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SMALL BUSINESS COMPETITION POLICY: ARE MARKETS OPEN FOR ENTREPRENEURS?

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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SMALL BUSINESS COMPETITION POLICY: ARE MARKETS OPEN FOR ENTREPRENEURS?

Thursday, September 25, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in Room 1539, Rayburn House Office Building, Hon. Nydia M. Velázquez [Chair of the Committee] Presiding.

Present: Representatives Velázquez, Altmire, Cuellar, Hirano, Clarke, Chabot, Shuster, and Westmoreland.

Chairwoman VELÁZQUEZ. Good morning.

I call this hearing of the House Small Business Committee to order. Competition is the crux of our economy. It not only drives innovation and development, but it also spurs invention. After all, you don't often see new products originating in unchallenged industries. Rather they come from diverse sectors that promote a wide range of options. In a free market economy, it is crucial that all businesses, large and small, have a level playing field. The FTC is charged with making sure that happens. With this in mind, it is important for the commission to be engaged and prevent industries from isolating themselves. A lack of competition does not benefit the economy and it certainly does not benefit the taxpayer.

In recognizing this fact the FTC already has a number of antitrust provisions in place. The commission's Bureau of Competition for example uses both administrative and judicial means for enforcing regulations. In this morning's hearing we will discuss the FTC's efforts to promote competition and its role in spurring small business development.

Competition is a powerful catalyst for financial growth. This is particularly true for America's entrepreneurs who thrive in an open economy. Competition is the key that allows small businesses to unlock new markets and expand existing industries. It lowers prices and raises the bar for quality, largely because it forces other companies to step up to the plate and elevate their standards. At the end of the day an entrenched business has little incentive to offer competitive values. Small firms, on the other hand, have every motivation to do so.

On top of lowering consumer costs, competition also promotes invention. Startups have historically led the lion's share of industry innovation. From the tech boom of the mid-1990s to the green energy revolution of today, entrepreneurs are the business world's best innovators. They are always looking to meet emerging needs and offer fresher, better choices. In order to remain competitive, big

brands are then forced to either innovate on their own or otherwise increase the values. Either way, consumers enjoy more choices.

Competition does more than level the playing field. It stimulates the economy. This is particularly true for America's small businesses whose survival depends on access to an open marketplace. If monopolies are permitted to dominate entire industries, then they have little incentive to innovate or contribute to economic expansion. That is why it is so important that competition be protected for entrepreneurs. Without the opportunities that it affords, these small firms will not be able to do what they do best, drive innovation, create jobs and spur financial growth.

I would like to take this opportunity to thank today's witnesses in advance for their testimony, and I look forward to hearing their thoughts on this issue.

With that, I yield to Ranking Member Chabot for his opening statement.

[The statement of Chairwoman Velázquez is included in the appendix at page 43.]

Mr. CHABOT. Thank you, Madam Chairman. And thank you for holding this important hearing examining the antitrust laws in the United States.

I might note that I had the honor to be the ranking member of the antitrust task force of the Judiciary Committee for much of the past Congress, and so it is an area that I have a significant amount of interest in; I would like to say some expertise, but definitely an interest, and so I do appreciate having this hearing.

Enforcement of the antitrust laws play a key role in maintaining open competition, an environment in which small businesses thrive because of their attention to customer service and nimbleness in making business decisions. The Committee has a longstanding and long interest in examining the competitiveness of markets and the impact of the Sherman Antitrust Act and Federal Trade Commission Act on small business. However, the Committee has not examined these matters in nearly two decades. And in light of the report issued last year by the Antitrust Modernization Commission, it seems timely for the Committee to turn its attention to aspects of market competition that fall within the confines of the antitrust laws. So I commend the chairwoman for doing that.

The Supreme Court has stated that, quote, the unrestrained interaction of competitive forces will yield the best allocation of our economic resources; the lowest prices, the highest quality and the greatest material progress, unquote. In short, competitive free markets represent the cornerstones of American progress and the success of our democracy. The antitrust laws were established to protect these precious values.

By providing a mechanism to ensure that competition is not unreasonably hindered, the antitrust laws can be seen as further bracing the competitive foundation of this country. The Antitrust Modernization Commission was created by Congress to examine whether laws written more than 100 years ago were appropriate and continue to be for the modern economy. The commission's conclusion that the antitrust laws are basically sound is one I fully support.

