FTC Affirms Use of Disgorgement and Restitution in Competition Cases

The Federal Trade Commission ("FTC") recently announced that it will continue to seek the forfeiture of profits by parties found guilty of violations of the Federal Trade Commission Act ("FTC Act"), the Hart-Scott-Rodino Premerger Notification Act, and the Clayton Act. The newly released policy statement provides that the forfeiture of profits, which may take the form of either disgorgement or restitution, is an appropriate remedy for violations of the above statutes.

“Disgorgement” and “Restitution” -- What Are They?
Disgorgement is a monetary equitable remedy that is designed to prevent a wrongdoer from unjustly enriching himself or herself as a result of the illegal conduct. Disgorgement takes away the profits earned by the wrongdoer from the illegal conduct. It is not concerned with the amount of damages sustained by the victims of the unlawful conduct.

Restitution, which is also a monetary equitable remedy, requires a wrongdoer to restore victims of the illegal conduct to the position they would have been in absent the conduct. Thus, the purpose is to compensate victims for their loss, irrespective of the amount of profits earned by the wrongdoer.

The difference between the two remedies is essentially one of focus. Disgorgement asks how much did the wrongdoer gain as a result of his illegal conduct, while restitution asks how much were the victims harmed by the conduct.

However, consistent with past practice, the FTC’s policy statement states that disgorgement and restitution will be sought only under “exceptional” circumstances. Specifically, the FTC will consider such remedies where: (i) the violation is “clear;” (ii) there is a reasonable basis for calculating the remedy; and (iii) other remedies would not provide complete or effective relief. The policy statement notes that a strong showing of one of the above factors, such as an especially flagrant violation, may offset a weak showing of the other factors.

Highlights of FTC Policy Statement
FTC will seek disgorgement or restitution in antitrust cases only under “exceptional” circumstances. Such circumstances are likely to occur where:

- Violation is clear based on existing precedent;
- Reasonable basis for calculating remedy exists; and
- Other remedies, like injunctive relief or private damages actions, are not effective.

However, a strong showing of one factor may offset a weak showing of another.

“Clear” Violation
The FTC’s policy statement provides that it will seek disgorgement or restitution only where there is a “clear” violation of the antitrust laws. A violation will be considered “clear” using an objective, as opposed to subjective, standard. In other words, the FTC will ask whether a reasonable party should expect that the conduct at issue would likely be found to be illegal. The policy statement expressly notes that, under this standard, per se offenses, such as price fixing or horizontal market allocation, are considered presumptively “clear” violations.

continued on page 2
However, “clear” violations include more than just per se offenses. The policy statement provides that the FTC will take existing precedent into consideration in deciding whether to seek monetary equitable remedies. As examples of “clear” violations, the FTC cites its two most recent antitrust cases where disgorgement was sought: FTC v. Mylan Labs and FTC v. The Hearst Trust. In Mylan, the FTC brought a monopolization case based on a large generic drug manufacturer’s long-term exclusive licenses for active ingredients needed to produce two generic drugs. According to the FTC’s complaint, the defendants locked up the supply of approximately 90% of the necessary ingredient for one drug and 100% of the necessary ingredient for a second drug. In Hearst, the FTC sought disgorgement for an anticompetitive merger and a violation of the pre-merger filing requirements in the integrated drug information database market. The policy statement suggests that Mylan was a “clear” violation because the exclusive licenses were not supported by any legitimate business purpose and that Hearst constituted a “clear” violation because the conduct included a merger to monopoly and a specific intent to monopolize.

On the other hand, the policy statement also indicates that where specific conduct has not been challenged before and occurs in a “complex regulatory context,” a violation will be not considered “clear” for the purposes of seeking a monetary equitable remedy. As an example, the policy statement cites its decision in Abbot Laboratories and Geneva Pharmaceuticals where the FTC sought only conventional remedies for an agreement between a brand name drug company and a generic drug company. Under the agreement, the brand name company paid the generic company to stay out of the market thereby enabling the brand name company to retain its 180-day exclusivity under the Hatch-Waxman Act. Although the FTC did not seek monetary equitable remedies in Abbot, the policy statement strongly emphasizes that the FTC will consider disgorgement and restitution for similar conduct occurring after the Abbot case.

