 94) at 101; CX 381 at 3TEN00000247; CX 386 at UMG004596; CX 423 at UMG003603.

75. PolyGram executives wished to differentiate the 1998 concert by including a guest performer. Stip. P128; Roberts Dep. (JX 92) at 25-27. However, this suggestion was rejected by the Tenors. Roberts Dep. (JX 92) at 25-26; CX 318 at UMG004150.

76. PolyGram considered the writing of original songs from Andrew Lloyd Webber, Elton John, Stevie Wonder, or, from writers associated with Celine Dion, Barbra Streisand, Andrea Bocelli and Whitney Houston. CX 485 at UMG004182. See also CX 331 at UMG004183-184. These ideas were not implemented.

77. PolyGram and Warner discussed "positioning" themes for 3T3. Positioning means "creating an identity or a set of messages

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around a CD that differentiate [it] from other CDs." Saintilan Dep. (JX 94) at 61. For example, emphasizing "that it was a spectacular Parisian event, that it was an awesome spectacle with a completely different context from either the '94 album or the '90 album." Saintilan Dep. (JX 94) at 101-02.

78. The parties also recognized the desirability of designing packaging for the 1998 Three Tenors products that was "as different as possible from the two previous releases." CX 383 at UMG003284; JX 26 at UMG000372; Saintilan Dep. (JX 94) at 66-67.

2. Rudas promises an all-new repertoire

79. On January 6, 1998, Tibor Rudas publicly announced that the Three Tenors would perform in Paris in front of the Eiffel Tower, on July 10, 1998, as part of the World Cup celebrations. Rudas promised "a totally new repertoire of operatic arias and world-renowned popular songs." CX 380 at 3TEN00003979.

80. Rudas assured the music companies that the album to be recorded in Paris would consist of new songs not appearing on the prior two albums. CX 387 at UMG003148.

81. The message that 3T3 would contain all new repertoire was one of the promotional themes presented to the media by PolyGram and Warner. CX 477 at 3TEN00008809; Saintilan Dep. (JX 94) at 112; CX 496; JX 82 at UMG003855.

82. Despite the desire for all new repertoire for 3T3 to increase the likelihood of 3T3's commercial success, PolyGram and Warner concluded that the repertoire was disappointing. F. 133-36.

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V. MORATORIUM AGREEMENT**A. Not to Promote Catalogue Products**

83. The idea of a moratorium came from Chris Roberts, President of PolyGram Classics. Saintilan Dep. (JX 94) at 41. Roberts was concerned about the activities of PolyGram's own operating companies, and wanted to be sure that they did not promote 3T1 in a way that would divert sales from 3T3. Saintilan Dep. (JX94) at 41, 44-45. Roberts expressed this concern to Paul Saintilan, PolyGram's employee responsible for managing the marketing of 3T3. Saintilan Dep. (JX94) at 41-42.

84. In early 1998, Paul Saintilan relayed to PolyGram operating companies Chris Roberts' view that 3T1 should not be promoted in a way that captures sales from 3T3, during its release. PolyGram operating companies replied that if Warner was promoting 3T2, they wanted to be free to promote 3T1. Saintilan Dep. (JX 94) at 41-42; Saintilan Dep. (JX 94) at 46.

1. Marketing of older albums

85. On January 29, 1998, representatives of PolyGram and Warner first met to discuss "marketing and operational issues" relating to the release of 3T3. Saintilan Dep. (JX 94) at 56-57. The minutes of the January 29 meeting, prepared by Paul Saintilan shortly after the meeting, are in evidence as CX 383. Saintilan Dep. (JX94) 55-56.

86. The following persons attended the January 29, 1998 meeting: From Warner, Pat Creed, Vicky Germaise, and Margo Scott. From PolyGram, Chris Roberts (PolyGram Classics), Rand Hoffman (PolyGram Holding), Roger Lewis (Decca), and Paul Saintilan (Decca). Wayne Baruch, a representative of Rudas also attended. CX 383 at UMG003282; Saintilan Dep. (JX 94) at 56.

87. The marketing of 3T3 was discussed at the January 29, 1998 meeting. Chris Roberts (PolyGram Classics) raised with the group his "general concern" over how older Three Tenors

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products would be marketed upon the release of 3T3. Saintilan Dep. (JX 94) at 42-43. One option, Roberts indicated, was to "impose an ad moratorium until November 15." CX 383 at UMG00328; Saintilan Dep. (JX 94) at 72-73. There were "no concrete discussions" regarding the proposed advertising moratorium. Roberts raised the issue of advertising older Three Tenors albums, and suggested that it could be resolved at some future date. Saintilan Dep. (JX 94) at 42-43.

88. At the January 29, 1998 meeting, PolyGram and Warner did not reach any agreement. Saintilan Dep. (JX 94) at 73, 109-10.

89. At an internal PolyGram meeting on February 9, 1998, Saintilan noted that there were "No restrictions on 1990/1994 products." CX 386 at UMG004596.

2. Restrict the marketing of 3T1 and 3T2

90. The next meeting of PolyGram and Warner to discuss the 3T3 project was held in New York on March 10, 1998. CX 383 at UMG003289; Saintilan Dep. (JX 94) at 75. Between the January 29 meeting and the March 10 meeting, there had been no communications between PolyGram and Warner relating to the proposed Three Tenors moratorium. Saintilan Dep. (JX 94) at 75. Saintilan's notes from the March 10 meeting, prepared on or about March 10, 1998, are in evidence as JX 5. Saintilan Dep. (JX 94) at 110-11.

91. The following persons attended the March 10, 1998 meeting: From PolyGram, Roger Lewis (Decca), Paul Saintilan (Decca), Rand Hoffman (PolyGram Holding), and Alex Darbyshire (PolyGram Video). From Warner, Vicky Germaise, Pat Creed, and Margo Scott. Wayne Baruch representing Rudas also attended. JX 5 at UMG001523; Hoffman, Tr. 308-09.

92. At the March 10, 1998 meeting, PolyGram and Warner discussed the marketing of 3T1 and 3T2. Saintilan Dep. (JX 94) at 113. Saintilan's notes of the March 10, 1998 meeting state that, at

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the meeting, the parties agreed "that a big push on catalogue shouldn't take place before November 15." JX 5 at UMG001527; see also CX 388 at 3TEN0000800.

93. Catalogue is a music industry term that refers to older albums that continue to be offered for sale by a music company. Hoffman, Tr. 309-10; O'Brien, Tr. 394.

94. The agreement between PolyGram and Warner to forgo a "big push" on catalogue products was explained by Saintilan at his deposition. According to Saintilan, at the March 10, 1998 meeting, PolyGram and Warner agreed to observe a "window" or "moratorium" at the time of the release of 3T3 in which price discounting and promotion of 3T1 and 3T2 would not take place. Saintilan Dep. (JX 94) 115-16.

95. Roger Lewis, President of Decca, attended the March 10, 1998 meeting and discussed the marketing of 3T1 and 3T2. Lewis approved of the moratorium agreement. Saintilan Dep. (JX 94) at 117.

96. Saintilan understood that, at this meeting, a commitment to the moratorium was made by Decca for all PolyGram companies worldwide, including the PolyGram affiliates in the United States. Saintilan understood that a commitment to the moratorium was made by the Warner representatives on behalf of all Warner companies worldwide, including the Warner operating companies in the United States. Saintilan Dep. (JX 94) at 124-25.

97. During the March 10, 1998 meeting, the starting date for the moratorium was not specified. JX 5 at UMG001527.

3. The moratorium applied in the United States

98. The understanding reached by PolyGram and Warner at the March 10, 1998 meeting was that the moratorium on discounts and advertising would include all markets worldwide, including the United States. Saintilan Dep. (JX 94) at 116. PolyGram was

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concerned about possible discounting of 3T2 by Warner. Saintilan Dep. (JX 94) at 77.

99. In order for PolyGram to implement the moratorium in the United States, PolyGram needed the cooperation of PolyGram Classics and PGD. Saintilan Dep. (JX 94) at 49.

100. In 1998, Kevin Gore was the Senior Vice President and General Manager of PolyGram Classics in the United States. Stip. P26.

101. In the spring of 1998, Paul Saintilan spoke to Kevin Gore about the Three Tenors moratorium. This conversation took place in the United States. Saintilan told Gore that he (Saintilan) wanted PolyGram Classics to forgo discounting and advertising for 3T1 in the United States for a period of time. Gore responded that PolyGram Classics "would seek to comply." Saintilan Dep. (JX 94) at 49-50. Saintilan understood that Gore intended to communicate with PGD regarding the moratorium, and to ensure that PGD complied with its terms. Saintilan Dep. (JX 94) at 51.

B. Marketing Plans for 3T1

102. By memorandum dated February 27, 1998, Saintilan requested that each PolyGram operating company provide Decca/PolyGram with an outline of its local marketing campaign for 3T1 and 3T3. CX 417 at UMG003382. With regard to 3T1, Saintilan sought a description of planned marketing activities, expenditures, and target incremental sales. CX 417 at UMG003390-003391. The memo requested that the operating companies respond by March 18, 1998. CX 417 at UMG003382, 003390.

103. The opcos responded to Saintilan's request by submitting a description of planned marketing activities for 3T1. JX 50 at UMG003661-62. Several of the PolyGram operating companies planned price discounting and advertising campaigns for 3T1 during 1998. JX 50 at UMG003666, 003685, 003746; CX 427; JX 37.

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104. During 1998, the practice within PolyGram was that if an operating company wished to reduce the price of 3T1, that operating company was supposed to request and obtain the consent of both Decca (the repertoire owner) and PolyGram Vice President Bert Cloeckaert. Cloeckaert Dep. (JX 97) at 52; Cloeckaert Dep. (JX 98) at 176-77; CX 510 at UMG006328; CX 543 at UMG006214; Hoffman, Tr. 313.

105. In the spring of 1998, several Polygram operating companies formally requested permission from Decca and PolyGram to discount and promote 3T1. JX 35; CX 401; CX 402; CX 403; CX 404; CX 427. PolyGram operating companies wished to offer 3T1 at a discount price for all or part of the period running from August 1 to October 15, 1998. CX 403; CX 428; CX 429 at UMG003056; CX 442 at UMG000195; JX 35; JX 46.

106. PolyGram's reduction in the price of 3T1 in Europe during the pre-moratorium period did lead to higher sales levels. Cloeckaert Dep. (JX 97) at 81.

107. PolyGram instructed its operating companies: (i) that in view of the upcoming World Cup tournament, they could reduce the price of 3T1 and advertise its availability; but (ii) pursuant to an agreement with Warner, aggressive marketing campaigns in support of 3T1 would have to terminate by the end of July 1998:

a. "To keep in line with an agreement laid down with Atlantic and [PolyGram Classics President] Chris Roberts, we should not encourage any promotion on the original [Three Tenors] album from the day of release of the new album (probably in-store August 10) for a period of around 6 weeks." JX 40.

b. "We have agreed with Warners to discourage any promotion on the first [Three Tenors] album from the day of release of the new album . . . for a period of around 6 weeks. So all promotion on the

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first album should have stopped by then." CX 404 (emphasis in original).

c. "PolyGram has made an undertaking to Atlantic Records that no advertising or point of sale material originated for the launch of the new album will feature packshots of the 1990 album. This is based on Atlantic reciprocating by omitting the 1994 album in their initial POS [point of sale]/ads, and telling their opcos to back off promoting the 1994 album worldwide until a sufficient window has been observed." JX 28 at UMG001487.

d. "Following further discussions with Warners regarding the joint marketing of the 1998 '3 Tenors' album, it is now felt that we should avoid any aggressive price campaigns of the 1st '3 Tenors' album. This means that we will be unable to give consent to Germany and France for their campaigns and that we shall discourage any further requests from other opcos We do hope that you will appreciate that this decision is partly beyond our control and arises from a complex set of ongoing negotiations between PolyGram, Warners and the Rudas Organization." JX 42 (emphasis in original).

e. "After considerable discussion with Atlantic and other parties, the mid-price campaign first canvassed by Bert Cloeckaert in Europe has also been reintroduced (mid-price royalty break available from Stephen Greene on application) Atlantic and PolyGram have agreed that we will jointly refrain from any promotion of the previous albums that could potentially undermine sales of the new album around the time of the initial release." CX 459 at UMG SK 0005.

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C. Warner Music International's Discount Campaign for 3T2

108. In April 1998, Chris Roberts, President of PolyGram Classics, instructed Paul Saintilan to "ensure" that Warner would comply with the moratorium agreement. JX 34.

109. Saintilan requested that Warner provide to PolyGram copies of Warner's internal directives to Warner operating companies instructing compliance with the moratorium agreement. JX 34.

110. During 1998, Pat Creed was Senior Director for Product Development for Atlantic Records, and was responsible for marketing and promotional activities for 3T3 in the United States. Stip. P36. Creed attended the March 10, 1998 marketing meeting at which the Three Tenors moratorium was first agreed upon by PolyGram and Warner. JX 5 at UMG001523.

111. On April 29, 1998, Saintilan (Decca/PolyGram) sent a letter to Creed (Atlantic/Warner) seeking assurance that Warner was planning to abide by the moratorium. The letter to Warner refers to PolyGram's written instructions to PolyGram operating companies requiring an end to discounting of 3T1 by July 24, 1998. Saintilan requested confirmation that Warner planned to "enforce the same window." JX 6.

112. Pat Creed forwarded Saintilan's April 29, 1998 letter to Anthony O'Brien, Executive Vice President and Chief Financial Officer of Atlantic. Creed's cover memo notes that Saintilan's letter includes "a copy of the message sent by Decca to their affiliates around the world. They are still looking for some sort of assurance from us that the same is being done for Warner Music International." CX 415 at 3TEN00010551.

113. Saintilan also sent a copy of his April 29, 1998 letter to Rand Hoffman (PolyGram Holding). Hoffman forwarded a copy of the letter to Margo Scott, an attorney for Warner. Hoffman, Tr. 320.

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114. Warner Music International ("WMI") personnel were not involved in planning for the release of 3T3, and were not aware of discussions concerning the moratorium. No WMI representatives attended any of the joint PolyGram/Warner marketing meetings, and there is no evidence that WMI was provided with any information regarding the marketing plans for 3T3. F. 86, 91.

115. In December 1997, WMI began planning a television advertising campaign for 3T2 to run in Europe from July through December 1998. WMI planned "to aggressively advertise, position and discount-price the 1994 album" throughout the second half of 1998. CX 443 at 3TEN00003641; CX 366 at 3TEN00007335; O'Brien, Tr. 414.

116. WMI forecast that dropping the wholesale price of the 3T2 from \$ 13.40 per unit to \$ 8.50 per unit, combined with an aggressive advertising campaign, would increase the company's sales of 3T2 by 170 percent. JX 31 at 3TEN00009930. In order to subsidize a price cut, in-store merchandising, and television and press advertising for 3T2, WMI asked Rudas to grant WMI a temporary reduction in royalties owed. JX 60 at 3TEN00003561. WMI assured Rudas that, given the anticipated increase in sales volume for 3T2, Rudas would garner higher profits at the lower royalty rate. JX 60 at 3TEN00003561; JX 31 at 3TEN00009930.

117. In May 1998, Tibor Rudas consented to a reduced royalty rate for the 3T2 audio and video products for the period from May to December 1998. CX 426 at 3TEN00003557-58; JX 60 at 3TEN00003561 ("to 1st Jan agree"); CX 431 at 3TEN00009923; CX 432; CX 434 at 3TEN00011049; CX 435 at 3TEN00017899; CX 436; CX 448 at 3TEN00011077-78.

118. On May 15, 1998, WMI issued a bulletin to its operating companies announcing the launch of a discount campaign for 3T2, effective from May 17, 1998 until December 31, 1998. CX 435 at 3TEN00017900.

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119. In June 1998, Polygram obtained a copy of WMI's bulletin announcing the discount campaign for 3T2, scheduled to run through December 1998. CX 425 at UMG000166-67.

120. PolyGram obtained information indicating that Warner would be selling 3T2 at a substantial discount. CX 429 at UMG003056; CX 441.

121. PolyGram's operating companies informed Saintilan and PolyGram's central management that they wanted to respond to Warner's price discounts on 3T2 by discounting PolyGram's 3T1. CX 425 at UMG000167; CX 429 at UMG003056; CX 440; CX 442 at UMG000194.

122. Rand Hoffman served as PolyGram's liaison with Warner for contract issues relating to the 3T3 project. In June 1998, Chris Roberts (PolyGram Classics) forwarded to Hoffman a note complaining that Warner was discounting 3T2 in Europe. JX 66.

123. Hoffman had attended the March 10, 1998 marketing meeting, and understood that PolyGram and Warner representatives had agreed to implement the moratorium. Hoffman, Tr. 280; JX 5 at UMG001523.

124. On June 11, 1998, Hoffman sent a letter to Warner. Hoffman, Tr. 322. Hoffman complained that in Denmark, and perhaps elsewhere in Europe, Warner was offering 3T2 at a "very low price." This action, Hoffman charged, contravened the understanding between PolyGram and Warner. Hoffman asked that Warner take steps to eliminate this discounting (JX 64).

125. Hoffman was not then aware that the moratorium period was scheduled to commence at the end of July. When informed of this fact, Hoffman revoked his letter. JX 66; Hoffman, Tr. 322-23; JX 63.

126. PolyGram understood that its central management did not have complete control over the prices charged by its operating companies, and understood that Warner had similar problems

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controlling its operating companies. Saintilan Dep. (JX 94) at 153. PolyGram therefore was concerned that it would be difficult for both companies to implement the moratorium consistently on a worldwide basis. Hoffman, Tr. 322; Saintilan Dep. (JX 94) at 153.

127. Chris Roberts, President of PolyGram Classics, advised that the moratorium agreement was likely to fall apart because of the mutual distrust between PolyGram and Warner at the level of the operating companies. Saintilan Dep. (JX 94) at 134-136; JX 66.

128. Saintilan distributed an e-mail message to PolyGram executives that PolyGram should not coax its operating companies to abide by the moratorium: If Warner discounted 3T2 in a local market, the PolyGram operating company would be permitted to "retaliate" with discounts on 3T1. Saintilan Dep. (JX 94) at 138; JX 66.

129. During June 1998, senior management at PolyGram felt that there was likely to be discounting and promotion of the older Three Tenors products upon the release of 3T3. Saintilan Dep. (JX 94) 139, 154. PolyGram did not modify its plans for advertising and promoting 3T3. Saintilan Dep. (JX 94) at 139.

130. PolyGram's response to the expectation that Warner would be discounting 3T2 upon the release of 3T3 was to notify its operating companies that they were free to retaliate by discounting 3T1. JX 9-B at 3TEN0000013; JX 1-B.