That being said does not eliminate the possibility for improvements, either in the actual legislative language of the laws or more rational enforcement of the existing laws. An issue that may not have raised competitive concerns 20 years ago might be one for the agencies charged with antitrust enforcement to reexamine. For example, the joint guidelines issued by the Department of Justice and the Federal Trade Commission on health care have not been evaluated in nearly 20 years. If this Committee can examine changes in the health care market and the impact of mergers on industry concentration, then it may make sense for the antitrust enforcement agencies to reassess their guidelines on antitrust enforcement. As with the Antitrust Modernization Commission, they may find that these guidelines are sound, but periodic review certainly may be warranted.

Of course, such reevaluations need not result in any modifications to any antitrust law enforcement by the Federal Trade Commission or the Department of Justice. However, good management suggests that standards developed by the government should be reevaluated on a periodic basis; otherwise, it is conceivable that government enforcement of the antitrust laws may not serve their purpose of ensuring competition given the changes in market conditions. I look forward to the thoughtful discussion from the witnesses and their ideas on how to ensure that small businesses will face a free competitive market.

And I again thank you Madam Chairwoman for holding this hearing, and I yield back.

[The statement of Ranking Member Chabot is included in the appendix at page 45.]

Chairwoman VELÁZQUEZ. Thank you.

And it is my pleasure to welcome the Honorable William Kovacic. The Honorable William Kovacic was designated Chairman to the Federal Trade Commission on March 30, 2008. Prior to this appointment, he was a commissioner with the FTC. The Federal Trade Commission is the only Federal agency with both consumer protection and competition jurisdiction in broad sectors of our economy.

Welcome.

STATEMENT OF THE HONORABLE WILLIAM E. KOVACIC, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. KOVACIC. Thank you, Madam Chairwoman, Ranking Member Chabot, Congressman Westmoreland and Members of the Committee.

I am very grateful for the opportunity to be here today to discuss the FTC's role in addressing competition policy, small business, and new entrepreneurship. I have submitted a statement on behalf of the Commission for the record, and what I have to say today represents my own views, not necessarily those of my colleagues.

I completely share the Chairwoman's view about the importance of new business development and the role that new entrepreneurship has played in providing a uniquely powerful source of vitality and rejuvenation for our economy. And I believe it would be fair to say that if my colleagues were here with me today they would agree with that sentiment completely.

What I would like to do is to highlight three ways in which I think our agency today and in the future will be seeking to preserve what Mancur Olson, the economist who served for so many years at the University of Maryland, in talking about new business development described as an enabling environment for new entrepreneurship. The first thing that we try to do is to challenge private restrictions upon behavior under the antitrust laws that tends to do two things: We challenge behavior that tends to raise the costs of key inputs on which small businesses and large businesses rely, inputs that have a uniquely significant role in the growth and development of small businesses. Examples include the work that we do in the professions to ensure that professional services are priced at relatively low rates and feature innovative means of delivery so that small and large businesses alike are able to achieve cost reductions.

The second form of conduct we attack is behavior that unreasonably restricts access to the market. Where private actors and incumbent firms band together, for example, to deny opportunities for innovative new firms to gain access to the market, a number of our cases have challenged that behavior. Our current program which involves real estate is but one example of areas where we have sought to ensure the innovative new models of providing important services get a test in the marketplace on the merits.

The second area that is a key area of our concern involves what I would call research and advocacy. Because Congress entrusted us not simply with enforcement authority but saw our role to be very much that of providing research, being a convenor of events, we take this role very seriously in providing advice to other public institutions, to challenge and force a rethink of restrictions on entry into the market that we regard to be unnecessary to achieve legitimate policy goals and that unduly restrict access to the market. That has been a major focus of our work involving Internet sales of wine and other products.

An increasing focus of our work is to inform policy development. That is to focus on emerging trends and, where necessary, to engage in a probing reassessment of what we have done. That was the ranking member's comment about the importance of always reevaluating the wisdom of what we have done. And for myself, given the work that I have done in the area of development economics in other countries around the world, an increasing concern for me is why poverty persists in areas of severe economic disadvantage and where it might be possible for our programs to focus more carefully on artificial impediments to the market in parts of our country in which we see persistent, difficult, and often unsuccessful efforts by entrepreneurs to enter the market. I am not suggesting we will find precise and always successful solutions to that, but I think the general questions of economic disadvantage and new business development tend to be extremely important concerns to me. I will use the resources as well as I can of our agency to promote efforts to explore that. The last is to provide guidance and information to entrepreneurships. To provide guidance, we prepare a number of materials for small businesses that might not be able to afford the elegant services of a fairly costly law firm by which people, in relatively plain and simple terms—and I would like to present these

for your record as an illustration of what we do—can understand what the mandates of the law are and, through consumer protection measures such as the franchise rule, to ensure that new businesses contemplating entry into the market have a better informed judgment of what lies ahead for them.