Reasonable Basis for Calculation of Remedy

The policy statement also states that a reasonable basis for calculating the amount of disgorgement or restitution must be available before the FTC will consider such a remedy. Where there is no reasonable means for calculating the gains or benefits from a violation or, in the case of restitution, the amount of injury suffered by the victims of the conduct, the FTC is less likely to seek a monetary equitable remedy. The policy statement, citing FTC v. Febre, 128 F.3d 530, 534-35 (7th Cir. 1997), goes on to say that a reasonable calculation does not require “undue precision.” In Febre, the Seventh Circuit rejected the defendants’ argument that the calculation of the disgorgement amount was fundamentally flawed because the underlying figures did not include every sale. At best, the court argued, this meant that the FTC had understated the amount that should be disgorged by the defendants.

Other than not requiring “undue precision,” the policy statement offers little guidance concerning the types of calculations that would be considered “reasonable.” For example, does an estimation of a wrongdoer’s profits have to take into account factors independent of the antitrust violation? What if the price of the product suddenly increases due to changes in supply and demand? Does the company have to disgorge these additional profits as well? Although it is reasonable to assume such amounts should be excluded from the calculation, the FTC does not address the issue. At least one court has suggested that such “independent” factors may offset the amount to be disgorged. SEC v. First City Financial Corp., 890 F.2d 1215, 1232 (D.C. Cir. 1989) (“[d]efendants … may make a showing that the disgorgement figure was not reasonable], for instance, by pointing to intervening events from the time of the violation.”).

An even more difficult issue is whether a “reasonable” calculation should take into account benefits indirectly related to the violation. For example, suppose a company illegally acquires another firm in violation of Section 7 of the Clayton Act and the acquisition results in substantial tax savings or stock market profits. Should the guilty company be required to disgorge all of the profits related to the illegal acquisition or only those profits directly related to the violation itself, such as overcharges to buyers?

Other Remedies Inadequate

The FTC will consider disgorgement or restitution only where other remedies, such as injunctive relief and private damages actions, are an insufficient deterrent to anticompetitive activity. The policy statement recognizes that in most instances conventional remedies are likely to provide complete and effective relief. However, where private damages actions are unlikely because of, for example, statute of limitations barriers or “market disincentives,” the FTC is more likely to seek monetary equitable remedies to prevent a defendant from profiting from anticompetitive conduct. To prevent injured parties from receiving multiple payments for the same injury, the FTC states that it will consider setting up an escrow fund and seeking the appointment of a special master or claims administrator to determine the appropriate allocation of funds.

However, if one looks to Mylan and Hearst for guidance, it seems doubtful that this factor would ever restrain the FTC from seeking disgorgement or restitution. The majority of Commissioners in Mylan justified the FTC action partly on the basis that until the action was filed there were no private suits underway. In other words, absent pre-existing litigation by private parties, this factor would not be particularly limiting. The same conclusion flows from the FTC’s position in Hearst, where private actions obtained substantial damages. In fact, Commissioners Leary and Swindle both noted that seeking disgorgement meant that the parties actually had to pay less than they would have if the FTC had sought only conventional remedies. Apparently, the FTC could have settled the case for higher penalties, which are not offset against awards in private damages actions, if it had been willing to forgo disgorgement.

Does the FTC Have the Power to Seek Disgorgement or Restitution?

Although the policy statement does not address questions surrounding the FTC’s authority to seek disgorgement or restitution, the issue is far from settled. The FTC bases its authority to seek such remedies on Section 13(b) of the FTC Act. However, this provision only refers to injunctive relief and not monetary equitable relief, such as disgorgement or restitution. The district court in FTC v. Mylan Labs agreed with the FTC’s interpretation based on broad readings of two Supreme Court cases involving interpretations of different statutes.

Implications of FTC’s Disgorgement and Restitution Policy

The FTC’s continued use of monetary equitable remedies has the potential to seriously undermine the policy rationale in Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 US 481 (1968), and Illinois Brick Co. v. Illinois, 431 US 720 (1977).
Justice Department Concludes Antitrust Investigation of Leading Travel Website

After a review that lasted more than three years, the Department of Justice announced in July that it has closed its antitrust investigation of the Orbitz joint venture, a travel website owned by five major domestic airlines. Assistant Attorney General for Antitrust, R. Hewitt Pate, said that the “Orbitz joint venture has not reduced competition or harmed airline consumers.” The Department of Transportation concluded its own investigation of the Orbitz joint venture in April, 2001, without taking action.

Orbitz was launched in June 2001 by American Airlines, United Airlines, Continental Airlines, Delta Airlines and Northwest Airlines. Non-owner “charter associates” include more than 40 domestic and foreign airlines, and the company provides flight information for many other airlines. Since its launch, Orbitz has quickly become a major distribution channel for airline ticket sales and is now the third largest online travel agency behind Expedia and Travelocity.