131. Anthony O'Brien and other executives at Atlantic/Warner became aware that Warner's international operation, WMI, was using a discount campaign to sell 3T2, and that the Three Tenors moratorium agreement was in jeopardy. JX 68.

132. On June 24, 1998, Atlantic forwarded a memo to Ramon Lopez, the President of WMI. Atlantic warned WMI that its price cut on 3T2 could lead PolyGram to discount its catalogue Three Tenors album. CX 443 at 3TEN00003641. Ramon Lopez,

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President of WMI, responded to Atlantic on July 1, 1998, insisting that PolyGram had initiated the price reduction. JX 8.

D. Repertoire for the Paris Concert

133. In June 1998, Rudas informed PolyGram and Warner of the intended repertoire for the upcoming Three Tenors concert. CX486-88. PolyGram and Warner were alarmed to learn that the intended repertoire for the 1998 Three Tenors concert was "not substantially new." CX 490; CX 489; O'Brien, Tr. 424-25. It would overlap with the repertoire of the earlier Three Tenors concerts: "4 out of the 5 songs Pavarotti is considering singing were performed in either 1990 or 1994. In addition, 7 of the 8 scheduled encores were performed in either 1990 or 1994." CX 489-90.

134. The parties were concerned that if the overlap in repertoire between 3T3 and the earlier Three Tenors albums was too extensive, then 3T3 could lose sales to 3T1 and 3T2. O'Brien, Tr. 426.

135. On several occasions from mid-June through to the date of the concert, PolyGram and Warner expressed to Tibor Rudas their dissatisfaction with the intended repertoire. CX 487; CX 489-90.

136. PolyGram and Warner understood that the Tenors' failure to deliver a new repertoire at the 1998 concert jeopardized the commercial success of the 1998 album and video. According to Warner executive Anthony O'Brien:

The problem that we had was that The Three Tenors [are] perhaps three of the laziest performers we have ever seen performing this type of music, and what we were hoping for, when we were making the '98 concert, was to have new and exciting repertoire. . . And they're not particularly given to sort of learning new arias, and so Nessun dorma! would come back again, or maybe Carreras would sing one of the

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Pavarotti songs or vice versa. And so although the album was different . . . it wasn't, perhaps, quite as new and exciting as we had hoped it to be.

O'Brien I.H. (JX101) at 74:2-16. Warner and PolyGram lost several million dollars on sales of 3T3. O'Brien, Tr. 523-25.

VI. POLYGRAM AND WARNER REAFFIRM THE MORATORIUM AGREEMENT

A. Oral Assurances

137. On June 25, 1998, Anthony O'Brien (Atlantic/Warner) and Paul Saintilan (Decca/PolyGram) discussed by telephone the Three Tenors moratorium. JX 9-A at 3TEN0000012; JX 74.

138. During the June 25, 1998 telephone conversation, Saintilan reaffirmed PolyGram's willingness to forgo discounting and advertising of 3T1, provided that Warner reciprocated with regard to 3T2. O'Brien assured Saintilan that his company, Atlantic, would comply with the moratorium agreement in the United States. O'Brien, Tr. 433.

139. O'Brien also told Saintilan that he would communicate with representatives of WMI to ensure that WMI would also abide by the moratorium. O'Brien, Tr. 433.

140. During the June 25, 1998 telephone conversation, O'Brien understood that Saintilan had the authority to agree, and did agree, to the moratorium on behalf of all of PolyGram. O'Brien, Tr. 434.

B. Further Assurances

141. On July 2, 1998, Paul Saintilan forwarded a letter to Anthony O'Brien confirming the terms of the moratorium, and requesting additional assurances that Warner intended to comply on a worldwide basis. The letter specifies that audio versions of

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3T1 and 3T2 will not be discounted or advertised for the period from August 1 to October 15, 1998. JX 9-E.

142. Later the same day, July 2, 1998, Paul Saintilan forwarded a revised letter to Anthony O'Brien confirming the terms of the moratorium, and requesting additional assurances that Warner intended to comply on a worldwide basis. The revised letter makes it clear that the proposed moratorium agreement should apply to both Three Tenors albums and Three Tenors videos. JX 9-A at 3TEN00000012.

143. O'Brien understood the July 2, 1998 letter from Saintilan to be for the purpose of detailing the terms of the moratorium. O'Brien, Tr. 434.

144. The two letters dated July 2, 1998 from Saintilan (Decca/PolyGram) to O'Brien (Atlantic/Warner) were sent to Rand Hoffman (PolyGram Holding) in New York, who forwarded them on to O'Brien (Atlantic/Warner). JX 9-A ("via Rand Hoffman") and JX 9-E ("via Rand Hoffman").

C. Follow-Up Letter

145. The Three Tenors performed in concert in Paris on July 10, 1998. O'Brien, Tr. 435.

146. O'Brien was in Paris on July 10 to attend the Three Tenors concert. O'Brien, Tr. 435.

147. On July 10, 1998, Saintilan (Decca/PolyGram) forwarded a follow-up letter to O'Brien (Atlantic/Warner) providing additional details regarding the implementation of the moratorium agreement, and again seeking formal confirmation of Warner's intention to comply on a worldwide basis:

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**re: THREE TENORS MORATORIUM ON 1990
& 1994 ALBUMS**

As discussed, we fully support a moratorium on the above albums which we strongly believe will be to our mutual benefit. The dates we are prepared to commit to are from August 1 to November 15 (subject to the qualifications in italics below).

The moratorium would constitute the following:

1. Advertising and promotion

The original 1990 album would not be advertised or promoted during this period. We have already omitted the 1990 album from all advertising and point of sale materials centrally originated for the new album.

2. Pricing

The original 1990 album would be sold at the top classical price point that it has historically traded at in each market

As discussed before, PolyGram operating companies have already been advised of the above moratorium, however we have informally allowed it to collapse at a local level to allow a response to Warners pricing. When we have a clear undertaking from Warners that the above agreement will be adhered to, we will re-enforce things from our side

So in summary, once a price agreement has been made, and we have clear

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evidence that Warners will enforce the moratorium, then we will re-enforce the moratorium on our side.

JX 1-A-B.

1. WMI

148. The PolyGram letters were distributed to senior executives within Warner, including Ramon Lopez, President of WMI. This led to a series of internal discussions. O'Brien, Tr. 434:-35, 437; CX 202; CX 457. Lopez acceded to the request of the Atlantic executives to comply with the moratorium between August 1, 1998 and October 15, 1998. O'Brien 437-39; JX 3; JX 2.

149. On July 13, 1998, WMI distributed a memorandum to Warner operating companies instructing that the company's discount campaign for 3T2 must end on July 31:

The previously announced period of the Three Tenors mid price campaign has changed. This campaign must now finish July 31st. No further discounting or new marketing activities which are not already in place may occur between August 1st and October 15th.

CX 458 at 3TEN00017892; See also JX 73; O'Brien, Tr. 438.

2. Atlantic relays WMI's assent to PolyGram

150. On July 13, 1998, Anthony O'Brien (Atlantic/Warner) telephoned Paul Saintilan (Decca/PolyGram) to confirm that WMI was on board and that the moratorium on discounting and promoting the older Three Tenors recordings would be honored throughout Warner. JX 3; JX 2; O'Brien, Tr. 440-41. O'Brien further informed Saintilan that WMI had issued a directive instructing all Warner operating companies to observe the Three Tenors moratorium. JX 3; JX 2.

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151. Saintilan independently confirmed (through a friend at Warner) that the directive had been issued throughout Warner. Saintilan was satisfied that the terms of the directive "complied perfectly" with his agreement with Warner. JX 4 at UMG000207.

3. PolyGram enforces the moratorium

152. Later that day, July 13, 1998, Saintilan forwarded an e-mail message to various PolyGram executives and managers describing his conversation with O'Brien, and informing them that the moratorium agreement was now securely in place at Warner:

Tony O'Brien advised today that Ramon Lopez had issued the directive through Warner that they will observe the moratorium from August 1 through to October 15. The exceptions will be in markets where four weeks notice of a price change is required. Lopez . . . believes that they should police us, and we should police them. The prices should be "normal" and not subject to any special discounts or promotion.

JX 3.

The recipients of Saintilan's July 13 e-mail message include Chris Roberts (President, PolyGram Classics), Kevin Gore (Senior Vice President, PolyGram Classics in the United States), Rand Hoffman (Senior Vice President, PolyGram Holding), and Roger Lewis (President, Decca). JX 3.

153. On or about July 14, 1998, Paul Saintilan (Decca/PolyGram) distributed a memorandum to PolyGram operating companies worldwide "re-enforcing" the company's intention to comply with the moratorium:

Ramon Lopez, the Chairman and CEO of Warner Music International issued a directive on July 13, that there should be no price discounting, advertising or promotion on the 1994 Warners Three Tenors album from August 1 until October 15. The only exceptions

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to this will be where legal obligations to retailers exist (such as four weeks notice of a price increase).

We now seek to re-enforce the moratorium on PolyGram's side, from August 1 to October 15, on a worldwide, not simply European basis. The moratorium prohibits price discounting, advertising and promotion of the 1990 album and video during this period

Should you find any evidence of Warners failing to comply with this agreement after August 1, please contact me providing as much detail as possible.

JX 4 at UMG000208; Saintilan Dep. (JX 94) at 171.

D. Intervention of PolyGram and Warner Attorneys

154. In late July 1998, after the Paris concert but prior to the release of 3T3, the legal departments of PolyGram and Warner became involved with the moratorium issue. F. 155, 160-63.

155. On July 17, 1998, Paul Saintilan forwarded his documents relating to the Three Tenors moratorium to PolyGram's General Counsel, Richard Constant. CX 459 at UMG SK 0001.

156. On July 30, 1998, Paul Saintilan forwarded a memorandum to PolyGram operating companies denying the existence of the moratorium agreement between PolyGram and Warner:

Contrary to any previous suggestion, there has been no agreement with Atlantic Records in relation to the pricing and marketing of the previous Three Tenors albums.

JX 76 at UMG000213.

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157. At trial, PolyGram executive Rand Hoffman acknowledged that Saintilan's statement that "there has been no agreement" was not correct. Hoffman, Tr. 367-68.

158. While disavowing the existence of a moratorium agreement, the July 30 memo also discourages any price discounting of 3T1:

With immediate effect Decca has concluded that it is appropriate to adopt a flexible position that allows operating companies the chance to make their own commercial decisions on the optimum pricing of the 1990 album. We should emphasize, however, that in deciding how to market and price the 1990 album, operating companies should take full account of PolyGram's massive investment in the 1998 album and the need to maximize returns on this investment.

JX 76 at UMG000213.

159. Saintilan's July 30, 1998 memorandum was likely understood by managers at the PolyGram operating companies as a pretense. They received at least three previous memoranda advising that there was an agreement between PolyGram and Atlantic restricting the discounting of previous Three Tenors albums. JX 43 at UMG000479-480; JX 4 at UMG000208. Although the memorandum purports to give discretion over 3T1 pricing to the operating companies, they understood that they still could not discount 3T1 without the express consent of Decca and Bert Cloeckert of PolyGram. Cloeckert Dep. (JX 98) at 175-76; Stainer Dep. (JX 89) at 80-81; Hidalgo Dep. (JX 88) at 110.

160. Attorneys for Warner and PolyGram reviewed a draft letter from O'Brien to Saintilan purporting to reject the moratorium agreement for non-U.S. markets. RX 706 at UMG SK 0021; RX 707 at UMG SK 0027; RX 708 at UMG SK 0030.

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161. On August 10, 1998, Anthony O'Brien was advised to sign and forward to Paul Saintilan a letter that the attorneys had drafted. O'Brien followed this advice. O'Brien, Tr. 452, 470.

162. The August 10, 1998 letter executed by O'Brien purports to reject the moratorium agreement, and asserts an intention to make unilateral decisions on pricing and promotion for 3T2. JX 81; O'Brien, Tr. 471.

163. On or about August 10, 1998, Anthony O'Brien had a final telephone conversation with Paul Saintilan regarding the moratorium agreement. O'Brien informed Saintilan that he (O'Brien) had been requested by counsel at Warner to send the August 10 letter. O'Brien further informed Saintilan that the August 10 letter notwithstanding, Atlantic and Warner Music International still intended fully to comply with the moratorium agreement. O'Brien, Tr. 470-71.

164. During the period August 1 through October 15, 1998, Anthony O'Brien understood that PolyGram was complying with the moratorium agreement. O'Brien, Tr. 472, 494-95.

E. Unfavorable Reviews

165. The 1998 Three Tenors album and video were released on August 18, 1998. O'Brien, Tr. 471.

166. Several music reviewers recognized the overlap in repertoire between the 1998 Three Tenors album and the earlier Three Tenors recordings. The Gazette (Montreal) (July 11, 1998) CX 575; The Seattle Times (Sept. 13, 1998) CX 580-B; The Boston Herald (Oct. 4, 1998) CX 579-B-C.

167. Published reviews of 3T3 were generally unfavorable: The San Francisco Chronicle (Oct. 4, 1998) CX 576; The Boston Globe at N1 (Oct. 4, 1998) CX 577-C; The Vancouver Sun at D12 (Sept. 26, 1998) CX 578-D; The Star-Ledger (Newark, NJ) (Sept. 26, 1998) CX 574-C; The Jerusalem Post at 9 (Sept. 2, 1998) CX 581-B.

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F. Marketing Campaign for 3T3 in the United States

168. Warner treated 3T3 as a high-priority record, and the marketing campaign for 3T3 in the United States was well-funded and in all media. Moore, Tr. 71. Warner's marketing campaign for 3T3 during 1998 included: the PBS broadcast of the Three Tenors concert in Paris, release of a single ("You'll Never Walk Alone") and a music video, six foot tall stand up floor merchandisers in the shape of the Eiffel Tower, newspaper and magazine ads, store circular, prominent positioning in retail stores (e.g., end caps, front counter displays, listening stations), radio spots, television ads, posters, mailers, New York City transit bus and rail ads, Access Hollywood feature to coincide with album release, E! Entertainment TV piece, and a web-site (featuring video interviews with the Tenors, conductor James Levine and Tibor Rudas, a tour of Pavarotti's dressing room and a fan bulletin board and chat room). CX 482-83. Warner's campaign for 3T3 in the United States included a cooperative advertising program with retailers that funded television and print advertisements. CX 483 at 3TEN00001423-1424; CX 482; Moore, Tr. 74-76, 82-83. Warner coordinated in-store displays for 3T3 and advertisements with major record chains. CX 483 at 3TEN00001418-1419; CX 482. This involved nameboards, four-color lightboxes, six-foot-tall stand-up floor merchandisers in the shape of the Eiffel Tower, window displays, end caps and posters. CX 482 at 3TEN00009048; Moore, Tr. 72-73, 79-83. Warner launched a publicity campaign with radio stations, release of an electronic press kit, a website, and solicitation of articles and reviews. CX 483 at 3TEN001425-1426; Moore, Tr. 76-79. Warner arranged to have the single "You'll Never Walk Alone" delivered to radio stations nationwide. Moore, Tr. 77-79, 234-35; CX 483 at 3TEN00001426.

169. Warner sought to increase sales of 3T3 by offering discounts to customers. The initial discount in the United States for 3T3 was seven percent to wholesale customers, and five percent to retail customers. CX 483 at 3TEN00001418.

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G. PolyGram and Warner Comply with the Moratorium Agreement in the United States

170. Atlantic (Warner) and PolyGram both complied with the moratorium agreement in the United States. O'Brien, Tr. 474-76.

171. Between August 1, 1998 and October 15, 1998, Atlantic (Warner) did not aggressively discount 3T2 in the United States; 3T2 was sold by Atlantic at full price only. O'Brien, Tr. 474.

172. Between August 1, 1998 and October 15, 1998, neither Atlantic (Warner) nor PolyGram funded advertising for 3T2 in the United States. O'Brien, Tr. 474; RX 728.

173. Between August 1, 1998 and October 15, 1998, Anthony O'Brien observed no discounting or advertising for 3T1 by PolyGram in the United States, and it was O'Brien's understanding that PolyGram was in fact complying with the moratorium. O'Brien, Tr. 476.

174. There is no evidence that during the moratorium period, PolyGram sold 3T1 at a discount price in the United States. See RX 713 at UMG004899-4900.

175. According to PolyGram's economic expert, Dr. Janusz Ordover, PolyGram's average wholesale price for 3T1 during the moratorium period (August/September/October 1998) was higher than the average wholesale price for 3T1 during the preceding three-month period (May/June/July 1998), and for the period August/September/October 1997. RX 716 (Ordover Expert Report) at P55.

176. Kevin Gore, Senior Vice President of PolyGram Classics during 1998 and currently President of Universal Classics, testified in his deposition that if he had found out that Warner was discounting 3T2 during the moratorium period, PolyGram's pricing and discounting decisions for 3T1 could have been affected. Gore Dep. (JX 87) at 111, 113.

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H. PolyGram and Warner Comply with the Moratorium Agreement Abroad

177. Warner complied with the moratorium agreement outside of the United States. O'Brien, Tr. 474; CX 453.

178. Between August 1, 1998 and October 15, 1998, Warner did not discount or advertise 3T2 outside of the United States. O'Brien, Tr. 474.

179. During the moratorium period, Warner's international operation (WMI) monitored PolyGram's prices for 3T1 outside of the United States. CX 450 at 3TEN00009904. If PolyGram were cheating on the agreement, then WMI wanted to respond by discounting and advertising 3T2. O'Brien, Tr. 476-77; CX 450 at 3TEN00009904.

180. Anthony O'Brien received no complaints from WMI during the moratorium period concerning PolyGram's marketing activities in support of 3T2. O'Brien, Tr. 476-77.

181. From August 1, 1998 through October 15, 1998, Warner perceived that PolyGram was substantially complying with the moratorium agreement outside of the United States. CX 204; O'Brien, Tr. 477.

I. Discounting on 3T2 After the Moratorium Expired

182. On October 2, 1998, Ramon Lopez (President, WMI) asked Val Azzoli (Co-Chairman, Atlantic) to contact PolyGram and discuss an orderly transition away from the moratorium. CX 204.

183. On October 15, 1998, the agreed-upon term for the Three Tenors moratorium came to an end. JX 3.

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VII. EACH OF THE RESPONDENTS AND THE MORATORIUM

184. Respondent Decca, through its employees Paul Saintilan and Roger Lewis, agreed to the Three Tenors moratorium. F. 92, 95, 110-13, 137-47, 150.

185. Respondent UMG (formerly PolyGram Records), through its employees Chris Roberts (President, PolyGram Classics division) and Kevin Gore conceived the Three Tenors moratorium. Roberts supervised Paul Saintilan with regard to the moratorium. F. 83-89, 101, 108, 122, 152, 155. PolyGram Records was responsible for the marketing for 3T1 in the United States, and it instructed PGD to comply with the moratorium. F. 15, 101.