This is a snapshot of our program. I welcome the opportunity to address your comments and questions. And I hope this is the first of a number of occasions in which we can carry on a conversation about this important area of concern.

Thank you, Madam Chairman.

[The statement of Mr. Kovacic is included in the appendix at page 70.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Chairman.

I hear you, hear you talk about agreeing with us regarding the importance of promoting new business through business development. I would like to hear from you with more specificity, from your perspective, how does the presence of small firms in the marketplace benefit consumers? And in particular, what steps has the FTC taken to actively work with the small business community on competition issues besides showing me the guidance that is going to be made part of the record?

Mr. KOVACIC. I would say one of the most important benefits, though not the only one, is the one that you highlighted in your comments before. And that is the importance of innovation, the significance of having the new idea, the new form of organization come into the marketplace. In many instances, it is the small entrepreneur, it is the individual perhaps working in a large organization who has the idea about how to enter. So I would underscore that as being perhaps the most important single benefit to consumers.

A large number of our programs seek to make sure that there are not artificial obstacles placed in the way of these individuals. And we do work through a fairly broad program of consultation with a variety of groups outside our walls. Academics who study these circumstances, trade associations before whom we appear regularly to discuss our programs, and to learn from the convening of workshops and programs - these are all measures by which we seek to make sure that we understand what is taking place in these communities and can make effective policies to address these concerns.

Chairwoman VELÁZQUEZ. Enforcement of our Nation's antitrust laws is critical to maintaining a level playing field and, of course, keeping markets open for small businesses. What kind of anticompetitive conduct do you see as posing the biggest threat to small firms, and how is the FTC working to counter these threats to entrepreneurs?

Mr. KOVACIC. I would say the single threat that strikes me as most important, though not the only, is where you have incumbent providers of a service seeing a threat by a new service provider who in particular threatens to topple the existing structure of things by doing something new and innovative, where the incumbent providers either ban together on their own to take measures to keep that person out, or they go to public institutions that have the power of law through regulation or statute to keep these individ-

uals out. We bring a number of cases that challenge the private restrictions, we use our advocacy program to approach public institutions and say that is harmful.

But I would say at the same time, we have a similar concern about the capacity of a single dominant enterprise to do the same thing acting on its own. I put first in the hierarchy the collective effort to exclude. I would add to that instances in which a single firm, either using private means or again going to public authorities and saying keep the threat off my back, both of those are important to us.

Chairwoman VELÁZQUEZ. I understand you are going to be holding a series of hearings to mark the 100th anniversary of your agency. Are you planning to hold any hearings with the small business sector?

Mr. KOVACIC. In a number of instances, I expect representatives of small business groups or individuals who started small and became large to address issues associated with the development of small business. I expect that will be a perspective. And we will be seeking it not only with the community at home but overseas, too, to tap experiences that foreign jurisdictions have had in trying to promote an enabling environment for their firms, too.

Chairwoman VELÁZQUEZ. Why is it so difficult just to design one hearing to listen to small business issues as they relate to antitrust laws?

Mr. KOVACIC. I found that since we are having perhaps a total of over a dozen individual events - and I am glad to discuss more with you and the Committee about whether the structure of these programs might be reconsidered - I find it useful to have them as part of a larger mix of organizations to say, let me tell you how my own situation is similar to or different from the others. I welcome the opportunity to speak with you, your colleagues and your staff about considering whether this assumption is a sound one.

Chairwoman VELÁZQUEZ. I welcome that.

The Justice Department recently issued a report on single firm conduct. While the FTC and the DOJ held nearly 20 joint hearings, the FTC refused to sign the report. The FTC's dissent stated the policies in the report placed the interest of monopolies ahead of consumers and downplaying the risk of under-enforcement. How do the commission's views differ from DOJ on monopoly policy?