Because of the risk of harm to competition and customers inherent in a horizontal arrangement between major players in a concentrated industry, the Antitrust Division began its investigation of Orbitz while the venture was still in the planning stages, over a year before its launch. Initial concerns voiced by would-be competitors, as well as consumer groups, state attorneys general, and Southwest Airlines, focused on the “most favored nation” provision in the agreement among the owner airlines and the charter associates. Under the most favored nation provision, airlines agreed that any publicly available fares the airlines offered through third party websites or through their own websites would be available to Orbitz.

The Antitrust Division examined whether the most favored nation agreement would facilitate coordination among the airlines or reduce their incentives to discount, ultimately resulting in higher fares, or whether the agreement would give Orbitz a dominant position in online air travel distribution. However, the three year investigation, which included extensive analysis of actual airline booking data, led the Division to conclude that the theories of harm considered were not supported by the facts. According to the Division, Orbitz, now in its second year of operation, has not resulted in higher airline fares, nor has the joint venture become dominant in online air travel distribution.

Although the Antitrust Division has recognized in its Competitor Collaboration Guidelines that joint ventures can have pro-competitive benefits that offset anticompetitive harms, joint ventures among leading suppliers can be expected to draw the attention and close scrutiny of antitrust enforcers nonetheless. In 2000, leading auto manufacturers created Covisint, an online B2B marketplace that connects automotive manufacturers, suppliers, and industry trade groups worldwide. The Federal Trade Commission took no action at the time, saying it would continue to monitor whether Covisint’s operations harmed competition. Now in its third year, Covisint has not been the subject of further antitrust inquiry. Other large scale joint ventures are now being planned or underway in other industries. Fried Frank Antitrust and Competition Law Alert ® will report on additional important developments in this area as they come about.

Federal Trade Commission Seeks to Unravel Another Consummated Transaction

In the latest in a recent string of enforcement actions involving transactions not subject to the Hart-Scott-Rodino Act, the Federal Trade Commission has filed an administrative complaint against Aspen Technology, Inc. for its May, 2002 acquisition of competitor Hyprotech Ltd.

The Hart-Scott-Rodino Act requires parties to transactions that meet certain dollar thresholds to notify antitrust enforcers of the transaction and observe a statutory waiting period prior to consummating the transaction. If the waiting period elapses without enforcement action taken, the parties are free to proceed with the transaction, although the antitrust enforcement agencies retain jurisdiction to bring action later if warranted. In transactions that do not meet the Hart-Scott-Rodino thresholds, the parties are free to consummate the transaction at any time, but always subject to the possibility that it could be challenged on antitrust grounds, before or after closing. The Aspen Technology case is the third such enforcement action brought by the Federal Trade Commission since 2001.

Aspen Technology develops simulation computer software used broadly in the chemical, oil and gas, pharmaceutical and other process manufacturing industries. According to the Federal Trade Commission, Aspen Technology is the market leader, counting most of the world’s largest oil, chemical, pharmaceutical and air processing companies as its customers. The Commission alleges that Aspen’s acquisition of Hyprotech, its closest competitor, dramatically increased concentration in the development, licensing, and support of process engineering software for a variety of industries. According to the Commission, the combination leaves the remaining alternative supplier, Sim-Sci-Esscor, a distant third rate player.

The complaint alleges that the merger dramatically increases concentration levels in the affected markets, eliminates direct and substantial competition between the parties and prevents other industry participants from possibly acquiring Hyprotech. The Commission also claims that the merger may undermine the ability of standard setting organizations to decrease barriers to entry, which, according to the complaint are high because of the substantial cost and time required to develop and establish a reliable reputation in the industry. The Commission is asking, among other things, that the transaction be rescinded.

While this case marks a cause for concern among companies entering into transactions involving arguably concentrated markets, it is not unique. Both the Federal Trade Commission and the DOJ have recently opened investigations into or challenged consummated transactions upon claims of competitive harm. In a number of situations, all or some of the acquired assets have been ordered divested. The agencies also have found occasion to challenge non-reportable transactions prior to closing.

This enforcement trend coincides with the 2001 increase in the Hart-Scott-Rodino transaction-size notification thresholds from $15 million to $50 million. In light of the increase in the reporting thresholds, the FTC has said that it deems this increased level of scrutiny particularly important, and that it will pursue acquisitions that it deems to harm consumers, even where the acquisition may not be reportable under the Hart-Scott-Rodino Act.
The Supreme Court in Hanover Shoe held that a company guilty of an antitrust violation could not escape liability by asserting that a direct purchaser “passed on” the amount of the overcharge to its customers (i.e., indirect purchasers). In Illinois Brick, the Court adopted a corollary that prevented indirect purchasers from recovering damages for overcharges passed on through the distribution chain. Based on these two Supreme Court cases, direct purchasers became the preferred plaintiffs in private damages actions under the Clayton Act.