186. Respondent PolyGram Holding, through its Senior Vice President Rand Hoffman, participated in the moratorium agreement. Hoffman attended the March 1998 meeting at which PolyGram and Warner first agreed to the moratorium. F. 91. Hoffman urged Warner to induce its operating companies to comply with the moratorium agreement. F. 122-25. Hoffman was responsible for the PolyGram/Warner collaboration, and corresponded with Warner about the moratorium agreement. F. 113, 144, 152. PolyGram Holding approved the actions of its subsidiaries PolyGram Records and PGD with regard to the moratorium.

187. Respondent UMVD (formerly PolyGram Group Distribution, or "PGD") participated in the moratorium in the United States by selling 3T2 at the conspiracy price during the moratorium period. Gore Dep. (JX 87) at 28-29; Caparro Dep. (CX 609) at 44-45. PGD executed the strategy developed by Decca and PolyGram Classic for marketing of 3T1 in the United States. F. 16-17, 101.

188. "PolyGram was a labyrinth of companies set for specific legal and tax purposes." Kronfeld Dep. (JX 86) at 15. In their dealings with Warner concerning the 3T3 and the moratorium, the

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PolyGram companies acted as a single entity. F. 65, 95-96, 124, 140.

189. Hoffman of PolyGram Holding, negotiated the moratorium with Warner on behalf of all of PolyGram. F. 65, 124.

190. Representatives from several different PolyGram companies (including Saintilan of Decca, Hoffman of PolyGram Holdings, and Roberts of PolyGram Records) attended the 3T3 meetings where the moratorium was discussed. F. 86, 91.

191. Decca's Saintilan sought approval for the moratorium from employees of PolyGram Records, including Chris Roberts. F. 127-28, 152, 155; JX 3-4. Saintilan corresponded regarding to the moratorium with PolyGram Holding's Rand Hoffman, and sought Hoffman's approval regarding the moratorium. F. 113.

192. PGD implemented the moratorium in the United States at the direction of Decca and PolyGram Records. F. 101.

193. Warner representative Anthony O'Brien understood that Paul Saintilan had the authority to agree to the moratorium on behalf of all of PolyGram. Saintilan believed that he was agreeing to the moratorium on behalf of all of PolyGram. F. 96, 140; JX 1-A-B.

194. As one of the entities responsible for the pricing of 3T1 in 1998, PolyGram Records had actual authority to determine the price of 3T1 charged by PGD in the United States. F. 15

195. As one of the entities responsible for the pricing of 3T1 in 1998, Decca had actual authority to determine the price of 3T1 charged by PGD in the United States. Gore Dep. (JX 87) at 98-99.

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**VIII. OTHER NEW THREE TENORS ALBUMS
RELEASED WITHOUT RESTRAINTS****A. Sony's Three Tenors Recording Without a Moratorium**

196. In 1999, Luciano Pavarotti was obligated by contract to record exclusively for PolyGram. CX 224 at UMG004248. In 1999, PolyGram agreed to waive its exclusive rights to the recording services of Pavarotti so as to permit Pavarotti to record a Three Tenors album for Sony. CX 515; CX 516.

197. In October 2000, Sony released an album derived from a performance of the Three Tenors in Vienna. The album is entitled The Three Tenors Christmas, and consists of Christmas songs from around the world. O'Brien, Tr. 482; Gore Dep. (JX 87) at 66-67.

198. Sony did not discuss with Warner restricting its competitive marketing activity in support of 3T2 and 3T3 at the time of the release of the 2000 Three Tenors album. O'Brien, Tr. 482.

199. Sony did not discuss with PolyGram restricting its competitive marketing activity in support of 3T1 and 3T3 at the time of the release of the 2000 Three Tenors album. Hoffman, Tr. 329.

B. In 1994, Warner Released 3T2 Without A Moratorium

200. In 1994, Warner controlled the rights to 3T2, while PolyGram controlled the rights to 3T1. Stip. PP85, 90, 106. 3T2 was distributed and marketed by Warner without any agreement between Polygram and Warner concerning Polygram's pricing or marketing of 3T1. Stip. P149.

201. During 1994, the marketing of 3T2 was a priority for Warner. Moore, Tr. 89-90; CX 247 at 3TEN00011271; CX 241 at 3TEN000007230.

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202. In its marketing campaign for 3T2, Warner anticipated that PolyGram would advertise and discount 3T1 when Warner released 3T2. CX 257; CX 249 at 3TEN00011254; CX 256 at 3TEN0004763, 4765-66; CX 258 at 3TEN00005402; CX 255; CX 244.

203. Warner's marketing effort was to differentiate 3T2 from 3T1. CX 259 at 3TEN00011109; CX 249 at 3TEN00011254-55; CX 242 at 3TEN00000441; CX 248 at 3TEN00011260.

204. Warner launched an aggressive and expensive international marketing campaign in support of 3T2. CX 247 at 3TEN00011271; O'Brien, Tr. 405-06; Hidalgo Dep. (JX 88) at 46-47; Stainer Dep. (JX 89) at 10.

205. Warner's marketing campaign for 3T2 in the United States was comprehensive and expensive. CX 243 at 3TEN00007150-58; Moore, Tr. 92-96; CX 251.

206. Warner offered compensation to secure prominent placement of 3T2 in music stores. CX 251 at 3TEN0008888-89; CX 249 at 3TEN00011253; CX 259 at 3TEN00011110.

207. Warner's U.S. and European operating companies offered key accounts a five percent discount for all orders taken in advance of the first shipment. CX 253 at 3TEN00011247. Warner also developed promotional programs to increase initial sales, including the introduction of a gold CD. CX 260 at 3TEN00011224; CX 332.

208. In the United States, Warner established a distinct identity for 3T2, and had a successful launch. CX 261 at 3TEN00017820; CX 262 at 3TEN00017828; CX 263 at 3TEN00017843; CX 264 at 3TEN00017822; CX 265 at 3TEN00017852.

209. Tibor Rudas was pleased with Warner's "total commitment and aggressive promotion" of 3T2. CX 325 at UMG004698.

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210. PolyGram did not sit back and permit the release of 3T2 to eclipse sales of 3T1. PolyGram developed an aggressive campaign to increase sales of 3T1, employing discounting and advertising. JX 29.

211. PolyGram instructed its opcos to promote the "original" Three Tenors concert and recordings as "unique and unrepeatable." CX 272 at UMG000524. See also CX 270 at UMG005050; CX 256 at 3TEN00004766.

212. During 1994, PolyGram launched a marketing campaign in support of 3T1 which distinguished this product through the use of product stickers, new posters, promotional discs for radio, and a deluxe edition. CX 283 at UMG005013; CX 272 at UMG000526-527; CX 271 at UMG005828; CX 270 at UMG005051. PolyGram used television advertising. CX 276 at UMG005033; CX 281 at UMG005028; CX 258 at 3TEN0005402-5403.

213. In the United States, PolyGram spent \$ 109,471 in cooperative advertising for 3T1 during 1994. JX 103 at UMG006407. PolyGram spent most of this money (nearly \$ 60,000) in September 1994, the month following the release of 3T2. JX 103 at UMG006407.

214. During 1994, PolyGram offered 3T1 at discounted prices. CX 275 at UMG005820; CX 256 at 3TEN0004766; CX 279 at UMG005031; CX 258 at 3TEN0005402; JX 44.

215. PolyGram reduced the wholesale price of 3T1 during 1994 by changing the list price to retailers; in some sales territories PolyGram moved 3T1 from the company's "top" price tier to the "mid-price" tier. E.g., JX 32; CX 400; CX 428; CX 249 at 3TEN00011254.

216. PolyGram also offered special discounts, while maintaining the "top" tier designation for this album. In the United Kingdom, PolyGram ran a successful campaign called "Three Tenors for under a Tenner," in which 3T1 was offered for

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less than 10 pounds. CX 273; Stainer Dep. (JX 89) at 38. PolyGram's U.K. operating company offered these incentives without reducing the wholesale list price. CX 275 at UMG005820.

217. PolyGram provided cooperative advertising funds to retailers. This method was used in the United States. JX 103 at UMG006407. Cooperative advertising is a monetary commitment that the label makes to a retailer for positioning the album in a desirable location in the store or including the album in an out of store advertisement placed by the retailer. Kopecky Dep. (CX 610) at 21-22; Moore, Tr. 47-48, 58-59.

218. When PolyGram provides cooperative advertising funds, the retailer deducts the value of the cooperative advertising from the amount it pays for product purchased from PolyGram. Kopecky Dep. (CX 610) at 28-29. Cooperative advertising programs are a form of discount. **CX 603-P** (in camera).

219. In September 1994--the first full month after the release of 3T2--PolyGram spent \$ 57,178 on cooperative advertising for 3T1 in the United States. JX 103 at UMG006407. During that same time period, PolyGram generated \$ 630,738.00 in U.S. sales of 3T1. RX 713 at UMG004889. PolyGram returned to retailers through 3T1 cooperative advertising programs approximately nine percent of the money 3T1 generated.

220. Cooperative advertising funds create an incentive for retailers to place the advertised product on sale in order to move a higher volume of product. Moore, Tr. 67; JX 105-I (Moore Expert Report). When music companies provide cooperative advertising for their products, the retail price for consumers tends to decrease. Moore, Tr. 65-66; Gore Dep. (JX 87) at 79-80. It is likely that retail prices of 3T1 in the United States following the release of 3T2 were lower.

221. Warner observed later: "In 1994, at the time of our release of the Three Tenors album, Decca dropped the price of their album to a midprice level. This was a temporary move by

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Decca to ensure sales of their recording at the time of our release of the 1994 album. At the end of 1994 Decca returned the pricing of the 1990 album back to the full line price." JX 32.

222. Competition from PolyGram notwithstanding, the 3T2 project was a business success for Warner. O'Brien, Tr. 406. See also CX 266 at 3TEN0009901. During 1994, Warner [redacted] achieved platinum sales on ship out of 3T2 in the United States and numerous other countries. **CX 394** (in camera); CX 260 at 3TEN00011224. 3T2 was the second-best selling classical album in the United States in 1994, and was the top-selling classical album in 1995. CX 587-88.

223. There is no evidence that Warner's spending in support of 3T2 was negatively affected by PolyGram's campaign for 3T1. In fact, the head of Warner's marketing campaign in the United Kingdom during 1994 (who later worked for PolyGram) testified in his deposition that PolyGram's 1994 campaign probably helped Warner's release. Stainer Dep. (JX 89) at 13-14; see also CX 249 at 3TEN00011254-55.

C. PolyGram and Warner Compete Directly and Aggressively During the Three Tenors World Tour

224. During 1996 and 1997, The Three Tenors had concerts in Tokyo, London, Munich, New York, Johannesburg, and Melbourne. Stip. P117. Warner and PolyGram capitalized on the opportunity to drive sales of their Three Tenors products. CX 289; Stip. PP118-119; see also F. 225-34.

225. PolyGram offered 3T1 at a discounted price in many markets. CX 305 at 3TEN00004983; CX 307; CX 400.

226. In 1996, PolyGram released a World Tour Commemorative Edition of the 1990 concert, digitally remastered on a gold CD. PolyGram placed promotional stickers on the albums to draw consumer attention to the product enhancement. Stip. P121; CX 288 at UMG006106; CX 272 at UMG000526.

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227. Warner viewed the 1996/1997 Three Tenors tour to be "a powerful marketing tool" and "an ideal opportunity to exploit our product and new variants again." Stip. P118; CX 294 at 3TEN00017902; CX 295 at 3TEN00005917; CX2 96 at 3TEN0005910.

228. In 1996, Warner issued a special "Three Tenors World Tour Edition" of 3T2, consisting of the original 1994 Three Tenors CD, new packaging, and a booklet of unpublished photographs and information about The Three Tenors. Stip. P120; CX 296 at 3TEN00005912; CX 299 at 3TEN00005904. Warner offered "the concept of value added in the form of the slip case and celebratory photo book to counter the anticipated price cutting by Decca." CX 300 at 3TEN00008946. The slip case contained cover art different from that contained on the original 3T2 cover. CX 301; CX 302.

229. Warner instructed its operating companies to develop marketing plans for 3T2 that took advantage of the Three Tenors concert tour. CX 294 at 3TEN000017902; CX 293 at 3TEN011189; CX 299 at 3TEN0005903-04.

230. To counter PolyGram's marketing activities for 3T1, Warner's marketing campaign highlighted the advantages of the 1994 album. CX 299 at 3TEN00005903.

231. The Three Tenors performed in New York in July 1996. At that time, Warner launched a major television campaign in support of 3T2. CX 298 at 3TEN00010826.

232. At the time of the 1996 world tour, PolyGram assured Tibor Rudas that the rivalry between Warner and PolyGram would be beneficial for The Three Tenors:

Warner and we [PolyGram] will fight head on for every inch of advantage we could possibly gain over each other in exploiting the 3T tour with our respective product. Fair enough, competition is good for the business Nevertheless, be assured the

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competition will be lively and the whole project will greatly benefit from it.

CX 309.

233. By 1996, Warner had sold more than eight million units of the 3T2 album and video, including more than two and a half million units in the United States. CX 306 at 3TEN00004902.

234. The Three Tenors albums, 3T1 and 3T2, were both among the best-selling classical recordings in the United States in calendar years 1994, 1995, 1996, and 1997. CX587-90.

IX. COMPETITIVE EFFECTS OF THE MORATORIUM AGREEMENT

235. PolyGram and Warner agreed that each would not to discount 3T1 and 3T2. JX 104-B (Stockum Expert Report); Stockum, Tr. 586.

236. When horizontal competitors enter into an agreement to restrict price competition, the potential adverse effect is obvious. Stockum, Tr. 583085; JX 104-B (Stockum Expert Report). Complaint Counsel's economic expert, Dr. Stephen Stockum, testified at trial that the potential effect of an agreement between competitors not to discount includes a loss to consumer welfare and to allocation efficiency. Stockum, Tr. 583-85; JX 104-B (Stockum Expert Report).

237. Dr. Stockum concluded that, absent an efficiency justification, an agreement not to discount is very likely to be anticompetitive. Stockum, Tr. 581-86.

238. Price discounting is a marketing tool in the recorded music industry. Moore, Tr. 44-45, 65-68; Stockum, Tr. 600-02.

239. PolyGram and Warner offer discounts to retailers in order to increase sales levels. This principle applies to the sale of catalogue products as well as new releases. O'Brien I.H. (JX 101)

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82; **O'Brien Dep. (JX 100) at 91-92** (in camera); Caparro Dep. (CX 609) at 49-50, 33, 43-44; Kopecky Dep. (CX 610) at 12; Cloeckaert Dep. (JX 97) at 25-26; Stainer Dep. (JX 89) at 9-10; Greene Dep. (JX 95) at 58; Saintilan Dep. (JX 94) at 69-70.

240. During 1994, PolyGram responded to the release of 3T2 by aggressively reducing the price of 3T1 in many markets. F. 214-21.

241. In 1996 and 1997, PolyGram offered discounts on 3T1 in order to compete with Warner's marketing of 3T2 and its special World Tour Edition. CX 308; F. 224-32.

242. In 1998, many PolyGram and Warner operating companies determined that the best way to capitalize upon the public's revived interest in the Three Tenors was by dramatically reducing the price of these products (with aggressive advertising campaigns). F. 103-05, 115-18.

243. In 1998, both PolyGram and Warner requested and received assurances that the other would abide by the moratorium on discounting. F. 84, 107-13, 121, 126, 130, 132, 137-43, 147-48, 152-53.

244. Consumers consider price in their decisions to purchase classical music. CX 540 at UMG006114; CX 541 at UMG006151.

245. Information disseminated through advertising educates consumers about the availability and quality differences among competing products, sales locations, means of purchase, and pricing. This information promotes low prices and competition. JX 104-C (Stockum Expert Report); Stockum, Tr. 587-92; Moore, Tr. 53-54, 59, 62-64.

246. Economists have studied the effect of advertising restrictions in numerous industries. These studies conclude that advertising restrictions result in consumers paying higher prices. JX 104-C-D (Stockum Expert Report); Stockum, Tr. 592-600. In

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the absence of the ability to advertise a low price, a firm has less incentive to charge a low price. Stockum, Tr. 589-92; Ordoover Dep. (JX 90) at 49.

247. Dr. Stockum considered these studies in his expert opinion. JX 104-C-D (Stockum Expert Report); Stockum, Tr. 592-600. One study that showed that advertising bans of a short duration can lead to higher prices; it involved a newspaper strike in New York, where supermarkets advertised heavily. For about a 60 day period, there were no advertisements in Queens, while in neighboring Nassau County a different paper continued to operate. The author found that the prices rose by 5.8 percent during the very first week of the strike. Stockum, Tr. 599-600; Amihai Glazer, Advertising, Information and Prices--A Case Study, 19 Econ. Inquiry 661 (1981).

248. On the basis of economic theory and empirical findings, Dr. Stockum concluded that, absent an efficiency justification, Respondents' agreement not to advertise or promote catalogue Three Tenors albums is very likely to be anticompetitive. JX 104-D (Stockum Expert Report); Stockum, Tr. 587-92, 616-17.

249. Respondents' economic expert, Dr. Ordoover testified at his deposition that naked agreements between competitors not to advertise their respective products "are likely to be adverse to consumers." Ordoover Dep. (JX 90) at 47.

250. Advertising is an important basis of rivalry in the recorded music industry. Moore, Tr. 59; Stockum, Tr. 601-02; Caparro (CX 609) at 59; Kopecky Dep. (CX 610) at 50; Gore Dep. (JX 87) at 90.

251. Music companies spend huge amounts of money advertising recorded music products in the United States. Caparro Dep. (CX 609) at 57, 59; O'Brien I.H. (JX 101) at 12-13.

252. Between July 1994 (release of 3T2) and August 1998 (moratorium), aggressive and successful advertising campaigns were run separately by Warner and Polygram to increase sales of

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their respective Three Tenors products. F. 103-07, 115-18, 200-34.

253. In 1994 and thereafter, PolyGram used advertising to tell consumers that 3T1, was still the best performance and was still widely available at a discounted price. F. 210-18; see also JX 12 at UMG005007; Stainer Dep. (JX 89) at 38-39; Cloeckaert Dep. (JX 97) at 81.

254. In 1994 and thereafter, Warner used advertising to create a distinct identity for 3T2, and to suggest that it was the superior product. F. 200-09; see also CX 259 at 3TEN00011109; CX 249 at 3TEN00011254-55; CX 254 at 3TEN0005589-0005590; Stainer Dep. (JX 89) at 10-11; Stainer Dep. (JX 89) at 17-18.