Mr. KOVACIC. I had my own statement in response, but I will try to say what I think my colleagues might agree with to put my finger on one thing. My sense is that the modern path of our jurisprudence, especially Supreme Court jurisprudence over the past 30 years, has been one of giving dominant enterprises progressively greater freedom to make business choices as they wish; and that the zone of exposure that they face for exclusionary conduct has been shrinking progressively over time. For myself, I don't see dominant enterprises today with being faced with particularly severe risks to their behavior over time. And with respect not only to dominant firms but other areas of our jurisprudence, I think the Supreme Court's efforts in particular to respond to what they think are infirmities in private rights of action are starting to encumber public enforcement authorities, too.

Chairwoman VELÁZQUEZ. So that explains why you didn't sign—

Mr. KOVACIC. That goes to the heart of my own views. And I suspect my colleagues wouldn't disagree with me, in fairly direct terms, you have seen as well, their own more specific concerns about the Justice Department report.

Chairwoman VELÁZQUEZ. Last year, we held a hearing on health care antitrust laws in this Committee, and there has been a concern among small businesses regarding the lack of enforcement of antitrust laws by the FTC and the DOJ. While consolidations are up, the rate of merger challenges ranks among the lowest in modern history. Why have antitrust enforcement activities plummeted during this administration, and what are the consequences for entrepreneurs and consumers?

Mr. KOVACIC. I hear that comment a lot, but it doesn't remind me at all of the agency I work for. I think a careful examination, and I will speak for my own agency, with respect to merger policy in particular, enforcement has been every bit as robust as it was in the decade before. And I would be happy to review with you in more detail what I think the numbers show. But I would even go farther to say that, when you look at a number of measures that we have pursued in the Federal Courts, if anything, we have been trying to extend the zone in which we look at individual transactions at greater detail. So it doesn't really capture the agency that I am talking about, and I think that it is not just my intuition. Again, I would be delighted to have a conversation with you and the Committee about this.

Chairwoman VELÁZQUEZ. I guess that, in 2007, The Wall Street Journal disagreed totally with you when it said that the Federal Government has nearly stepped out of the antitrust enforcement business leaving companies to mate as they wish. Isn't it true that consolidation is up?

Mr. KOVACIC. I don't know that members of the Committee would agree with me completely, but I would ask you to accept the possibility that there are times when journalists lapse and perhaps don't always get it exactly right.

Chairwoman VELÁZQUEZ. Okay. Answer my question, is consolidation up or not?

Mr. KOVACIC. No, no, I think not - and not above levels in the areas that we are looking at that prevailed in the decade before. Now, we can have a larger conversation about whether—

Chairwoman VELÁZQUEZ. Okay. So let me ask you, in the area of health care insurers is consolidation up or not?

Mr. KOVACIC. I know there have been a number of transactions but I don't see the ultimate level of consolidation to be at a range that would not have been permitted in the previous decade too. Now, I think it is a valid point for discussion about whether things are at the right level.

Chairwoman VELÁZQUEZ. You are telling me that consolidation with insurers is not up in this country.

Mr. KOVACIC. I am saying the level of consolidation is up.

Chairwoman VELÁZQUEZ. What is the level of consolidation? Can you be more specific?

Mr. KOVACIC. The health insurer sector is not one that we oversee when it comes to mergers and acquisitions. I don't have the specific data on trends available there. But this is something that

I would be glad to discuss in more length. The Department of Justice has been the agency that has looked at health care consolidation. But my impression from a distance is that they are using well accepted standards to examine transactions. I think a useful focal point for discussion would be to look. And we would be glad to engage in that discussion about specific areas or types of transactions that perhaps ought not to have been allowed. That is a valid point for consideration.

Chairwoman VELÁZQUEZ. Last October, the Committee held a hearing on how the market power of insurers is harming the ability of physicians to care for patients. As chairman, what are your plans to examine this issue?

Mr. KOVACIC. We have been having a number of workshops that deal with efforts of individual physicians to provide care. This is an issue that I expect will continue to be a focal point for our own research and for these public deliberations. So I expect that it is an issue that will remain high on our agenda.

Chairwoman VELÁZQUEZ. And you examine this by conducting workshops?

Mr. KOVACIC. We conduct workshops. It is an argument that is often raised in our enforcement efforts with regard to what we believe to be impermissible forms of collaboration among physicians.

Chairwoman VELÁZQUEZ. So let me ask you, can you explain to us why in the past 7 years have all nonmerger enforcement actions involved health care providers with virtually no enforcement involvement involving health insurers?