The rationale behind such a policy, as discussed in Illinois Brick, was three-fold. First, the Court believed that measuring an indirect purchaser’s damages and apportionment of the total recovery would be unduly complex. Second, the Court believed that direct purchasers would more effectively enforce the antitrust laws if they could recover the full amount of the overcharge. Third, allowing indirect purchasers to bring a damages action would run the risk of multiple (and excessive) liability for defendants.

Because the FTC sought disgorgement in Mylan and Hearst on behalf of indirect purchasers, the FTC’s past practice has already undermined the Illinois Brick policy rationale. The policy statement indicates that the FTC will continue to seek monetary equitable remedies for “indirect purchasers [who] are precluded from suit under Section 4 of the Clayton Act.” Seeking disgorgement on behalf of indirect purchasers means that the courts will have to apportion damages between direct and indirect purchasers, contrary to the first rationale in Illinois Brick. As Commissioner Leary noted in his dissent in Mylan, “an essentially ad hoc allocation of the disgorgement amount in this case, under the aegis of a single judge, is not an adequate answer.” An even greater concern is the effect that the FTC’s disgorgement policy may have on the incentives of direct purchasers to bring private damages actions. If the FTC obtains disgorgement or restitution on behalf of indirect purchasers, direct purchasers will likely have any recovery they obtain offset by the amount of the FTC award. Direct purchasers are less likely to incur substantial litigation costs if there is uncertainty about whether they will have to share their damages award with indirect purchasers. Again, in his dissent in Mylan, Commissioner Leary stated that “[t]he the Illinois Brick decision was also based on the idea that deterrence is best achieved by giving direct purchasers the right to recover full damages and not share them with others down the line.”

The FTC’s disgorgement policy is also likely to increase the risk of multiple liability on the part of defendants. First, the ability to limit the risk of multiple liability by, for example, setting off two sets of claims, is up to the discretion of the courts and not the FTC. Second, even if courts are willing to exercise their discretion, the policy statement places undue reliance on the courts ability to handle the complex calculations of set-offs in antitrust cases. While courts have a great deal of experience and flexibility with set-offs, the types of set-offs in antitrust cases differ from the largely securities-related set-offs in the cases cited in the policy statement. Most notably, most securities-related set-offs involve the same set of victims receiving funds from two different sources. Antitrust cases, however, are likely to involve different sets of victims at different levels in the distribution chain. The calculations required to divide the funds among these different injured parties is a much more complex task. Such over-deterrence, as noted by Commissioner Leary in his dissent in Mylan, “can have the unfortunate consequence of chilling neutral or even procompetitive, efficiency-enhancing conduct.”

For more information please contact any of the following attorneys in Fried Frank’s Antitrust Department:

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<tr>
<th>Washington, DC</th>
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<th>New York</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deborah A. Garza</td>
<td>Charles F. (Rick) Rule</td>
<td>Linda R. Blumkin</td>
</tr>
<tr>
<td>202 639.7270</td>
<td>202 639.7300</td>
<td>212 859.8085</td>
</tr>
<tr>
<td>Tony Nanni</td>
<td>Allen Kezsbom</td>
<td>Eric Queen</td>
</tr>
<tr>
<td>202 639.7373</td>
<td>212 859.8148</td>
<td>212 859.8077</td>
</tr>
<tr>
<td>Charles F. (Rick) Rule</td>
<td>Linda R. Blumkin</td>
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<td>202 639.7300</td>
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<tr>
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<td>1001 Pennsylvania Ave, NW</td>
<td>350 South Grand Avenue</td>
<td>99 City Road</td>
<td>5, boulevard de la Tour Maubourg</td>
</tr>
<tr>
<td>New York, NY 10004-1980</td>
<td>Washington, DC 20004-2505</td>
<td>Los Angeles, CA 90071</td>
<td>London EC1Y 1AX</td>
<td>75007 Paris</td>
</tr>
<tr>
<td>Tel. 212.859.8000</td>
<td>Tel. 202.639.7000</td>
<td>Tel. 213.473.2000</td>
<td>England</td>
<td>France</td>
</tr>
<tr>
<td>Fax 212.859.4000</td>
<td>Fax 202.639.7003</td>
<td>Fax 213.473.2222</td>
<td>Tel. 44.20.7972.9600</td>
<td>Tel. 33.140.62.22.00</td>
</tr>
<tr>
<td></td>
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<td>Fax 44.20.7496.9293</td>
<td>Fax 33.140.62.22.29</td>
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