255. During 1998, Warner proposed to Tibor Rudas an aggressive marketing campaign for 3T2. Warner's strategy was "to aggressively advertise, position, and discount price the 1994 album." JX 31 at 3TEN00009930; JX 7 at 3TEN00001492; O'Brien I.H. (JX 101) at 99-100; JX 29 at 3TEN00003592; JX 32 at 3TEN000011058.

256. Warner forecast that by cutting the wholesale price of 3T2 and advertising on television and in other media, the company could increase sales by 170 percent and increase overall profits as well. CX 396 at 3TEN00011072; JX 31 at 3TEN00009930.

257. During 1998, PolyGram authorized its operating companies to sell 3T1 at significantly discounted prices, supported by an advertising campaign. JX 41 at UMG003075; JX 43 at UMG000479-481; CX 413 at UMG003058.

258. PolyGram's operating companies forecast substantial additional sales of 3T1 if they were permitted to discount and advertise. JX 35; Cloeckaert Dep. (JX 97) at 57-58; JX 50 at UMG003746; CX 427.

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259. Advertising of recorded music creates demand, and discounting by music companies is more likely to occur. Stockum, Tr. 589-91; JX 104-C (Stockum Expert Report) at P8; Ordoover Dep. (JX 90) at 49; Caparro Dep. (CX 609) at 55-56; see also Cloeckaert Dep. (JX 97) at 23-24, 52-53; Saintilan Dep. (JX 94) at 71; Moore, Tr. 64-65, 67.

260. When music companies advertise their products, the retail price for consumers tends to decrease. Moore, Tr. 65-66; Gore Dep. (JX 87) at 79-80.

261. Respondents chose a moratorium on discounting and advertising in order to achieve their goal of limiting the sales of 3T1 and 3T2. Stockum, Tr. 614.

X. EFFICIENCY JUSTIFICATION

A. Purpose of the Collaboration

262. During the hearing, Respondents stipulated that the Three Tenors moratorium was not necessary to the formation of the PolyGram/Warner collaboration:

MR. PHILLIPS: First of all, Your Honor, we have never contended that the moratorium agreement was necessary to the formation of the joint venture. The moratorium agreement, the evidence suggests, was not discussed before the formation of the joint venture. That's simply a nonissue in the case, Your Honor.

JUDGE TIMONY: Okay.

MR. PHILLIPS: [The President of PolyGram Classics] did approve the deal, but the moratorium agreement hadn't been discussed at the time he approved the deal, so how could he know, remember something that hadn't occurred.

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JUDGE TIMONY: You'd stipulate that?

MR. PHILLIPS: That the moratorium agreement hadn't been entered into before the joint venture was formed?

JUDGE TIMONY: And was not necessary to the agreement.

MR. PHILLIPS: It wasn't necessary to their entering into the deal, correct.

JUDGE TIMONY: Because they hadn't discussed it.

MR. PHILLIPS: Because they didn't discuss or even think about it. Because they didn't discuss or even think about it.

PHC Tr. 83-84.

263. PolyGram and Warner executed the written contract for 3T3 on December 19, 1997, months before entering into the moratorium agreement. Compare JX 10 with JX 5 at UMG001527; and CX 388 at 3TEN0008009 (same). PolyGram and Warner were committed to the formation of the PolyGram/Warner collaboration, the production of the Paris concert, the creation of 3T3, and the distribution of 3T3 in the United States well before discussions of the moratorium even commenced. The moratorium was not necessary for the 3T3 project.

264. If no moratorium on competition had been agreed to by PolyGram and Warner, Warner would still have distributed 3T3 in the United States; Warner was not going to walk away from its \$ 9 million investment. O'Brien, Tr. 446-47; Stockum, Tr. 623. Respondents estimate that the moratorium made only a small contribution to the value of the PolyGram/Warner collaboration. RX 716 (Ordoover Expert Report) at P35; Stainer Dep. (JX 89) at 46, 49-51; Saintilan Dep. (JX 94) at 106.

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265. At the time that PolyGram and Warner executed their agreement to collaborate on the distribution of 3T3, the firms retained the unconstrained right to exploit their respective Three Tenors catalogue products, 3T1 and 3T2. JX 10 at UMG001843-844. PolyGram's rights to 3T1 pre-date the arrangement and were not part of the collaboration for 3T3.

266. PolyGram's U.S. marketing operation was not involved in the 3T3 collaboration, and thus was not used efficiently for the betterment of the collaboration. Gore Dep. (JX 87) at 59, 60.

267. PolyGram's U.S. distribution assets were uninvolved in the distribution of 3T3. Caparro Dep. (CX 609) at 24-25, 39-40.

268. The parties were concerned that 3T3 might lose sales to 3T1 and 3T2. O'Brien, Tr. 490.

269. The parties were concerned that competition among Three Tenors products may adversely affect the profitability of the 3T3 project. Anthony O'Brien, the Warner executive responsible for the moratorium agreement, testified at trial that the purpose of the moratorium was to prevent consumers from selecting a lower priced alternative to 3T3. O'Brien, Tr. 485-87.

270. Warner received no profit from sales of 3T1 (owned by PolyGram), a smaller profit from each sale of 3T2 (substantial royalty owed to Rudas), and a larger profit from each sale of 3T3. O'Brien, Tr. 406; Hoffman, Tr. 300-01. Warner did not want consumers to compare the recordings and to determine that a catalogue Three Tenors album "is just fine for a few dollars less." O'Brien, Tr. 485-87.

271. Rand Hoffman, PolyGram's representative in the United States also testified that the function of the moratorium was to deter consumers from purchasing 3T1 and 3T2, with the expectation that such consumers would by default select 3T3. Hoffman I.H. at 43.

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272. This strategy, Hoffman expected, would protect the venturers' investment in the new Three Tenors album. Hoffman I.H. at 47.

273. Paul Saintilan, the PolyGram manager responsible for negotiating the moratorium agreement, testified at his deposition that the purpose of the moratorium was that without it: "consumers would choose, instead of buying the new album, to take advantage of the cheaper price of the old album and buy the old album." Saintilan Dep. at 90; see also JX 9-A.

274. Chris Roberts, the President of PolyGram Classics during 1998, professed not to know the purpose of the moratorium. Roberts Dep. (JX 93) at 141-45.

275. Stephen Greene was identified as a witness for the efficiency justifications proffered by Respondents. Stip. P64. He was unable to identify any risks to 3T3 if the older albums were promoted around the time of the release of 3T3. Greene Dep. (JX 95) at 192-94.

B. Free-Riding

276. The assumption underlying the free-riding defense is that, "some consumers who come to the store, because of the promotion of the 1998 Album and intending to buy that album, may [in the absence of the moratorium] be attracted by the cheaper 1990 and 1994 albums and buy them instead." RX 717 (Wind Expert Report) at P5(b). There is potential consumer harm only if the free-riding is so pervasive that Warner declined to advertise 3T3 in an appropriate manner at the time that the album was released. See RX 716 (Ordover Expert Report) at P30-32; Stockum, Tr. 624, 730, 739-41.

1. Diversion of sales

277. That advertising for one product may benefit another company's product is a ubiquitous phenomenon. Stockum, Tr.

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625-26, 629, 633; CX 612 (Stockum Rebuttal Expert Report) at P17; Wind Dep. (JX 91) at 126-27.

278. Respondents' expert, Dr. Wind, testified in his deposition that there are "tons of examples" of one firm capitalizing upon the marketing activities of a competitor. Wind Dep. (JX 91) 133-34. Dr. Wind explained that sellers generally respond to this challenge by sharpening their marketing campaigns, and by using advertising and other marketing tools to create a distinct identity for the target product. Wind Dep. (JX 91) at 125-29.

279. The "spillover" effect of advertising is a "fact of life" and the prospect of free-riding does not lead sellers of consumer products to abandon advertising. Stockum, Tr. 635-36; CX 612 (Stockum Rebuttal Expert Report) at P17; Kopecky Dep. (CX 610) at 55; Caparro Dep. (CX 609) at 85.

280. Within the recorded music industry, advertising intended to benefit one album often leads to sales of competing albums. RX 716 (Ordoover Expert Report) at P36; Ordoover Dep. (JX 90) at 130; Cloeckaert Dep. (JX 98) at 122-23; Moore, Tr. 59.

281. A strong, popular album creates spillover effects that are beneficial to the entire recorded music industry. For this reason, both labels and retailers often blame slow overall store traffic on the absence of heavily-advertised major new releases during a particular fiscal quarter. JX 105-F (Moore Expert Report) at P23; Cloeckaert Dep. (JX 97) at 46; Kopecky Dep. (CX 610) at 52-54; Caparro Dep. (CX 609) at 83-85.

282. In 1994, as Warner was preparing to market 3T2, it anticipated competition from PolyGram (3T1). F. 200, 202.

283. Warner advertised 3T2, and did not enter into a moratorium with its rival. F. 200-09.

284. Instead, Warner devised a marketing campaign aimed at convincing consumers that 3T2 was preferable to 3T1. F. 203.

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The company's marketing campaign for 3T2 was a success and 3T2 was profitable. F. 222, 223.

285. In 1996 and 1997, Warner was anxious to distribute 3T3 independently, with no prospect of a moratorium with PolyGram. CX 321 at 3TEN00004277.

286. In 1996 and 1997, PolyGram (certainly aware of its own marketing activity in 1994), was anxious to distribute 3T3 independently, with no prospect of a moratorium with Warner. CX 323 at UMG000487-88; CX 324 at UMG004669; CX 327 at UMG004679. Other music companies also were interested in distributing 3T3, with no prospect of a moratorium with PolyGram and Warner. CX 317.

287. The fourth Three Tenors album, Three Tenors Christmas, was produced and marketed by Sony in 2000 without restricting competition from 3T1, 3T2 or 3T3. F. 197-99.

288. Advertising in support of 3T3 would not have been curtailed on account of free-riding. Stockum, Tr. 637-38. Witnesses representing both Warner and PolyGram testified that 3T3 would have been promoted without the moratorium, and that the moratorium had no effect on the resources for advertising and promoting 3T3. "I think that 3T3 would have been appropriately marketed and promoted in the United States without regard for the moratorium with PolyGram." O'Brien, Tr. 490. See also O'Brien, Tr. 448; Roberts Dep. (JX 92) at 50-52.

289. Paul Saintilan testified that PolyGram's advertising budget for 3T3 was determined in January or February 1998, before the moratorium was agreed upon. After February 1998, there was little opportunity for PolyGram to increase or decrease marketing expenditures for 3T3. And even if there were such an opportunity, PolyGram did not view competition from Warner as a rationale for altering its advertising expenditures. Saintilan Dep. (JX 94) at 88-89; Saintilan Dep. (JX 94) at 194-95.

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290. In June 1998, when it appeared to PolyGram that the Three Tenors moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. The company notified its operating companies that if Warner was found selling 3T2 at discounted prices in any territory, then the local PolyGram operating company could respond by discounting 3T1. F. 129, 130.

291. Before the moratorium, PolyGram executives were not concerned that PolyGram operating companies would not use their best efforts to promote 3T3 at the time of the launch, regardless of whether they were allowed to discount 3T1 or Warner discounted 3T2. Greene Dep. (JX 95) at 89-90, 189-90.

2. Free-riding defense

292. In 1998, PolyGram and Warner did not quantify the extent to which consumers drawn to record stores by promotion for 3T3 would (absent the moratorium) have purchased 3T1 or 3T2. O'Brien, Tr. 491; Saintilan Dep. (JX 94) at 82.

293. That PolyGram or Warner executives may have been concerned that 3T3 may lose sales to 3T1 and 3T2 is not a reliable gauge of the magnitude of the free-riding effect. Cloeckaert Dep. (JX 97) at 42-43.

294. Dr. Ordoover calculated that absent the moratorium agreement the sales diverted from 3T3 to 3T1 in the United States due to free-riding during the moratorium period (August - October 1998) would have been small (less than \$ 86,000 per month). RX 716 (Ordoover Expert Report) at P35; Ordoover Dep. (JX 90) at 158. Dr. Ordoover was unable to conclude that free-riding in the United States would have had a significant impact on the venturers' incentives to advertise 3T3. Ordoover Dep. (JX 90) at 158-59.

295. Dr. Ordoover acknowledged that discounting and promotion of 3T1 by PolyGram might increase Warner's incentive to promote 3T3. Ordoover Dep. (JX 90) at 115-16, 118-19.

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296. Dr. Ordoover testified that he "cannot answer the question" whether the moratorium was reasonably necessary for the efficient marketing of 3T3 in the United States. Ordoover Dep. (JX 90) at 55. He does not conclude that free-riding was a significant problem for PolyGram and Warner in the United States - only that it was a plausible concern. Ordoover Dep. (JX 90) at 66; Ordoover Dep. (JX 90) at 36-37. Dr. Ordoover did not consider any less restrictive alternatives to the moratorium. Ordoover Dep. (JX 90) at 77.

297. Although Dr. Ordoover's report states that the moratorium is "reasonably necessary" to avoid free-riding (apparently outside the United States), he defines "reasonably necessary" as meaning plausible, or not obviously pretextual. Ordoover Dep. (JX 90) at 50-51.

298. Dr. Ordoover contends that "a quick look of restraints would be best left for those joint ventures that are a sham." He further argues that any restraint related to a legitimate joint venture should be analyzed under the fullest rule of reason. Ordoover Dep. (JX 90) at 44. As a result, Dr. Ordoover did not determine whether the restraint in this case actually promoted the efficient operation of the venture, or whether the efficiency justifications were valid.

299. For these reasons Dr. Ordoover's testimony is given little weight.

3. Sharing of advertising expenses

300. A method of addressing a free-riding problem associated with advertising is to ensure that all those who benefit from such advertising contribute toward the funding for the advertising. CX 612 (Stockum Rebuttal Expert Report) at P25; Stockum, Tr. 816-18; Ordoover Dep. (JX 90) at 94, 96.

301. The collaboration agreement between Warner and PolyGram provides that the two music companies shall each be entitled to 50 percent of the net profits and net losses derived

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from sales of 3T3 worldwide. Any advertising or marketing expenses incurred by either party are to be deducted from revenues for purposes of calculating net profits (losses). Every dollar spent in the United States by Warner to promote 3T3 is partially reimbursed by PolyGram; fifty cents comes from each of the venturers. Stockum, Tr. 735; JX 10-Q at UMG001072; JX 10-I at UMG0001075; O'Brien, Tr. 419-20; CX 348 at UMG002158; JX 20; CX 532 at 3TEN00009949; CX 533; CX 534 at UMG000577.

302. If the proportional benefit to each party of the advertising is equivalent to the proportional cost of advertising borne by each party, then there is no distortion of incentives. For example, if Warner paid 50 percent of the cost of advertising 3T3, and received 50 percent of the benefit that is an efficient arrangement. Stockum, Tr. 819-20; Ordoover Dep. (JX 90) at 114-15.

303. If the forecasted benefit to PolyGram and Warner from advertising 3T3 were not equal, then the parties could have altered the cost-sharing mechanism accordingly. For example, if Warner were expected to gain 52 percent of the benefit of the advertising, then the parties could have agreed that Warner would pay 52 percent of the cost. Stockum, Tr. 820-21.

304. It is efficient for PolyGram and Warner to allocate advertising costs based upon forecast (rather than actual) sales levels because Warner's advertising expenditures in support of 3T3 in the United States were also based upon forecast rather than actual sales levels. Stockum, Tr. 820-22; CX 321 at 3TEN00004279; Saintilan Dep. (JX 94) at 88-89, 194-95; O'Brien, Tr. 542; 401.

305. If PolyGram and Warner were unable to make a reasonably reliable forecast regarding the relative benefits from advertising 3T3, then each party's contribution to the advertising of 3T3 could have been determined by the parties after the launch of 3T3. Stockum, Tr. 822-23.

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4. Free-riding in the United States

306. Respondents' economic expert, Dr. Ordoover, opined that if there were any serious free-riding problem in connection with the marketing of 3T3, it existed in Europe, but not the United States. Ordoover Dep. (JX 90) at 36-37; Ordoover Dep. (JX 90) at 25, 27.

307. There is no evidence that, during the moratorium period, discounted copies of 3T1 and 3T2 would have been resold, or transshipped, from the United States to Europe.

308. PolyGram considered transshipment to be a problem only within Europe. When PolyGram ran a campaign to discount 3T1 during June and July 1998, it was concerned about ensuring that prices in Europe were roughly equivalent, or "harmonized." JX 40. No effort was made to "harmonize" prices between Europe and the U.S. Cloeckart Dep. (JX 97) at 12-13; Gore Dep. (JX 87) at 24.

5. Making 3T3 more distinct from 3T1 and 3T2

309. Firms generally respond to spillover by "emphasizing the uniqueness of their offering." Wind Dep. (JX 91) at 127, 129.

310. Dr. Ordoover acknowledged that the free-riding problem would be ameliorated if 3T3 were more distinct from 3T1 and 3T2, in repertoire and appearance. Ordoover Dep. (JX 90) at 126, 130, 144; RX 716 (Ordoover Expert Report) at P16.

311. In 1994, Warner used the tools of marketing (e.g., packaging, advertising) to create a unique identity for 3T2, distinct from 3T1. F. 203-08. A similar strategy could have been pursued for 3T3 in 1998. Moore, Tr. 123-35.

C. Consumer Confusion

312. Paul Saintilan was concerned that consumers would find it confusing to choose among three different Three Tenors

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albums. This concern was not based upon research, data, or observation. Saintilan Dep. (JX 94) at 81-82.

313. There is no evidence that consumers were confused in selecting among the Three Tenors albums. Hidalgo Dep. (JX 88) at 84-85. It was "speculation." Greene Dep. (JX 95) at 193, 195; Stainer Dep. (JX 89) at 42-43.

314. PolyGram designed the cover art for 3T3 and could have designed packaging for 3T3 that was distinct from the older Three Tenors products. CX 500; CX 501; CX 502; CX 503; CX 505; CX 508; see also JX 5 at UMG001523-001524; JX 26 at UMG000372; CX 383 at UMG003284.

315. There was no confusion between 3T1 and 3T2 prior to the release of 3T3. Stainer Dep. (JX 89) at 12-13, 19-20; Hidalgo Dep. (JX 88) at 22-24.

316. In 1994, PolyGram and Warner distinguished their respective Three Tenors products by slip case covers (a type of CD packaging), enhanced photo books, and product stickers. CX 272 at UMG00526; CX 288 at UMG006106; CX 296 at 3TEN00005912; CX 299 at 3TEN00005904; CX 300 at 3TEN00008946; see also Moore, Tr. 127-35.

317. Advertising campaigns for 3T1 and 3T2 could have differentiated these products from the new Three Tenors release. This was done in 1994 to distinguish 3T2 from 3T1. Stainer Dep. (JX 89) at 21; CX 249 at 3TEN00011254; CX 259 at 3TEN00011108.