Mr. KOVACIC. For ourselves, the insurance portfolio itself is one that has been the province of the Department of Justice. That is in the rough distribution of authority that we have over matters, that—

Chairwoman VELÁZQUEZ. Isn't it true that the administration has focused more on antitrust enforcement activities on physicians but not on insurers?

Mr. KOVACIC. With our area of authority, our focal points have been physicians and hospitals.

Chairwoman VELÁZQUEZ. I will come back in the second round. And I will recognize Mr. Chabot.

Mr. CHABOT. Thank you.

Chairman Kovacic, just a couple of questions. Are there procedural changes that you would recommend or that you think that we should consider that they be made in the antitrust laws that would increase competition in the marketplace, and if so, what type of things do you think that we should consider?

Mr. KOVACIC. One thing that I would take a careful look at, Congressman, is the full spectrum of exemptions that now affect commercial activity in our country. I think, for myself, and it is a fairly familiar list, I think that one of the suggestions of the AMC report was that exemptions that be a significant focus of attention. I think that would be useful. I also think it would be very helpful for Congress to consider eliminating specific curbs on our authority to act. We have recommended, for example, that the common carrier exemption be reconsidered. There are limitations in our legislation that curb our capacity to do certain types of studies involving insurance unless we have approval first from the Congress. So two

focal points I would mention: one, exemptions generally; and second, I think specific limitations on our own authority to act.

Mr. CHABOT. The FTC, as you mentioned, generally doesn't support legislation concerning the granting of exemptions from the antitrust laws. Would you consider such exemption appropriate in a market in which either the purchaser or the seller already has an exemption from antitrust laws?

Mr. KOVACIC. Generally speaking, no. We would certainly examine and consider specific arguments, as well as the context in which they are offered, but we would generally not. And as I suggested before, in the spirit of the AMC report, we would like to go back and reexamine in many instances the sensibility of the exemptions that already exist.

Mr. CHABOT. Let me ask you about kind of a specific example here. And you can answer it to the degree that you feel is appropriate. Is the bowl, the College Bowl Championship Series in college football, in your opinion, does it constitute a contractor conspiracy to restrain trade since certain universities have contracts with certain bowl sponsors that exclude other institutions of higher education from participation?

Mr. KOVACIC. Owing to a very important limit on our jurisdiction, Congressman, that is not one that I have looked at a great deal. If you were to take away to a large extent the not-for-profit exemption that excludes our consideration of these issues, I would like for us to be in the position to know more about this and give you a fuller answer. And, in my own view, not-for-profit institutions are educational institutions but they are also large entertainment providers. The extent to which the not-for-profit exclusion keeps us from looking at that sector of the economy, I think, is unwise. That is the carve-out from our jurisdiction that I would applaud Congress reconsidering.

Mr. CHABOT. And another somewhat specific example is the auto manufacturers and the fact that they don't provide independent auto repair shops with key computer codes and other pertinent repair information. Would that be considered a reasonable restraint of trade or could you comment on that area?

Mr. KOVACIC. Yes, Congressman. I think the general trend in doctrine since the early 1990s has been one of giving original equipment manufacturers a greater measure of control over how the distribution of know-how takes place downstream with respect to their own retail outlets and to independents as well. It seemed in the early 1990s that our Supreme Court was giving a fairly broad charter for competition law to take a look more closely at these arrangements. The lower courts since then have backed off some of those suggestions. I would say that it is comparatively difficult to establish under existing doctrine a cause of action for those types of restrictions. I would say, as my predecessor mentioned I think 2 years ago in a hearing, we think there is a great deal of promise at a minimum to use the process of voluntary industry cooperation in negotiations that have taken place before to see if there might be a sensible result achieved between the original equipment manufacturers and the independent repair shops.

Mr. CHABOT. Thank you.

And then, finally, related to the McCarran-Ferguson Act, could you comment on the imbalance in bargaining position relative to physicians in hospitals and their inability to negotiate contracts with health insurers? And the Chairwoman, to her credit, has been very focused on trying to do what we can in this Committee to improve affordable, accessible health care to small business folks. And that is one of the things, in traveling around my district, is one of the things I hear over and over again. One of the greatest challenges of small business folks is providing affordable health care for their employees. So could you discuss physicians in hospitals and their ability or inability to negotiate when it comes to the health care company?

Mr. KOVACIC. I know this has been a contentious point. It is one we look at in great detail, whether we are looking at hospital mergers or collaborations involving physicians. Our sense in many instances is that physician groups in hospitals in fact have strong countervailing power when they deal with insurance companies. My larger plea is to put us in a position to be able to address these phenomena more competitively. I am not fond at all and I speak for myself, of the McCarran-Ferguson exemption. I think that is very much worth a rethink by this body. Again, -you find in our statute a limitation imposed in the early 1980s that curbs our ability to do research and studies concerning the business of insurance without a fairly elaborate process of approvals, I think it would be time to put us in a position to examine and rethink some of the positions I have been suggesting to you. It would be helpful if that were disbanded.

Mr. CHABOT. Thank you very much.

Madam Chair, I yield back my time.

Chairwoman VELÁZQUEZ. Ms. Hirono.

Ms. HIRONO. None at this time.

Chairwoman VELÁZQUEZ. Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Madam Chair.

Mr. Chairman, where does intellectual property rights come into play when you are trying to weigh competition, where does that come in?

Mr. KOVACIC. Increasingly the perspective of the competition agencies, certainly going back to the mid-1990s, has been to treat intellectual property as a valuable form of property right on a plane with other forms of valuable property; that is, to regard the property in ideas as being an extremely important asset, just as we could point to other forms of physical property. There has been a trend to regard those property rights as being extremely important and to take a great deal of care to see in what respects the specific character of property in ideas dictates any variation or adjustment in the way in which we enforce the laws. T000his has been a matter of pressing concern for both of the competition agencies, certainly going back a long period of time, but intensely since the mid-1990s when the agencies revised their antitrust IP guidelines.

Mr. WESTMORELAND. I have got an iPod, and it quit working, and so I took it to where I bought it. And they told me that I would have to take it back to Apple to get it looked at, that they didn't have the ability to do it, that only an Apple store could do it. Would you think that when Apple sells an iPod, that they need to give you

a manual of how you could repair it yourself, or is that some type of antitrust something that I have got to go back—there is only one place I can take it? Is that an antitrust—if I have a complaint with you, can I call you and tell you that I can only get my iPod—

Mr. KOVACIC. My phone is 202-326—(laughing) I think it depends from our point of view on at least two things: One is, with respect to that device, do you have other choices in the marketplace? That is, let's assume there are a number of them, and they chose a policy that irritated and frustrated you. I suspect your reaction and mine might be the next time I was thinking of buying things, I am not going to buy this device from them. In fact, I remember that producer's name, I am not going to buy anything from them because they made my purchasing experience worse.

A second thing we would look at carefully is, why the limitation? One argument that would depend on a more careful factual evaluation, is assumptions we might make about the care with which individuals who would be able to do the repairs. If one could make a good argument that it took a highly specialized type of individual with a good deal of training to do that right, we might think that there is a greater basis for restricting who could do that, because if it doesn't work after the repair, you are going to look at the name on the device and you will probably remember that rather than that it was Bill's Repair Shop that did the work on it. That is the kind of issue that we would spend a great deal of time looking at in careful detail.

Mr. WESTMORELAND. The aftermarket, which the ranking member mentioned, as far as automobile repairs, you mentioned an independent industry group, I guess, that handles some of the complaints that would come from an automotive repair shop or whatever as far as getting some of these codes or whatever for repair. Do you know from that group how many complaints have been filed in a year, and the total number of repairs done to automobiles once they leave that showroom floor, and what percentage is done by who?

Mr. KOVACIC. I don't know those numbers, Congressman.

I know that, indirectly, one thing we track very carefully is how many complaints come our way. And certainly over the past 12 months, with respect to end users, the consumers you were referring to before in your other example, we have not received complaints of this type. Occasionally we get them. I am not acquainted with what the experience within the dispute resolution process itself has been. Certainly if the Committee, you or other researchers, have data on that, that we ought to be focusing on, I would welcome the chance to do that.

Mr. WESTMORELAND. Would you be surprised if I told you that of 500 million post-warranty service orders are done each year, 75 percent of those are done by independent repair services; 25 percent by new car dealers? And I think that there was less than 100 complaints last year that was filed with the National Automotive Service Task Force. That doesn't seem like a large number when you think of those repairs. Do you think that you have any trained staff enough? Because I understand in some of the hearings they had last year, I didn't attend any of the hearings, but my understanding was they wanted your agency to be involved in this, do

you think that you have got the staff, the trained personnel to investigate, respond, compile, update these stats and statistics and innovations that are in the automobile industry every year?