318. Discounting of 3T1 and 3T2 also could have differentiated these products from the new Three Tenors release. Saintilan Dep. (JX 94) at 91-92.

319. Consumer confusion comes from the retail display of the albums. Saintilan Dep. (JX 94) at 91. If products are displayed appropriately, discounting need not lead to consumer confusion. Saintilan Dep. (JX 94) at 92.

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320. Record retailers display their products to avoid confusing consumers. Saintilan Dep. (JX 94) at 83; Caparro Dep. (CX 609) at 70-71.

321. PolyGram and Warner could have remedied any consumer confusion by requesting that retailers display 3T3 separately from 3T1 and 3T2. Saintilan Dep. (JX 94) at 84-85.

322. Warner could have secured commitments from retailers that 3T3 would be positioned prominently in the stores, and that 3T1 would not be positioned alongside 3T3. CX 612 (Stockum Rebuttal Expert Report) at P30; Stockum, Tr. 793-94; Wind Dep. (JX 91) at 81-86. Warner could have prevented any CD other than 3T3 from being placed in the special Eiffel Tower display it provided to retailers. O'Brien Dep. (JX 100) at 82. Record companies have been able to achieve exclusive space in retail stores. CX 249 at 3TEN00011253; Caparro Dep. (CX 609) at 66-67; Kopecky Dep. (CX 610) at 36-37, 64; Moore, Tr. 52, 261-62.

1. Respondents' evidence of consumer confusion

323. Respondents' expert witness, Dr. Yoram Wind, opined that it is theoretically possible that some consumers faced with too much variety may elect to postpone their purchase because they are not yet certain of the relative merits of the various products. Wind Dep. (JX 91) at 20-22, 131-33. However, the theory is premised upon "small studies" that are "not necessarily generalizable to the whole population." Wind Dep. (JX 91) at 25. Dr. Wind does not know how many, if any, consumers would find the offering of three albums so confusing that they buy none. Wind Dep. (JX 91) at 23.

D. Commercially Sound Marketing Strategy

324. Respondents' executives conclude that disappointing sales of 3T3 were probably attributable to the "tiring of the concept more than anything else." Cloeckaert Dep. (JX 97) at 73-74; see also Stainer Dep. (JX 89) at 74; Hidalgo Dep. (JX 88) at

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91, 60-61; Saintilan Dep. (JX 94) at 35-37; Ordoover Dep. (JX 90) at 147.

325. Respondents' expert, Dr. Wind argues that the moratorium was "sound commercial strategy." Dr. Wind's opinion assumes that 3T1, 3T2, and 3T3 are a single product line. Wind Dep. (JX 91) at 78. Dr. Wind assumes that, when marketing a product line, the goal is to target the various products to different segments of the market. Wind Dep. (JX 91) at 77-78. However, Dr. Wind's essential assumption is inconsistent with the facts of the case - where Warner and PolyGram specifically retained their rights to exploit 3T1 and 3T2. F. 61-62.

326. Dr. Wind did not review the evidence in this case to determine if the moratorium was necessary, as opposed to merely theoretically or "plausibly" necessary. Wind Dep. (JX 91) at 10-11.

327. Dr. Wind has not studied, worked in, or consulted for the recorded music industry. Wind Dep. (JX 91) at 5.

328. Professor Catherine Moore, an expert in the marketing of recorded music products who testified at trial, explained that while it may be useful to market recorded music products by one artist together, this is not necessary because a new release must be given its own unique identity and form its own message to consumers. Moore, Tr. 139.

329. Unlike Dr. Wind, Professor Moore has substantial first hand experience in marketing music products. Based upon her demeanor and experience I found her testimony to be particularly credible. Professor Moore is the director of the music business program at New York University, and is also a professor in that program. The music business program is an academic program that trains students for careers in the music industry, particularly in marketing, advertising, and promotion. Professor Moore teaches courses that focus on marketing and pricing issues in the recorded music industry and consults in that field. In addition, Professor Moore has nearly 20 years of experience working in the

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recorded music industry in retail music stores, distribution companies and for labels. Moore, Tr. 8-18.

330. For these reasons, Dr. Wind's opinions about the "necessity" of a "commercially sound" strategy are given little weight.

XI. RISK OF RECURRENCE

331. It is not unusual for an artist to release material on more than one label. Moore, Tr. 85; Hoffman, Tr. 293-94; Gore Dep. (JX 87) at 68-69; Caparro Dep. (CX 609) at 76; Constant Dep. (JX 96) at 97; CX 604-D. Examples of artists that have switched from one label to another include Janet Jackson, Mariah Carey, Rod Stewart, Placido Domingo, Jose Carreras, Vladimir Horowitz, Daniel Barenboim and Leonard Bernstein. Moore, Tr. 85-87. Other examples identified by PolyGram witnesses include Terry Dexter and Fabulous (Hoffman, Tr. 293-94); Elton John and Willie Nelson (Caparro Dep. (CX 609) at 73-74); and Miles Davis, George Benson, Sarah Brightman, Peter White, and Keith Jarrett (Gore Dep. (JX 87) at 63-64, 68-69). Since it is common for an artist to record for more than one label over time, many artists have catalogue albums that appear on a label different from the label that releases the artist's new records. Moore, Tr. 85-89. When that occurs, the same incentives to enter into an agreement not to compete will exist that caused PolyGram and Warner to enter into the Three Tenors moratorium agreement.

332. It is common for one music company to "release" an exclusive artist to a competing company for purposes of a particular project. Moore, Tr. 39-40. The music company that receives the services of another company's exclusive artist, may reciprocate by releasing one of its exclusive artists for a future project. CX 513; CX 515; CX 516.

333. A music label may release an artist from his exclusive recording contract in return for a royalty on the artist's first album on his new label. When this occurs, the two competing labels have a shared financial interest in the success of a particular

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album. Hoffman, Tr. 357. Unless enjoined, Universal may seek a moratorium agreement to limit discounting or advertising of an artist's catalogue items on a competitor's label where it has obtained a release to have that artist perform for it.

334. Universal Music Group and Sony Music Entertainment have formed a joint venture to distribute music over the Internet. Universal, Sony, and other music companies will provide their music to the venture, known as "pressplay" on a non-exclusive basis. Accordingly, the music products marketed by the joint venture may also be marketed through traditional retail outlets. CX 553.

LEGAL ANALYSIS

I. SUMMARY OF FACTS

A. Joint Venture

The Three Tenors released three audio and video recordings from three concerts at three World Cup final games. F. 4-5. They first performed together at the Baths of Caracalla in Rome during the summer of 1990. F. 27. PolyGram acquired the rights to distribute audio and video recordings of the concert. F. 28. The 1990 Three Tenors album ("3T1") became the best selling classical record of all time. F. 29.

In 1994, the Three Tenors planned a second World Cup performance at Dodger Stadium in Los Angeles. F. 31. Concert promoter Tibor Rudas offered PolyGram a license for the rights to the concert. F. 32. They did not agree upon terms, and Rudas instead authorized Warner to distribute audio and video recordings derived from the 1994 Three Tenors concert ("3T2"). F. 33.

PolyGram reacted to Warner's new album. F. 210. In response to the release of 3T2, PolyGram advertised that 3T1 was the "original" Three Tenors recording - "unique and unrepeatabe," F.

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211, and marketed 3T1 at a discounted price, several dollars below the price of Warner's 3T2. F. 214-21.

Warner supported the release of 3T2 with a "high-power pop marketing effort," F. 202-04; CX 247, advertising the new album in newspapers and magazines, on television and billboards, and with elaborate in-store displays. F. 205. Warner offered retailers discounts on 3T2, and worked to secure prominent placement for the album within music stores. F. 206-07. A PolyGram executive described Warner's marketing of 3T2 as "the most impressive campaign I have seen in my days." Hidalgo Dep. (JX 88) at 46-47; F. 204. The 3T2 project was a commercial success for Warner. F. 222. Warner did not seek or secure a moratorium on competition. F. 200.

During 1996 and 1997, the Three Tenors participated in a worldwide tour. F. 224. Warner and PolyGram used the opportunity to drive sales of their respective Three Tenors products. F. 224. PolyGram offered 3T1 at discounted prices. F. 225. In addition, PolyGram released a World Tour Commemorative Edition of the 1990 concert, digitally re-mastered on a gold CD. F. 226. Warner's marketing campaign emphasized the virtues of 3T2 and downplayed the benefits of PolyGram's offering ("The digital re-mastering will be detectable by very few. . . . The so called 'Gold' disc is almost certainly not real gold."). F. 230.

Consumers benefitted from the price discounts, promotions, and product enhancements that flowed from this unrestrained competition. F. 232; CX 309. Both of the Three Tenors albums were among the best-selling classical recordings in the United States in 1994, 1995, 1996, and 1997. F. 234.

B. Collaboration on 3T3

During 1996, Tibor Rudas approached PolyGram and Warner separately to discuss the next Three Tenors project, a huge open-air concert in front of the Eiffel Tower to coincide with the World Cup finals in Paris in July 1998. F. 51. Both music companies

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were interested in acquiring the right to distribute the 3T3 products. F. 52-54.

In the spring of 1997, the Chairman of Atlantic Recording Corp. (a Warner subsidiary based in the U.S.) met with his counterpart at PolyGram "to ask that PolyGram allow Luciano Pavarotti to record the project for [Warner]." n3 F. 55. PolyGram responded with an offer of its own: Warner and PolyGram should share financial and operational responsibility, profits, and losses for the 1998 Three Tenors project. F. 56.

n3 Pavarotti was under exclusive contract with PolyGram. F. 55. In 1994, PolyGram had waived its exclusive rights, permitting Pavarotti to record 3T2 for Warner. F. 34. Warner was seeking a similar arrangement for 3T3. F. 55.

For \$ 18 million, Rudas licensed to Warner worldwide audio, video, and home television rights to the 1998 concert ("the 3T3 Rights"). F. 58. Warner sub-licensed to PolyGram the right to exploit the 3T3 Rights outside the United States. F. 59-60. Warner would distribute the new album and video in the United States, and PolyGram was responsible for the rest of the world. The parties also agreed:

. that Warner and PolyGram would each receive 50 percent of the net profits and losses derived from the exploitation of the 3T3 Rights (as well as from the production of a Greatest Hits album and/or a Box Set incorporating the 1990, 1994, and 1998 concerts);

. that PolyGram would reimburse Warner for 50 percent of the \$ 18 million advance paid to Rudas; and

. that other expenses would be shared by Warner and PolyGram on a 50/50 basis.

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In negotiating the terms of the 1998 Three Tenors project, PolyGram and Warner discussed the scope of a covenant not to compete. F. 61. The parties agreed that, for four years, neither would release a new Three Tenors album (except as part of the parties' collaboration). Warner insisted that the non-compete should not apply to the pre-existing Three Tenors albums. F. 62. The final collaboration agreement, dated December 19, 1997, provides that PolyGram and Warner shall each be free separately to exploit its older Three Tenors recordings. F. 62-63.

PolyGram and Warner recognized that the success of the new Three Tenors album was tied to the repertoire, F. 66, and wanted to be sure that the repertoire would be "distinctive," and that it would not repeat selections from the earlier Three Tenors recordings. F. 66. Rudas insisted that he and the artists should control the choice of songs. F. 67-68. PolyGram and Warner agreed. F. 69-72.

During 1998, PolyGram and Warner were concerned that their new Three Tenors album would not be as appealing as the 1990 and 1994 releases. F. 73. Various marketing strategies were considered. F. 74-78. Rudas assured that the album recorded in Paris would be new. F. 79-80. The record companies decided that the all new repertoire would be a key selling point. F. 81. PolyGram and Warner agreed that the packaging for 3T3 "must be as different as possible from the two previous releases." F. 78.

C. Moratorium Agreement

At a meeting of PolyGram and Warner representatives in New York in March 1998, PolyGram and Warner agreed not to discount or advertise 3T1 or 3T2 audio and video products in the weeks surrounding the release of the new recording. F. 90-96. They agreed that competition from the older Three Tenors products could reduce the sales and profitability of the new Three Tenors release. F. 268-73.

In April 1998, PolyGram instructed its opcos n4 that, pursuant to an agreement with Warner, aggressive marketing campaigns in

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support of 3T1 should terminate by the end of July. F. 107. Paul Saintilan (Senior Marketing Director, PolyGram) notified Warner of PolyGram's actions. F. 108-13. Later, PolyGram became concerned that the moratorium would not be implemented by Warner. F. 118-21, 126-27. PolyGram instructed its opcos that if, following the release of 3T3, Warner was discovered discounting 3T2 in a particular market, then the PolyGram opco was free to retaliate by discounting and promoting 3T1. F. 128-29.

n4 Both PolyGram and Warner distribute their products through a network of affiliated operating companies responsible for sales within a particular country or region. F. 23.

D. Repertoire for the 1998 Concert

In mid-June 1998, Rudas informed PolyGram and Warner of the intended repertoire for the upcoming Three Tenors concert. F. 133. The repertoire would include several compositions that were also included on 3T1 and/or 3T2. F. 133-34. PolyGram and Warner expressed to Rudas their dissatisfaction with the intended repertoire. F. 135.

E. Reaffirmance

On June 25, 1998, Anthony O'Brien (Warner) and Paul Saintilan (PolyGram) discussed by telephone their mutual desire to re-enforce the moratorium. F. 137-38. Once again they affirmed that, in the United States, 3T1 and 3T2 would not be discounted or advertised in the weeks following the release of 3T3 (scheduled for August 10, 1998). F. 138. O'Brien assured Saintilan that he would speak with other Warner executives about implementing the moratorium on a worldwide basis as well. F. 139.

On July 2 and July 10, 1998, Saintilan (PolyGram) provided O'Brien (Warner) with letters clarifying the terms of the moratorium, and seeking assurance that Warner would comply in all markets. F. 141-47. O'Brien conferred with executives from

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Warner's international distribution operation and secured their assent to the scheme. F. 148-49. Thereafter, O'Brien notified Saintilan that Warner would adhere to the moratorium on a worldwide basis. F. 150. In mid-July 1998, PolyGram and Warner issued written directives to their respective operating companies instructing that all discounting, advertising, and promotion of 3T1/3T2 was prohibited from August 1, 1998 through October 15, 1998. F. 148-49, 152-53.

F. Intervention of Attorneys

In late July 1998, after the Paris concert but prior to the release of 3T3, lawyers for PolyGram and Warner became involved with the moratorium issue. Paul Saintilan forwarded to PolyGram's General Counsel his documents relating to the Three Tenors moratorium - and then proceeded to "delete" such documents from his files. CX 459. On July 30, 1998, Saintilan wrote to PolyGram operating companies denying an agreement between PolyGram and Warner to restrict competition. F. 156-57.

Attorneys for the two record companies reviewed a draft letter from O'Brien (Warner) to Saintilan (PolyGram) purporting to reject the moratorium agreement for non-U.S. markets. F. 160-62. On August 10, 1998, O'Brien signed the letter and forwarded it to Saintilan. F. 161. Shortly thereafter, O'Brien telephoned Saintilan. O'Brien informed Saintilan that he (O'Brien) had been requested by counsel to send the August 10 letter. O'Brien further informed Saintilan that the Warner still intended fully to comply with the moratorium agreement on a worldwide basis. F. 163. O'Brien's understanding was that PolyGram likewise intended to comply with the moratorium agreement. F. 164.

G. Compliance

Warner and PolyGram complied with the moratorium agreement in the United States. F. 170-75. Between August 1, 1998 and October 15, 1998, neither Warner nor PolyGram discounted its respective catalogue Three Tenors products in the United States. F. 171, 173-74. Between August 1, 1998 and

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October 15, 1998, neither Warner nor PolyGram funded advertising for 3T1/3T2 in the United States. F. 172.

Both Warner and PolyGram substantially complied with the moratorium agreement outside of the United States as well. F. 177-81.

By memo dated October 26, 1998, Warner notified its operating companies that the moratorium on discounting older Three Tenors products was no longer in effect. CX 463. With the expiration of the moratorium agreement, Warner anticipated that PolyGram would "now discount [3T1] heavily." CX 462.

II. LEGAL DISCUSSION

A. Joint Venture

To encourage new output, the rules for evaluating collaboration by competitors are generally more lenient for joint ventures. n5 Firms may lack capital, labor or technology required to compete effectively in a new business, and case law has favored such collaboration by lowering the antitrust barriers to coordination which plausibly would generate procompetitive benefits. n6 Joint ventures are typically analyzed under the rule of reason. n7 A separate agreement connected to a joint venture will also be evaluated under the rule of reason where the agreement restraining competition is ancillary to the main purpose of the venture and "reasonably adapted and limited to the necessary protection of a party in carrying out of such purpose" *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 283 (6th Cir. 1897), *aff'd*, 175 U.S. 211 (1899) (Taft, J.). n8

n5 *In re Brunswick Corp.*, 94 F.T.C. 1174, 1265 (1979); *aff'd sub. nom. Yamaha Motor Corp. v. FTC*, 657 F.2d 971 (8th Cir. 1981).

n6 Thomas A. Piraino, Jr., *A Proposed Antitrust Approach to Collaborations Among Competitors*, 86 Iowa L. Rev. 1137, 1139 (2001).

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n7 Id. Joint ventures have no immunity from the antitrust laws, however. *NCAA v. Bd. of Regents*, 468 U.S. 85, 113 (1984). The rule of reason may involve only a quick look at justifications before condemning a naked restriction on price or output. *Chicago Prof'l. Sports Ltd. Partnership v. NBA*, 961 F.2d 667, 674 (7th Cir. 1992).

n8 Under the ancillary restraint doctrine "some agreements which restrain competition may be valid if they are . . . necessary to make that transaction effective." *Los Angeles Mem'l Coliseum Comm'n v. NFL*, 726 F.2d 1381, 1395 (9th Cir. 1984) (quoting Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 Yale L.J. 775, 797-98 (1965)).

B. Ancillary Restraint Doctrine

A joint venture involves contractual undertakings by the parents. Some agreements, such as providing equipment, management, or capital, are central to the joint venture's operation and purpose. Other commitments not intrinsic to the venture may be given to reassure parents that some collateral event harmful to the venture does not occur. If the collateral agreement is necessary to make the joint venture work, and no broader than necessary, it will be ancillary to the venture and must be analyzed under the rule of reason. In *re Brunswick*, 94 F.T.C. at 1275 (citations omitted) described the ancillary doctrine:

Certain reductions in competition between the parents are an inevitable consequence of a joint venture agreement. For example, it is to be expected that the joint venturers will put their venture-related business into the venture and "not compete with their progeny." The Supreme Court has recognized that these limited reductions in competition are often necessary to make a joint venture operate efficiently, and therefore may escape the strict application of per se rules.

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But such agreements, to be legitimately ancillary to a joint venture, must be limited to those inevitably arising out of dealings between partners, or necessary (and of no broader scope than necessary) to make the joint venture work.

To be ancillary to the joint venture, then, a collateral restraint must be an integral part of the venture, or reasonably necessary to make it work. In *Brunswick*, one of the collateral agreements found to violate Section 5 foreclosed Yamaha, one of the joint venturers, from selling its own brand in the United States in competition with the joint venture product. *Id.* at 1276. Yamaha had been buying and reselling outboard motors in the United States under its label, and this business was not included in the assets placed into the joint venture, and was not integral to it. Here, similarly, 3T1 and 3T2 were not placed into the joint venture.

Complaint Counsel argue that the moratorium agreement, to be ancillary, must be essential to the purpose of the joint venture. Respondents argue that it need only be plausibly connected to the venture. *Brunswick* states the law needed to answer this question. To be ancillary, the restriction is "limited to those inevitably arising out of dealings between the partners, or necessary (and of no broader scope than necessary) to make the joint venture work." *Id.* at 1275. In *Polk Bros, Inc. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985), Respondents' strongest case, the restraint was held ancillary because it "may promote the success of" the venture; but the court further held that "the covenant allocating items between the retailers played an important role in inducing the two retailers to cooperate" and Polk "would not have entered into this arrangement . . . unless it had received assurances that [Forest City] would not compete with it. . . . The agreement not to compete was an integral part of the lease and land sale." 776 F.2d at 189-90 (emphasis added). Thus, to be ancillary, the restraint must be an integral part of the venture or reasonably necessary to its promotion. n9

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n9 Cases in which suspect restraints were upheld involved restraints on products created by, not outside of, the joint venture. *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 23-24 (1979) ("BMI") (price restraint affected blanket license that was the product of the joint venture; participants were free to separately license and price their individual works); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 214 (D.C. Cir. 1986) (restrictions concerned ventures' use of joint venture assets); *Polk Bros.*, 776 F.2d at 189-90 (restraint applicable to sales from jointly constructed facility only; ventures remained free to increase output from separately operated facilities). Unlike these cases, the restraint here was not necessary for the creation of the product of the joint venture nor was it a restraint on the product created by the joint venture.

The moratorium agreement was not necessary for the creation of 3T3. The negotiators of the 3T3 joint venture did not have it in their minds while creating the joint venture and in fact specifically agreed that they could continue to exploit 3T1 and 3T2 during the sale of the venture product 3T3. F. 62, 262. The belated moratorium may have been intended to support the introduction of 3T3, but it was created months after the joint venture agreement. F. 263. n10 Further, Warner successfully introduced 3T2 in 1994 in the face of serious competition, with discounts and advertising, by PolyGram's 3T1. F. 200-23. Unless Respondents meet their burden of showing an efficiency justification, the moratorium agreement therefore would not be ancillary to the joint venture.

n10 Just as in *NCAA*, involving a lawful joint venture to organize college athletic teams, the agreement at issue was not a legitimate ancillary agreement. *NCAA*, 468 U.S. at 113; see also *Law v. NCAA*, 134 F.3d 1010, 1018 n.18 (10th Cir. 1998). In both *NCAA* cases, the restraints may have been supportive of the lawful joint venture but were not integral to it and were broader than necessary to accomplish the purpose. Although *NCAA v. Regent* held

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the television plan as an unreasonable restraint violating the Sherman Act, the Court could well have found that the plan was supportive of the legitimate joint venture. The television plan there promoted the balance of teams, one of NCAA's essential lawful objectives. *Gen'l Leaseways Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 595 (7th Cir. 1984) (Posner, J.). However, NCAA held that the television plan was not a legitimate joint venture agreement because, unlike BMI, it did not act as a joint sales agent. The selection of the individual games and the negotiation of particular agreements were left to the networks and the individual schools. The television plan did not eliminate individual sales of broadcasts, since these still occurred, albeit subject to the fixed prices and output limitations, just as in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982). Similarly, the moratorium agreement here could support the lawful joint venture but still violate Section 5 because it was not integral to the venture nor necessary to market the product. *NCAA*, 468 U.S. at 114. To prove that the moratorium was integral to the venture, Respondents rely on the testimony of Mr. O'Brien that had he known that PolyGram was going to discount 3T1 during the introduction of 3T3 he would not have entered into the joint venture. Tr. at 514-15. The weight of such after the fact reasoning to show intent is generally suspect. *Gen'l Leaseways*, 744 F.2d at 595-96. Since the joint venture agreement specifies that Warner and PolyGram shall be free separately to exploit [e.g., sell at a discount] its older Three Tenors recordings, F. 62-63, this testimony seems to be questionable.

C. Burden of Proof

Complaint counsel argue that the moratorium agreement is price fixing and reduction in output presumptively anticompetitive, requiring the use of the per se or quick look analysis and shifting the burden to respondents to demonstrate a countervailing efficiency sufficient to overcome the presumption. Complaint counsel further argue that the

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respondents' proffered efficiency justifications are implausible or invalid. Thus, complaint counsel urges a finding of a violation of Section 5 of the FTC Act.

Respondents argue that the moratorium agreement was ancillary to the joint venture, since it plausibly supports the main purpose of the joint venture; that the rule of reason applies to ancillary restraints; that complaint counsel failed to prove competitive injury from the moratorium agreement, relying instead on a presumption of anticompetitive effects from the nature of the agreement; and that the lack of evidence of harmful market effects under the rule of reason requires dismissal of the case.

1. Per Se Rule

The moratorium agreement restricted competition in advertising and the price of 3T1 and 3T2, which were not products produced and sold by the joint venture. F.264-67. n11 It was not ancillary to the joint venture and appears to be a naked agreement to fix prices and restrict output. The moratorium agreement could, therefore, be analyzed as a naked agreement n12 violating Section 5 under the per se rule. n13

n11 The Warner and PolyGram joint venture agreement did provide that a selection of hits and box products taken from 3T1 and 3T2 might be sold through the joint venture starting in 1999. During the term of the moratorium agreement, August 1 to October 15, 1998, F. 149, the joint venture sold only 3T3. Speculative future joint activity cannot justify a price-fixing agreement in effect during 1998. Herbert Hovenkamp, XI Antitrust Law P1906b at 212 (1998), ("The principle reason for rejecting defenses that a restraint is competitive in the long run is that proof is nearly always highly speculative and the defense could be asserted so often that it would effectively undermine a large proportion of instances properly subject to per se disposition.").

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n12 Law analyzed the agreement on coaches' salaries under the rule of reason because college sports is an industry where some horizontal agreements among NCAA members are necessary if there is to be a product at all. 134 F.3d at 1019. Respondent did not prove that the music industry requires joint ventures in order to increase output.

n13 Price fixing agreements lack redeeming virtue and are conclusively presumed to be unreasonable. *Nat'l Soc'y of Prof'l Engineers v. United States*, 435 U.S. 679, 692 (1978) ("NSPE"); *Maricopa*, 457 U.S. at 344.

2. Rule of Reason

If the case is analyzed under the rule of reason: n14 (1) complaint counsel bears the initial burden of showing that an agreement had a substantially adverse effect on competition; (2) if complaint counsel meets this burden, the burden shifts to respondent to come forward with evidence of procompetitive virtues of the alleged wrongful conduct; and (3) if respondents are able to demonstrate procompetitive effects, complaint counsel then must prove that the challenged conduct is not reasonably necessary to achieve the legitimate objectives or that those objectives can be achieved in a substantially less restrictive manner. Ultimately, if those steps are met, the harms and benefits must be weighed against each other in order to judge whether the challenged behavior is, on balance, reasonable. n15

n14 Judge Posner felt it was prudent to use both rules in *Gen'l Leaseways*, 744 F.2d at 569, since "it is possible we are wrong in holding this case is governed by the per se rule. . . ."

n15 The sequence of shifting of burdens is described in *Law*. 134 F.3d at 1019; see also *United States v. Brown University*, 5 F.3d 658, 669 (3rd Cir. 1993).

Since it was unnecessary and not integral to the joint venture, the moratorium agreement appears to be one that would always or

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almost always tend to restrict competition and decrease output. BMI, 442 U.S. at 19-20. The elimination of competition is apparent on a quick look. A restraint on competition between parents and the joint venture may be a naked agreement, subject to quick look analysis under the rule of reason. California Dental Ass'n v. FTC, 526 U.S. 756, 770 (1999) ("CDA"); Law, 134 F.3d at 1020. If the anticompetitive effects of price fixing are obvious the burden of proceeding switches. NSPE, 435 U.S. at 692. n16

n16 A naked, effective restraint on market price or volume can establish anticompetitive effect under a truncated rule of reason analysis. Chicago Prof'l Sports, 961 F.2d at 674; see also General Leaseways, 774 F.2d at 595.

Respondents therefore would have the burden of showing that the procompetitive benefits of the restraint justify the anticompetitive effects. Law, 134 F.3d at 1021. Justifications offered under the rule or reason may be considered only to the extent that they tend to show that, on balance, the challenged restraint enhances competition. NCAA, 468 U.S. at 104.

D. Competitive Effects

Some restraints almost always tend to raise price or reduce output; the presumptively anticompetitive effect of such an agreement is "intuitively obvious." CDA, 526 U.S. at 781; NCAA, 468 U.S. at 110. Where anticompetitive effects are presumed, the burden shifts to the respondents to demonstrate a countervailing efficiency sufficient to overcome the presumption. CDA, 526 U.S. at 770-71 (1999); NCAA, 468 U.S. at 113. This shift occurs in the "abbreviated or 'quick-look' analysis under the rule of reason." CDA, 526 U.S. at 770. n17 Where restraints raise obvious potential anticompetitive effects, the merits of the proffered efficiency justifications should be considered in advance of conducting a market analysis. Presumptively anticompetitive restraints may be condemned without assessing market power or examining actual anticompetitive effects. Id. at 779; Brown University, 5 F.3d at 673. "The absence of proof of market power does not justify a naked restriction on price or

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output This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." NCAA, 468 U.S. at 109-10. The Court rejected the NCAA's efficiency justifications, finding that they were plausible but unsupported by the evidence (i.e., invalid). n18

n17 See BMI, 441 U.S. at 30; NCAA, 468 U.S. at 110; F.T.C. v. Indiana Fed'n of Dentists, 476 U.S. 447, 459 (1986) ("IFD"); Continental Airlines v. United Airlines, 277 F.3d 499, 508-510 (4th Cir. 2002); Law, 134 F.3d at 1019-1020; Brown University, 5 F.3d at 669; Chicago Prof'l Sports, 961 F.2d at 674; General Leaseways, 744 F.2d at 595; In re: Detroit Auto Dealers Assoc., 111 F.T.C. 417, 493 (1989); In re: Massachusetts Bd. Of Registration in Optometry, 110 F.T.C. 549, 603-604 (1988).

n18 A naked restraint on price and output is unaccompanied by new production or products; an ancillary restraint is part of a larger endeavor whose success it promotes. Polk Bros., 776 F.2d at 188-89. A naked restraint may be found unlawful even though contained in elaborate joint ventures that were not being challenged and were socially beneficial. For example, while the NCAA is a socially beneficial athletic venture involving colleges and universities, both its rule limiting televised football games and the rule fixing maximum coaches salaries were properly characterized by the court as 'naked' restraints on price or output. NCAA 468 U.S. at 113-14; Law, 134 F.3d at 1018 n.10.

The issue here, then is whether the agreements between PolyGram and Warner to forgo discounting and advertising fall within a category of restraints that is likely, absent an efficiency justification, to lead to higher prices or reduced output. n19 The assessment of whether a category of restraints is inherently likely to be anticompetitive should be guided by common sense, legal precedent, and economic theory and research. n20

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n19 BMI, 441 U.S. at 19-20; IFD, 476 U.S. at 459; NCAA, 468 U.S. at 109-110; Brown University, 5 F.3d at 669 (abbreviated antitrust analysis appropriate where "'no elaborate industry analysis is required to demonstrate the anticompetitive character' of an inherently suspect restraint"); Detroit Auto Dealers Assoc., 111 F.T.C. at 498; Mass. Board, 110 F.T.C. at 604 ("First, we ask whether the restraint is 'inherently suspect.' In other words, is the practice the kind that appears likely, absent an efficiency justification, to 'restrict competition and decrease output'").

n20 See CDA, 526 U.S. at 781; NCAA, 468 U.S. at 103; Detroit Auto Dealers' Assoc., 111 F.T.C. at 496.

1. Agreement on price

The agreement between PolyGram and Warner not to discount 3T1 and 3T2 is price fixing, n21 and subject the abbreviated review. n22 An agreement between competitors to fix minimum prices threatens the efficient functioning of a market economy. FTC v. Ticor Title Ins. Co., 504 U.S. 621, 639 (1992); FTC v. Super. Ct. Trial Lawyers Ass'n, 493 U.S. 411, 435 n.16 (1990) ("SCTLA"); NCAA, 468 U.S. at 100.

n21 F. 235. Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643, 648 (1980).

n22 BMI, 441 U.S. at 1; NCAA, 468 U.S. at 100; NSPE, 435 U.S. at 692.

PolyGram and Warner often find it necessary to offer discounts to retailers in order to increase sales levels; this is true of both new releases and older (or catalogue) recordings. F. 239. During 1994, PolyGram responded to the release of 3T2 by aggressively reducing the price of 3T1 in many markets--to the benefit of consumers. F. 214-21. And again in 1998, many PolyGram and Warner operating companies determined that the best way to capitalize upon the public's revived interest in the Three Tenors was by reducing the price of these products

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(coupled with aggressive advertising campaigns). F. 103-05, 115-18.

An agreement to forgo discounting has an obvious anticompetitive potential. And it is no defense that the competitive injury here was small. That the restrictions were relatively small in scope and is limited in time provides no escape from liability. "A court applying the Rule of Reason asks whether a practice produces net benefits for consumers; it is no answer to say that a loss is 'reasonably small.'" *Chicago Prof'l Sports*, 960 F.2d at 674; *SCTLA*, 493 U.S. at 434-35.

2. Agreement on advertising

The agreement between PolyGram and Warner to forgo all advertising is also presumptively anticompetitive. n23 CDA expressed a more permissive view toward limited advertising restraints in a professional services market. However, the Court indicated that a complete ban on truthful, non-deceptive advertising--especially in an ordinary commercial market--should continue to be viewed harshly. CDA, 526 U.S. at 773.

n23 See *Blackburn v. Sweeney*, 53 F.3d 825, 827 (7th Cir. 1995); *United States v. Gasoline Retailers Ass'n*, 285 F.2d 688, 691 (7th Cir. 1961); *Federal Prescription Serv., Inc. v. American Pharm. Ass'n*, 484 F. Supp. 1195, 1207 (D.D.C. 1980), *aff'd in part rev'd on other grounds in part*, 663 F.2d 253 (D.C. Cir. 1981); *Massachusetts Bd.*, 110 F.T.C. at 606-608.

Antitrust law's hostility to advertising bans is supported by economic theory and empirical research. Information disseminated through advertising serves to educate consumers about the availability of alternatives, quality differences among competing products, sales locations, means of purchase, and pricing. This information assists consumers to find their preferred products at low prices, and thus serves to promote competition. F. 244-45; see CDA, 526 U.S. at 773 n.10; *Bates v. State Bar of Arizona*, 433 U.S. 350, 364 (1977).

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Advertising restrictions result in consumers paying higher prices. F. 246. Even a short-lived restraint on advertising can have a significant effect on consumers. Dr. Stockum described a study of the New York newspaper strike. n24 In New York, newspapers are important for grocery store advertising. After only a single week without newspapers, supermarket prices increased because of the restriction on advertising. Absent an efficiency justification, Respondents' agreement not to advertise or promote catalogue Three Tenors albums is also likely to be anticompetitive. F. 248.

n24 F. 246-47; Stockum, Tr. 599-600.

Advertising has proven to be an important competitive tool in the marketing of Three Tenors products. In 1994, PolyGram used advertising to teach consumers that 3T1, the "original" Three Tenors recording, was still the best performance, still widely available, and indeed often available at a discounted price. F. 210-13, 253. Warner used advertising in its effort to create a distinct identity for 3T2, and to suggest to consumers that the newer release was the superior product. F. 201-09, 254.

During 1998, PolyGram and Warner operating companies wished to offer their older Three Tenors recordings at a discount. Discounting was coupled with an aggressive advertising campaign. F. 103-05, 115-18, 255-58. Warner forecast that by advertising the discount on the wholesale price of 3T2, the company sales could increase by 170 percent. F. 256. Advertising of recorded music can create additional demand, and hence an environment in which discounting by record companies is more likely to occur. F. 259. Upon the release of 3T3 in 1998, PolyGram and Warner aggressively advertised it in every available media. F. 168. The record companies intended that their advertising ban would conceal the availability of better value Three Tenors recordings, and that consumers would instead purchase the higher margin 3T3 release. F. 269. The potential anticompetitive effect of this strategy is obvious.

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E. Efficiency Defenses**1. Must be plausible and valid**

Since the Three Tenors moratorium involved presumptively anticompetitive restraints, Respondents must demonstrate a plausible and valid efficiency justification. CDA, 526 U.S. at 771; NCAA, 468 U.S. at 113. n25 Respondents must show that the moratorium was necessary in order to promote competition and benefit consumers. BMI, 441 U.S. at 23; NCAA, 468 U.S. at 114. n26

n25 Respondents put into evidence the reports of its experts Dr. Yoram Wind and Dr. Janusz Ordovery. Expert reports are not as reliable as expert testimony at trial. *Tokio Marine and Fire Ins. Co. v. Norfolk & Western Rwy. Co.*, 1999 U.S. App. LEXIS 476, *10 (4th Cir. 1999); *Engerbretsen v. Fairchild Aircraft Corp.*, 21 F.3d 721, 729 (6th Cir. 1994). The report is not submitted under oath. There is no basis to evaluate the expert's qualifications or credibility. *EPIS, Inc. v. Fidelity and Guar. Life Ins. Co.*, 156 F. Supp. 2d 1116, 1124 (N.D. Cal. 2001). The witness has not been judicially designated as an expert. The witness has not been subject at trial to cross-examination. *Weil v. Long Island Sav. Bank*, 2001 U.S. Dist. LEXIS 22915, *10-11 (E.D.N.Y. 2001).