Mr. KOVACIC. One of the reasons that we have found it helpful to explore the sorts of alternative dispute resolution in the industry, voluntary industry cooperation mechanisms that you described before, is that it is a way to see if we can get good solutions that doesn't involve that kind of commitment of resources. I would add that there have been a number of areas in which Congress has asked us at different times by statute to take on demanding new challenges. We have a pretty good history of responding to those challenges with resources that Congress has generously provided us. So I wouldn't say immediately that it would be an easy thing for us to do. I think some of these other paths are certainly worthy of further exploration. But were the choice to be made to ask us to do it, it has been a highly adaptable and successful process by which we have taken on major challenges.

Chairwoman VELÁZQUEZ. Would the gentleman yield for a second?

Mr. WESTMORELAND. Yes.

Chairwoman VELÁZQUEZ. I hear you when you talk to us about listening and voluntary agreement and workshops. He is asking you about complaints that have been raised. Can you talk to us about any specific action taken on behalf of small businesses regarding enforcement of antitrust laws?

Mr. KOVACIC. Many of our cases involving real estate, professional services, restrictions on the use of the Internet, has—

Chairwoman VELÁZQUEZ. And specifically on the issue that he raised.

Mr. KOVACIC. On the issue of auto repair, no, we haven't. We have done investigations.

Chairwoman VELÁZQUEZ. And?

Mr. KOVACIC. We haven't brought any cases. We do look at the complaints carefully. As I mentioned before, the existing legal framework on which an antitrust complaint would be premised imposes some extremely demanding standards, in my view, about bringing cases. But we have taken complaints that have come to us, Madam, with the greatest care.

Chairwoman VELÁZQUEZ. I yield back.

Mr. WESTMORELAND. And I thank the Chairwoman for bringing that up because I think it is important to know that you have looked at some of these cases. And I am assuming you are saying that they haven't risen to the level of where you feel like there has been any action needed or necessary from the FTC?

Mr. KOVACIC. That is correct.

Mr. WESTMORELAND. Madam Chairman, I will yield back the balance of my time and thank you.

Chairwoman VELÁZQUEZ. Mr. Altmire.

Mr. ALTMIRE. Thank you, Madam Chair.

Mr. Chairman, thank you for being here.

Mr. KOVACIC. Thanks for the chance to do this.

Mr. ALTMIRE. Of course. I wanted to focus on antitrust law and get your opinion on something more than anything else. There was a recent Justice Department paper that said, and I quote, the fun-

damental reason we favor competition over monopoly is that competition tends to drive markets to a more efficient use of scarce resources. So I was wondering, in your opinion, given the scope of this Committee, how does participation of smaller firms in the market increase economic efficiency?

Mr. KOVACIC. I think the economy and the jurisdiction that provides an environment in which the best ideas get a test in the market is the jurisdiction that is going to be more prosperous than others. Quite often, the good idea, whether it is about a product, about how to deliver an existing product, how to organize a particular form of business entity, those ideas often come from new entrepreneurs, so that the competition of new entrepreneurs in a number of different settings is a tremendous spur to economic progress. Antitrust enforcement and a collection of policies that I would call competition policy have a tremendous contribution to make. This Committee's work is part of that.

Mr. ALTMIRE. In your opinion, do you see any correlation or anything you want to add about what we are dealing with as a Congress with a larger financial market and where smaller firms would fit into that?

Mr. KOVACIC. Financial services is an area where Congress decades ago decided that, with the most limited exceptions, the FTC does not participate. That is one of the major carve-outs from our jurisdiction. There are some areas where we act. With respect to the larger phenomena that this body has been focusing on in recent days and the upheaval in that sector, those are institutions, for the most part, that are beyond the scope of our examination.

Mr. ALTMIRE. Thank you.

I have no further questions Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Shuster.

Mr. SHUSTER. Thank you, Madam Chair.

And thank you for being here today. And sorry I didn't hear your testimony earlier and didn't hear some of the earlier questions, so if I ask any that are redundant, please let me know.

But my colleague from Georgia mentioned intellectual property rights, and in full disclosure, I should say I am a former automobile dealer, so I know firsthand the situation here. And my question deals with, what are the rights of, when you are viewing these cases, on investment in not only the auto manufacturer investing huge sums of capital to develop these products and parts but the auto dealer, who is also investing thousands and millions of dollars in some cases on repair facilities, and that they should have that competitive advantage in my view. If I am spending the money, I am the one who has to sign a deal with the auto manufacturer to carry their product line, what weight is given to that and how am I protected to make sure my investment is protected when you come into a situation?