In preparing his report, Dr. Wind reviewed no documents from the files of Warner or deposition testimony of any individual responsible for marketing 3T3 in the United States; or any Warner employee. F. 327. Dr. Wind discusses whether the moratorium is plausibly pro-competitive, but he does not evaluate whether the restraints were actually necessary to achieve some efficiency in the United States. Wind Dep. (JX 91) at 10-11. Dr. Ordovery's report rejects the basic premises of modern antitrust analysis. According to Dr. Ordovery, if a restraint is adopted in the context of a non-sham joint venture, then the restraint should be considered to be "reasonably necessary," Ordovery

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Dep. (JX 90) at 50, and analyzed under the full rule of reason. Ordoover Dep. (JX 90) at 44 ("I would say that a--a quick look of restraints would be best left for those joint ventures that are a sham."). According to Dr. Ordoover, there is no threshold requirement to consider the validity of the efficiency argument, Ordoover Dep. (JX 90) at 213, and no need to consider the availability of less restrictive alternatives. Ordoover Dep. (JX 90) at 77. This is inconsistent with the antitrust case law governing abbreviated rule of reason, *NCAA*, 469 U.S. 85; *Law*, 134 F.3d 1010; *Chicago Prof'l Sports*, 961 F.2d 667; *General Leaseways*, 744 F.2d 588. Because they are unsupported by live testimony, untested by cross-examination, detached from the evidence adduced in this case, and inconsistent with the case law, the reports of Drs. Wind and Ordoover have little evidentiary value.

n26 An efficiency argument is implausible (insufficient on its face) where, for example, it is pretextual, *Eastman Kodak Co. v. Image Technical Servs. Inc.*, 504 U.S. 451, 461 (1992), inapposite to the factual circumstances presented, *Law*, 134 F.3d at 1022, or where the argument is premised upon the claim that competition is unworkable or undesirable. *IFD*, 476 U.S. at 463; *NCAA*, 468 U.S. at 116-7; *NSPE*, 435 U.S. at 696. An efficiency justification should be rejected as invalid where, inter alia, it is speculative or unproven, *IFD*, 476 U.S. at 463; *Chicago Prof'l Sports*, 961 F.2d at 674-76, where the argument sweeps too broadly, *IFD*, 476 U.S. at 463; *Catalano*, 446 U.S. at 649-50; *NSPE*, 435 U.S. at 696; *Mass. Board*, 110 F.T.C. at 607-08, where there is a less restrictive alternative, *NCAA*, 468 U.S. at 114; *Maricopa County Med. Soc'y*, 457 U.S. at 351-52; *NSPE*, 435 U.S. at 696; *Chicago Prof'l Sports*, 961 F.2d at 674-76; *Mass. Board*, 110 F.T.C. at 607-08, or where the restraint is not an effective remedy for the competitive problem that it purports to address. *NCAA*, 468 at 116, 119; *Law*, 134 F.3d at 1022-24.

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Respondents must demonstrate that the moratorium did in fact promote the efficiency of the PolyGram/Warner collaboration. In re: Indiana Fed. of Dentists, 101 F.T.C. 57, 175 (1983), vacated, 745 F.2d 1124 (7th Cir. 1984), rev'd, 476 U.S. 447 (1986); CDA, 526 U.S. at 775 n. 12. n27 Respondents have the burden of showing "empirical evidence of procompetitive effects" in the context of a "quick look" analysis. CDA, 526 U.S. at 775 n.12. n28 The case can be resolved on an abbreviated analysis of the proffered efficiency justifications without an examination of market power or actual anticompetitive effects. n29

n27 See also Timothy J. Muris, The Federal Trade Commission and the Rule of Reason: In Defense of Massachusetts Board, 66 Antitrust L.J. 773, 778-79 (1998) ("Compared to the plausibility stage inquiry, the court must delve more deeply into the factual assertions of the parties to determine whether (1) the claimed efficiency benefits are real, and (2) the restraint is reasonably necessary to achieve them. If a proffered explanation fails on either count, then the court should declare the challenged restraint unlawful under the abbreviated rule of reason.").

n28 CDA, 526 U.S. at 779-81.

n29 Continental Airlines, 277 F.3d at 508.

The parties' motivation for the moratorium was to shield 3T3 from competition. F. 268-75. But even if the parties harbored a good faith belief that the moratorium was necessary and procompetitive, this would not establish the validity of any efficiency justification. NCAA, 468 U.S. at 101 n.23. Respondents' assertion that the moratorium would assist PolyGram and Warner to recoup their \$ 18 million investment is not a procompetitive (i.e., pro-consumer) justification for the Three Tenors moratorium. Chicago Prof'l Sports v. NBA, 754 F. Supp. 1336, 1359 (N.D. Ill. 1991), aff'd, 961 F.2d 667 (7th Cir. 1992). n30 It is not a defense under the FTC Act. SCTLA, 493 U.S. at 422.

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n30 See also *Law*, 134 F.3d at 1023; *Delaware & Hudson Ry. Co. v. Consolidated Rail Corp.*, 902 F.2d 174, 178 (2d Cir. 1990).

Respondents contend that the Three Tenors moratorium was adopted in response to the risk that certain European operating companies would free ride on the promotional opportunity created by the Paris concert. Respondents cannot justify the agreement to restrain competition in the marketing of Three Tenors products in the United States with the claim that the moratorium was necessary for the efficient marketing of 3T3 in Europe. *Law v. NCAA*, 902 F. Supp. 1394, 1406 (D. Kan. 1995), *aff'd*, 134 F.3d 1010 (10th Cir. 1998); *Sullivan v. National Football League*, 34 F.3d 1091, 1112 (1st Cir. 1994); *RSR Corp. v. FTC*, 602 F.2d 1317, 1325 (9th Cir. 1979).

2. The moratorium must be necessary

In December 1997/January 1998, Polygram and Warner agreed to pay \$ 18 million to Rudas in exchange for the right to distribute audio and video recordings of the next Three Tenors concert. F. 58-59. The parties first agreed to the moratorium later, in March 1998. F. 92-94. The later moratorium agreement cannot be deemed necessary for the earlier agreement to collaborate. F. 263.

Respondents stipulate that the Three Tenors' moratorium was not necessary to the formation of the joint venture between PolyGram and Warner. F. 262. It also was not necessary for the production of the Paris concert, for the creation of 3T3, or to assure the distribution of 3T3 in the United States. PolyGram and Warner were committed to these activities well before discussions of the moratorium even commenced. F. 263-64. The challenged restraints were not necessary to procure any of the activities. n31

n31 *Blackburn*, 53 F.3d at 828 (allocation of territories was not ancillary to agreement to dissolve law partnership where restraint was adopted after the termination of the partnership); *Polk Bros.*, 776 F.2d at 189.

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3. Free-riding

Respondents argue that without the moratorium agreement, promotional investments by PolyGram and Warner intended to benefit sales of 3T3 in Europe may instead have led some consumers in Europe to purchase at a lower price 3T1 (distributed by PolyGram) or 3T2 (distributed by Warner).ⁿ³² To be sufficient to justify an agreement to fix prices and forgo all advertising in the United States, Respondents must show that: (i) absent the challenged restraints, free-riding is likely to have the effect of eliminating some valued service from the marketplace; (ii) there was no reasonable means by which the competitor that benefits from the valued service (the alleged free rider) could have compensated the firm that was providing such service; and (iii) there were no less restrictive alternatives. *Toys "R" Us, Inc.*, 126 F.T.C. 415, 600-07 (1998) ("TRU"), *aff'd*, 221 F.3d 928 (7th Cir. 2000).

ⁿ³² Respondents' Trial Brief at 13.

It is common for advertising to benefit a competitor different from the firm that funded the advertising. CX 612 (Stockum Rebuttal Report) at P17. The prospect of free-riding does not, however, lead sellers of consumer products to abandon all advertising.ⁿ³³ Instead, sellers generally respond to this challenge by using advertising to create a distinct identity for the target product.ⁿ³⁴

ⁿ³³ Wind Dep. (JX 91) at 128-29.

ⁿ³⁴ Ordoover Dep. (JX 90) at 199; CX 612 (Stockum Rebuttal Expert Report) at P17.

Within the recorded music industry, free-riding is commonplace. Advertising intended to benefit one album often leads to sales of competing albums. F. 280.ⁿ³⁵ Warner introduced 3T2 during 1994. Warner anticipated competition from PolyGram (3T1). F. 200, 202. But Warner did not forgo all

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advertising (and Warner did not seek a moratorium with its rival). F. 200-09. Instead, Warner devised an aggressive marketing campaign aimed at distinguishing 3T2 and convincing consumers that 3T2 was preferable to 3T1. F. 203. Warner's marketing campaign for 3T2 was a success; the project was profitable; and four years later Warner was anxious to acquire distribution rights to 3T3--initially without the participation of PolyGram. F. 52, 222-23.

n35 Cloeckaert Dep. (JX 97) at 46; F. 281; RX 716 (Ordoover Expert Report) at P36; Ordoover Dep. (JX 90) at 130.

Advertising for one product often will benefit rival products, however more than just lost sales is required in order to justify a resort to price fixing--or else price-fixing agreements would be the rule rather than the exception. Herbert Hovenkamp, XII Antitrust Law P2032b at 184 (1999) ("free-riding is ubiquitous in our society"). Respondents must show a danger that, because of free-riding and absent a restraint, advertising for 3T3 would have disappeared or have been substantially curtailed.

The evidence on this issue does not support Respondents' free-riding defense. Witnesses representing both Warner and PolyGram testified that 3T3 would have been aggressively and appropriately promoted without the moratorium, and indeed that the moratorium had no significant effect on the resources devoted to advertising and promoting 3T3. O'Brien, Tr. 448, 490; Saintilan Dep. (JX 94) at 88-89, 194-195. In June 1998, when it appeared to PolyGram that the Three Tenors moratorium would fall apart, PolyGram did not alter its marketing strategy or cut back on its advertising budget. PolyGram's only response was to notify its operating companies that if Warner were found selling 3T2 at discounted prices in any territory, then the local PolyGram operating company could respond by discounting 3T1. F. 129-30. n36

n36 Saintilan Dep. (JX 94) at 82.

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If there were a serious free-riding problem in connection with the marketing of 3T3, the problem existed in Europe but not the United States. Ordoover Dep. (JX 90) at 36-37. Dr. Ordoover calculated that the magnitude of sales diverted from 3T3 to 3T1 in the United States due to free-riding during the moratorium period (August - October 1998) would have been small (sales of less than \$ 86,000 per month). F. 294. Dr. Ordoover was unable to conclude that free-riding in the United States would have had a significant impact on the venturers' incentives to advertise 3T3. Ordoover Dep. (JX 90) at 158-59.

The Three Tenors moratorium agreement was not necessary to preserve incentives to advertise and promote 3T3 in the United States. Respondents' free-riding defense therefore fails. See TRU, 126 F.T.C. at 605.

Even assuming that there was a legitimate concern with free-riding here, there is also a solution: joint advertising arrangements. Where firms that share the benefits from advertising also share of the costs of such advertising, any free-riding problem is remedied. TRU, 126 F.T.C. at 602.

PolyGram and Warner decided to share the cost of promoting 3T3 in the United States, on a 50/50 basis. O'Brien, Tr. 419-20. n37 The ability of PolyGram and Warner to compensate one another for the value of the 3T3 advertising defeats the free-riding defense. Chicago Prof'l Sports, 961 F.2d at 675, and General Leaseways, 744 F.2d at 592. n38

n37 The license agreement between Warner and PolyGram provides that the two music companies shall each be entitled to 50 percent of the net profits and net losses derived from sales of 3T3 worldwide. Any advertising or marketing expenses incurred by either party are to be deducted from revenues for purposes of calculating net profits (losses). Given the financial structure of the venture, every dollar spent in the United States by Warner to promote 3T3 is partially reimbursed by

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PolyGram; fifty cents comes from each of the venturers. F. 301.

n38 See also *High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 992 (9th Cir. 1993); *United States v. Microsoft Corp.*, 1998-2 Trade Cas. (CCH) P72, 261 at 82,682 (D.D.C. 1998); *TRU, Inc.*, 126 F.T.C. at 601.

Respondents contend that whereas PolyGram and Warner allocate the costs of advertising on a 50/50 basis, the division of benefits from 3T3 advertising may not be precisely equal. It is not important that compensation from one competitor to the other be exactly the right amount. It is sufficient that the cost-sharing mechanism "ensure[s] the continuation of the beneficial activity." *TRU*, 126 F.T.C. at 602.

Warner and PolyGram agreed to share the cost of advertising and promoting 3T3 upon terms satisfactory to them. This limited form of cooperation eliminates the free-riding problem and obviates the need for the parties to engage in price-fixing or to adopt an advertising ban. F. 300-05. The scope of the moratorium could also have been limited to Europe. F. 306. n39

n39 There is no evidence that, during the moratorium period, discounted copies of 3T1 and 3T2 would have been transshipped from the United States to Europe. Nor is there evidence that such transshipment would disrupt the marketing of 3T3 in the United States or anywhere else. F. 307-08.

In addition, any danger that advertising for 3T3 may have benefitted the older Three Tenors albums arose principally because 3T3 was not sufficiently different from 3T1 and 3T2. RX 617 (Ordovery Expert Report) PP16, 31. In 1994, Warner used the tools of marketing (e.g., packaging, advertising) to create a unique identity for 3T2, distinct from 3T1. F. 203-08. A similar strategy could have been pursued for 3T3 in 1998. n40

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n40 See JX 106 (Moore Rebuttal Expert Report) PP5-11; Moore, Tr. 123-35; Ordoover Dep. (JX 90) at 144.

4. Consumer confusion

Respondents argue that the moratorium helped eliminate the risk that some consumers would confuse the various Three Tenors albums and not purchase the new album that they intended to buy. Analogous challenges to consumer sovereignty were dismissed in IFD and NSPE, as "nothing less than a frontal assault on the basic policy of the Sherman Act." n41

n41 IFD, 476 U.S. at 463 (rejecting claim that providing x-rays to insurance companies will necessarily lead them to make unwise and dangerous choices); NSPE, 435 U.S. at 694 (rejecting claim that competitive bidding will necessarily lead to inferior engineering work).

There is no evidence that consumers were confused in selecting among the various Three Tenors albums--only that PolyGram marketing manager Paul Saintilan was "concerned" that confusion may arise. F. 312-13. This feeling was not based upon research, data, or observation. F. 312. It does not justify restraints on competitive activity. n42

n42 Absent the moratorium, discounting of 3T1 and 3T2 could have helped to differentiate these products from the new Three Tenors release. F. 318. Advertising campaigns on behalf of 3T1 and 3T2 could have emphasized the distinctive features of these albums (as was done in 1994). F. 317. The competitive activity squelched by the moratorium should dispel rather than foster consumer confusion. Cf. Law, 134 F.3d at 1024.

Confusion identified by Respondents could have been remedied though measures less restrictive than the moratorium. If the cover art for 3T3 resembled the cover art for 3T1 and 3T2, packaging for 3T3 could be made more distinct. F. 314. Music retailers have the incentive and ability to display their products in

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a manner that would not confuse their customers. F. 319-20. Warner could have worked with music retailers to ensure that 3T3 was displayed in a manner that consumers would not find confusing. F. 321-22.

To cure consumer confusion, a seller is not permitted to make its product appear unique by inducing a competitor to withdraw its competing products. n43 Confusing competition is preferred to the clarity offered by collusion. n44

n43 NCAA, 468 U.S. at 116-17.

n44 United States v. Western Electric Co., 583 F. Supp. 1257, 1260 (D.D.C. 1984).

The suppression of 3T1 and 3T2 was not necessary to the effective marketing of 3T3. In 1994, Warner marketed 3T2 effectively and successfully without suppressing 3T1. In 2000, Sony released the fourth Three Tenors album, consisting principally of Christmas songs. Sony marketed its Three Tenors album without seeking a moratorium on the marketing of previous Three Tenors albums. F. 197-99.

The real issue is not that consumers are confused by multiple Three Tenors products. Consumers are discerning. Given a choice between 3T3 and one of the older Three Tenors albums, some consumers may view a discounted 3T1 or 3T2 as the better value. F. 268-69. The safest way for PolyGram and Warner to maximize their profits on 3T3 was, therefore, to agree to maintain high prices on the older Three Tenors recordings.

That 3T3 was (in the eyes of the record companies and perhaps consumers) a disappointing product cannot justify an effort by the venturers to insulate this product from competition. F. 324. A similar argument was rejected in NCAA. The NCAA joint venture argued that a restriction on the telecast of college football games was necessary in order to protect live attendance at games. Such a strategy, the Supreme Court explained, would diminish rather than enhance consumer welfare: "By seeking to

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insulate live ticket sales from the full spectrum of competition because of its assumption that the product itself is insufficiently attractive to consumers, petitioner forwards a justification that is inconsistent with the basic policy of the Sherman Act." NCAA, 468 U.S. at 116-117.

5. The moratorium as product promotion

Respondents argue that if the moratorium agreement succeeded in generating early sales of 3T3, such sales would garner publicity for this new product. Hoffman, Tr. 360. The Brown University case rejected that claim that a price restraint may benefit consumers by channeling resources into efforts to improve quality. "This is not the kind of pro-competitive virtue contemplated under the [Sherman] Act, but rather one mere consequence of limiting price competition." 5 F.3d at 675. In the same way, suppressing promotion of 3T1 and 3T2 may by default lead consumers to pay greater attention to 3T3, but this is not a pro-competitive benefit. n45

n45 See also NCAA, 468 U.S. at 116-117 (increased ticket sales is not a legitimate justification for limitations on telecasts of college football); Catalano, 446 U.S. at 649.

The moratorium agreement was not a necessary strategy for publicizing 3T3. Warner had many less restrictive alternative methods of generating attention for 3T3. F. 168. In lieu of raising the price of 3T1 and 3T2, Respondents could have reduced the price of 3T3. F. 169.

F. Respondents' Withdrawal From the Moratorium

In the United States during the moratorium period (August 1 to October 15, 1998), there was no significant discounting or advertising of 3T1 by PolyGram; and during the moratorium period, there was no significant discounting or advertising of 3T2 by Warner. F. 170-76. Respondents assert, however that PolyGram withdrew from the moratorium agreement, that PolyGram did not implement the agreement, and that neither

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PolyGram nor Warner would have discounted or advertised 3T1/3T2 regardless of any agreement.

Withdrawal from an unlawful agreement does not erase the underlying violation. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940). n46 The government is not required to prove any overt acts in furtherance of the alleged conspiracy. n47 An accepted invitation is not immune from liability under Section 5. n48

n46 See also *United States v. Hayter Oil Co.*, 51 F.3d 1265, 1270-71 (6th Cir. 1995); *United States v. Mobile Materials, Inc.*, 871 F.2d 902, 908 (10th Cir. 1989) (per curiam), modified per curiam, 881 F.2d 866 (10th Cir. 1989); *Konik v. Champlain Valley Physicians Hosp. Med. Ctr.*, 733 F.2d 1007, 1019 (2d Cir. 1984).

n47 *Summit Health, Ltd. v. Pinhas*, 500 U.S. 322, 330 (1991); *Nash v. United States*, 229 U.S. 373, 378 (1913) (Holmes, J.) (Sherman Act "does not make the doing of any act other than the act of conspiring a condition of liability"); *Mobile Materials, Inc.*, 871 F.2d at 908; *United States v. Miller*, 771 F.2d 1219, 1226 (9th Cir. 1985); *United States v. Portsmouth Paving Corp.*, 694 F.2d 312, 324 (4th Cir. 1982).

n48 Even an unaccepted invitation to collude may raise antitrust liability. *United States v. American Airlines*, 743 F.2d 1114, 1121 (5th Cir. 1984).

Paul Saintilan testified at deposition that in July 1998 he informed Warner executive Anthony O'Brien that PolyGram would not implement the moratorium. But O'Brien credibly testified at trial and denied that such conversation ever occurred. No PolyGram representative ever told O'Brien that PolyGram intended to withdraw from its agreement not to compete. O'Brien, Tr. 473.

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The documentary record supports O'Brien. In July 1998, in an effort to conceal his actions, Saintilan destroyed documents regarding the moratorium, but he had no incentive to destroy exculpatory materials. JX 76 at UMG000213. It is most likely then that the conversation described by Saintilan never took place.

Warner and PolyGram attorneys exchanged draft versions of what later became the August 10 letter from O'Brien to Saintilan (purporting to reject the moratorium proposed by PolyGram). F. 160-62. These communications cannot constitute PolyGram's effective withdrawal from the conspiracy. The August 10 letter describes Warner's intended conduct in Europe, not PolyGram's, and the August 10 letter was countermanded by O'Brien. F. 160-63.

Warner perceived and understood that PolyGram was in fact complying with the moratorium on a worldwide basis between August 1 and October 15, 1998. F. 170, 173-74, 177-81. PolyGram's supposed "withdrawal" was not communicated to Warner: only after October 15 did Warner promote 3T2; and only after October 15 did Warner anticipate that PolyGram would discount 3T1. F. 182. Little weight can be accorded to deposition testimony that conflicts with the contemporaneous written record.

n49

n49 United States v. United States Gypsum Co., 333 U.S. 364, 396 (1947); Millar v. FCC, 707 F.2d 1530, 1541 (D.C. Cir. 1983); Gainesville Utils. Dep't v. Florida Power & Light Co., 573 F.2d 292, 301 n.14 (5th Cir. 1978); Pension Benefit Guar. Corp. v. Envirodyne Industries, Inc., 1988 U.S. Dist. LEXIS 16044 *2-3 (N.D. Ill. 1988).

CONCLUSIONS OF LAW

I. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding, and over Respondents PolyGram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc., and Universal Music & Video Distribution Corp. (collectively, "PolyGram" or "Respondents").

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II. At all relevant times, each respondent was a corporation within the meaning of Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

III. Respondents' acts and practices, including the challenged acts and practices, are in or affect commerce as "commerce" is defined in the Federal Trade Commission Act, 15 U.S.C. § 44.

IV. Respondents have entered into contracts, combinations, or conspiracies with their competitor, Warner Music Group ("Warner"), constituting unfair methods of competition, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

V. In 1998, PolyGram and Warner agreed to observe a "moratorium" on competitive activity. The parties agreed to forgo discounting and advertising of older Three Tenors audio and video products (referred to as "3T1" and "3T2") for a period of time following the release of a new Three Tenors recording (referred to as "3T3").

VI. Certain categories of restraints almost always tend to raise price or reduce output, and hence are presumptively anticompetitive.

VII. The moratorium agreement between PolyGram and Warner to forgo discounting and advertising is likely, absent an efficiency justification, to lead to higher prices or reduced output, and hence is presumptively anticompetitive.

VIII. Where a presumptively anticompetitive agreement is proven, the burden shifts to the Respondents to prove the existence of a plausible and valid efficiency justification for the restraint. That is, Respondents must show that the moratorium was necessary in order to promote competition and benefit consumers.

IX. Where a presumptively anticompetitive restraint is ancillary to a collaboration, Respondents must show that the

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restraint is necessary in order to achieve the pro-competitive benefits of that collaboration.

X. An agreement entered into following the formation of a joint venture to forgo discounting and advertising for the pre-existing, separately produced, and separately distributed products of the individual venturers is not ancillary to the joint venture agreement. The price restraint is per se illegal.

XI. Where the proffered efficiency justifications are either implausible on their face or invalid in view of the relevant facts, the presumptively anticompetitive restraint can be condemned, without assessing market power or examining actual anticompetitive effects.

XII. An efficiency argument is implausible (insufficient on its face) where, for example, it is pretextual, inapposite to the factual circumstances presented, or where the argument is premised upon the claim that competition is unworkable or undesirable.

XIII. An efficiency justification should be rejected as invalid where, for example, it is speculative or unproven, where the argument sweeps too broadly, where there is a less restrictive alternative, or where the restraint is not an effective remedy for the competitive problem that it purports to address.

XIV. Respondents have not met their burden of identifying a plausible efficiency justification for the challenged restraints. Respondents' claim that the moratorium agreement addresses a market failure in Europe can not justify the agreement to restrain competition in the United States.

XV. Even if the justifications proffered by Respondents were deemed plausible, Respondents have not met their burden of proving the existence of a valid efficiency justification.

XVI. In order to demonstrate a valid free-riding defense, Respondents must show that: (i) absent the challenged restraints, free-riding was likely to have the effect of eliminating some

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valued service from the marketplace; (ii) there was no reasonable means by which the competitor that benefitted from the valued service (the alleged free rider) could have compensated the firm that was providing such service; and (iii) there were no less restrictive alternatives. Respondents have satisfied none of these requirements.

XVII. In the recorded music industry, it is common for advertising and other promotional activity to benefit a competitor different from (and in addition to) the firm that funded the advertising. Generally, this does not lead record companies to abandon or even significantly to curtail advertising. The evidence does not support a finding that the venturers' advertising expenditures in support of 3T3 would have significantly decreased in the United States without the moratorium agreement.

XVIII. Where firms that share the benefits from advertising also share the costs of such advertising, free-rider problems are reduced or eliminated. Even assuming that there was a potential free-riding problem in connection with advertising for 3T3, PolyGram and Warner effectively remedied the free-riding problem by sharing the costs of advertising 3T3.

XIX. Other substantially less restrictive alternatives for addressing the purported free-riding concern were also available to PolyGram and Warner. For example, Respondents could have limited the moratorium to Europe (the site of the alleged free-riding problem).

XX. The Three Tenors moratorium agreement was not necessary to eliminate consumer confusion. The evidence does not support a finding that consumers were actually confused in selecting among the various Three Tenors products. Further, the potential for confusion could have been remedied by making the packaging for 3T3 more distinct, and/or by working with retailers to ensure that the Three Tenors products were displayed in a manner that consumers would not find confusing.

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XXI. The claim that suppressing promotion of similar, competing products is necessary in order to eliminate confusion conflicts with the basic policy of the antitrust laws.

XXII. The Three Tenors moratorium agreement was not necessary for the formation of the 3T3 collaboration between Warner and PolyGram.

XXIII. The Three Tenors moratorium agreement was not necessary for the effective marketing of 3T3 in the United States.

XXIV. Modest cost savings may be achieved by any joint selling arrangement; this however is not a sufficient justification for the adoption of presumptively anticompetitive restraints.

XXV. When a firm withdraws from the market at the behest of a rival, this will enable the surviving competitor to generate additional consumer attention, publicity, and sales. These effects may be the by-product of any market division agreement, and are not a cognizable antitrust defense.

XXVI. Section 5 of the FTC Act proscribes anticompetitive agreements. Respondents' claim that the moratorium agreement was not implemented in the United States is not supported by the evidence, and is not a valid antitrust defense.

XXVII. Respondents' claim that they withdrew from the moratorium agreement is not supported by the evidence, and is not a valid antitrust defense.

XXVIII. The acts or practices of Respondents were and are to the prejudice and injury of the public. The acts or practices constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. These acts may recur in the absence of the Order entered in this proceeding.

XXIX. Entry of the Order is in the public interest, and is necessary to protect the public now and in the future.

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CEASE AND DESIST ORDER

"Once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." *United States v. E.I. du Pont De Nemours and Co.*, 366 U.S. 316, 334 (1961). "The Commission has wide discretion in its choice of a remedy deemed adequate to cope with the unlawful practices" so long as the remedy has a "reasonable relation to the unlawful practices found to exist. *Jacob Siegel v FTC*, 327 U.S. 608, 611-13 (1946). Further, "the Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past. . . . It must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity." *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952).

The Commission may issue an order even where the respondent has discontinued the illegal practice, where the possibility of a recurrence of the illegal activity exists. n50 Where, as here, the respondents have refused to acknowledge their past lawlessness, this may be viewed as evidence that the illegal activity may recur. *Wilk*, 895 F.2d at 366.

n50 See *United States v. Oregon State Med. Soc'y.*, 343 U.S. 326, 333 (1952); *Wilk v. American Med. Assoc.*, 895 F.2d 352, 366-68 (7th Cir. 1990); *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 928 (2d Cir. 1980); see also, *Marlene's, Inc. v. FTC*, 216 F.2d 556, 560 (7th Cir. 1954).

The marketing challenge that gave rise to the Three Tenors moratorium may recur: the fear that a new release by a given artist may lose sales to the artist's older albums. Respondents have recording contracts with several artists that formerly released albums with one of Respondents' competitors. F. 331-32. n51 Universal is engaged in other joint ventures where a similar incentive and opportunity to restrain competition is presented. Universal and Sony have formed a joint venture known as "Pressplay" to distribute music over the Internet. Universal, Sony,

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and other music companies will provide their music to the venture on a non-exclusive basis. This means that music products marketed by the venture may also be marketed (e.g., by Sony) through traditional retail outlets. Absent an order, Universal and Sony may find it profitable to fix prices on products sold to retail stores in order to enhance the venture's internet sales and profits. F.334.

n51 A music label may release an artist from his exclusive recording contract in return for a royalty on the artist's first album on his new label. When this occurs, the two competing labels may have a shared financial interest in the success of a particular album. Hoffman, Tr. 357.

ORDER**I.**

1: "PolyGram Holding" means PolyGram Holding, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by PolyGram Holding, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

2: "Decca Music" means Decca Music Group Limited, its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Decca Music Group Limited; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

3: "UMG" means UMG Recordings, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by UMG Recordings, Inc.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

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4: "UMVD" means Universal Music & Video Distribution Corp., its directors, officers, employees, agents, representatives, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Universal Music & Video Distribution Corp.; and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

5: "Respondents" means PolyGram Holding, Decca Music, UMG, and UMVD, individually and collectively.

6: "Commission" means the Federal Trade Commission.

7: "Audio Product" means any prerecorded music in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any compact disc, magnetic recording tape, audio DVD, audio cassette, album, audiotape, digital audio tape, phonograph record, electronic recording, or digital audio file (i.e., digital files delivered to the consumer electronically to be stored on the consumer's hard drive or other storage device).

8: "Video Product" means any prerecorded visual or audiovisual product in any physical, electronic, or other form or format, now or hereafter known, including, but not limited to, any videocassette, videotape, videogram, videodisc, compact disc, electronic recording, or digital video file (i.e., digital files delivered to the consumer electronically to be stored on the consumer's hard drive or other storage device).

9: "Seller" means any Person other than a Respondent that produces or sells at wholesale any Audio Product or Video Product.

10: "Joint Venture Agreement" means a written agreement between a Respondent and a Seller that provides that the parties to the agreement shall collaborate in the production or distribution (including, without limitation, through the licensing of intellectual property) of Audio Products or Video Products.

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11: An Audio Product or Video Product is "Jointly Produced" by a Respondent and a Seller when, pursuant to a written agreement between such Respondent and such Seller, each contributes significant assets to the production or distribution of the Audio Product or Video Product (including, without limitation, personal artistic services, intellectual property, technology, manufacturing facilities, or distribution networks) to achieve procompetitive benefits. For example and without limitation, an Audio Product or Video Product is "Jointly Produced" by a Respondent and a Seller when (1) such product is manufactured or packaged by such Seller and sold at wholesale by such Respondent, or (2) such product is manufactured or packaged by such Respondent and sold at wholesale by such Seller.

12: "Person" means both natural persons and artificial persons, including, but not limited to, corporations, partnerships, and unincorporated entities.

13: "Officer, Director, or Employee" means any officer or director or management employee of any Respondent with responsibility for the pricing, marketing, or sale in the United States of Audio Products or Video Products.

14: "United States" means the fifty states, the District of Columbia, the Commonwealth of Puerto Rico, and all territories, dependencies, and possessions of the United States of America.

II.

IT IS ORDERED that Respondents shall cease and desist from, directly, indirectly, or through any corporate or other device, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, soliciting, participating in, entering into, attempting to enter into, implementing, attempting to implement, continuing, attempting to continue, or otherwise facilitating or attempting to facilitate any combination, conspiracy, or agreement, either express or implied, with any Seller:

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A. to fix, raise, or stabilize prices or price levels, in connection with the sale in or into the United States of any Audio Product or any Video Product; or

B. that prohibits, restricts, regulates, or otherwise places any limitation on any truthful, non-deceptive advertising or promotion in the United States for any Audio Product or any Video Product.

III.

IT IS FURTHER ORDERED that:

A. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement to set the prices or price levels for any Audio Product or Video Product when such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

B. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio Product or Video Product where such written agreement is reasonably related to a lawful Joint Venture Agreement and reasonably necessary to achieve its procompetitive benefits.

C. It shall not, of itself, constitute a violation of Paragraph II.A. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement to set the prices or price levels for any Audio Product or Video Product that is Jointly Produced by such Respondent and such Seller.

D. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent and a Seller to enter into, attempt to enter into, or comply with a written agreement that regulates or restricts the advertising or promotion for any Audio Product or

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Video Product that is Jointly Produced by such Respondent and such Seller.

E. It shall not, of itself, constitute a violation of Paragraph II.B. of this Order for a Respondent to enter into, attempt to enter into, or comply with a written agreement, industry code, or industry ethical standard that is: (1) intended to prevent or discourage the advertising, marketing, promotion, or sale to children of Audio Products or Video Products labeled or rated with a parental advisory or cautionary statement as to content, and (2) reasonably tailored to such objective.

F. In any action by the Commission alleging violations of this Order, each Respondent shall bear the burden of proof in demonstrating that its conduct satisfies the conditions of Paragraph(s) III.A., III.B., III.C, and III.D. of this Order.

IV.**IT IS FURTHER ORDERED** that:

A. Within sixty (60) days after the date this Order becomes final, each Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which the Respondent has complied and is complying with this Order.

B. One (1) year after the date this Order becomes final, annually for the next nine (9) years on the anniversary of the date this Order becomes final, and at other times as the Commission may require, each Respondent shall file with the Commission a verified written report:

1. setting forth in detail the manner and form in which it has complied and is complying with this Order; and

2. identifying the title, date, parties, term, and subject matter of each agreement between any Respondent and any Seller, entered into or amended on or after the date this Order becomes final, that: (a) fixes, raises, or stabilizes prices or price levels in

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connection with the sale in or into the United States of any Audio Product or Video Product, or (b) prohibits, restricts, regulates, or otherwise places any limitation on any truthful, non-deceptive advertising or promotion in the United States for any Audio Product or any Video Product (other than those Audio Products and Video Products that are Jointly Produced).

PROVIDED HOWEVER that Respondents shall not be required to identify in their reports to the Commission any agreement that: (i) was previously identified to the Commission pursuant to Paragraph IV.B.2., and (ii) was not amended following such previous identification.

C. Each Respondent shall retain copies of all written agreements identified pursuant to Paragraph IV.B.2. above; and shall file with the Commission, within ten (10) days' notice to the Respondent, any such written agreements as the Commission may require.

V.

IT IS FURTHER ORDERED that each Respondent shall notify the Commission at least thirty (30) days prior to any proposed change in the Respondent such as dissolution, assignment, sale resulting in the emergence of a successor corporation, or the creation or dissolution of subsidiaries or any other change in the corporation that may affect compliance obligations arising out of the Order.

VI.

IT IS FURTHER ORDERED that, for the purpose of determining or securing compliance with this Order, upon written request, each Respondent shall permit any duly authorized representative of the Commission:

A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and

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documents in the possession or under the control of the Respondent relating to any matters contained in this Order; and

B. Upon five (5) days' notice to the Respondent and without restraint or interference from it, to interview officers, directors, or employees of the Respondent.

VII.

IT IS FURTHER ORDERED that each Respondent shall:

A. Within thirty (30) days after the date on which this Order becomes final, send a copy of this Order by first class mail to each of its Officers, Directors, and Employees;

B. Mail a copy of this Order by first class mail to each person who becomes an Officer, Director, or Employee, no later than (30) days after the commencement of such person's employment or affiliation with the Respondent; and

C. Require each Officer, Director, or Employee to sign and submit to the Respondent within thirty (30) days of the receipt thereof a statement that: (1) acknowledges receipt of the Order; (2) represents that the undersigned has read and understands the Order; and (3) acknowledges that the undersigned has been advised and understands that non-compliance with the Order may subject the Respondent to penalties for violation of the Order.

VIII.

IT IS FURTHER ORDERED that this Order shall terminate twenty (20) years after the date on which the Order becomes final.

Complaint

IN THE MATTER OF

GUESS?, INC., ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket C-4091; File No. 0223260
Complaint, July 30, 2003--Decision, July 30, 2003

This consent order, among other things, prohibits Respondents Guess?, Inc. and Guess.com, inc. (“Guess”) – together an international company that designs and produces men’s, women’s, and children’s clothing and accessory products that are marketed, distributed, and sold under various Guess brand names through its own stores, a limited number of independent retailers, and its online store – in connection with the online advertising, marketing, promotion, offering for sale, or sale of any product or service, from misrepresenting the extent to which it maintains and protects the security, confidentiality, or integrity of any personal information collected from or about consumers. The order also requires Guess to establish and maintain a comprehensive information security program in writing that is reasonably designed to protect the security, confidentiality, and integrity of personal information collected from or about consumers. In addition, the order requires Guess to obtain – within one year, and on a biannual basis thereafter for twenty years – an assessment and report from a qualified, objective, independent third-party professional, certifying that (1) Guess has in place a security program that provides protections that meet or exceed the protections required by Part II of this order; and (2) Guess’s security program is operating with sufficient effectiveness to provide reasonable assurance that the security, confidentiality, and integrity of consumer’s personal information has been protected.

Participants

For the Commission: *Jeffrey S. Davidson, Alain Sheer, Jessica L. Rich, Joel Winston, Louis Silversin, Gerard R. Butters, and Paul A. Pautler.*

For the Respondents: *Debra Valentine, O’Melveny & Myers, and Deborah Siegel, Guess.*