Mr. KOVACIC. Something that you have certainly observed from your previous life in that sector is that the automobile sector in North America, I think we might say, is pretty competitive.

Mr. SHUSTER. Extremely.

Mr. KOVACIC. During my childhood growing up in southeastern Michigan, there were four companies you talked about; three big ones, American Motors on the fringe and a couple of quaint things

called Volkswagen Beetles driving around. That is not the industry we see today, is it? Notice how many choices for original equipment consumers have. A basic assumption we would make as a starting point is that those manufacturers have every possible incentive to get things right with respect to the design of the distribution system. And generally speaking, providing incentives for them to invest in improving that distribution system is an important value to be recognized.

At the same time, if I were to go back to my home at George Washington University where if I weren't doing this I would be teaching contracts in the first semester, I don't doubt that there are instances in which you see disagreements between the manufacturer and the dealer about that relationship over time. Perhaps you had some of those yourself.

Mr. SHUSTER. Every day.

Mr. KOVACIC. Every day. And generally, in our country, with respect to those kinds of disagreements, that has largely been the province of contract law. It is not that the disappointed dealers invariably are marching into courtrooms to wage battles over time. There can be instances in which the manufacturer or perhaps a dealer can behalf opportunistically to exploit certain investments that are made. But contract law has generally been the province where we examine that. I think because our courts and our Supreme Court has been concerned about those incentives to invest, they have tended to impose fairly demanding requirements on antitrust plaintiffs, including us, who would want to upset or challenge activity and behavior that is taking place in the course of that relationship.

Mr. SHUSTER. The notion that it is anticompetitive out there because the dealers or the manufacturers aren't giving out that information to me is a ruse I believe because, as my colleague stated, of the 500 million repairs, 70 to 80 percent of them are done by independent shops. Also, within, I am sure within 45 minutes of where we sit today, you can get any car that you—a Toyota, a Ford, a Chrysler—you can get it repaired by several, multiple dealerships around the area, so the competition is robust. Firsthand, there were 45 Chrysler dealers within 45 minutes of my store.

Mr. KOVACIC. Congratulations (laughing).

Mr. SHUSTER. So the idea that there is not competition, would you agree with that? I mean, there is robust competition between automobile dealers.

Mr. KOVACIC. I believe there is. And I wouldn't denigrate the role that independents have. Sometimes independents, and I suspect it was your experience, too, sometimes they see a better way to do this. And we would be interested and we do examine and take seriously the examination of why they would not receive access. And there are instances in which we would be doubting of that. But generally speaking if we compare the automobile sector that we know today to the automobile sector of, well, my childhood, it has been a dramatic transformation in the direction of better choices for consumers.

Mr. SHUSTER. And I think you make an excellent point. Before I was in the automobile business I worked with Good Year Tire and Rubber Company and spent time in their real time operations,

which are independent operators. And many times you do find that they can find a better way or more efficient way to repair an automobile. So I have seen it from both sides, and I just—this legislation that I think we are talking about is, just seems to me it is not necessary because there is robust competition, there is information provided to the independent garages, and it is maybe not perfect information flow, but it gets out there. So I appreciate your time today. Thank you. And I yield back.

Chairwoman VELÁZQUEZ. Ms. Hirono.

Ms. HIRONO. Thank you Madam Chair.

Mr. Chairman I don't know if you have had a chance to read the statement of the American Medical Association.

Mr. KOVACIC. I have, Madam.

Ms. HIRONO. You have.

Mr. KOVACIC. Yes.

Ms. HIRONO. So their concern is, in these challenging times, where mainly small practices, solo practices, are trying to figure out ways to keep going, the scrutiny on physician collaboration through network arrangements, their statement indicates that the FTC has put a very high bar on these kinds of arrangements to the point where most physicians are not able to avail themselves of these kinds of arrangements. Would you like to comment on that?

Mr. KOVACIC. Yes, Madam. I would disagree. We can debate what the high bar is. I think we have applied sensible standards. And I think to a degree that I would disagree with the very thoughtful people who put that statement together. I would disagree with their characterization of how carefully we have been reviewing and considering arguments about what kinds of integration of activity promote desirable marketplace consumer ends. We think we have been very attentive to arguments based on efficiencies, based on what the antitrust laws consider to be procompetitive justifications to arguments that would justify different types of collaboration.

But let's suppose I am wrong, and I don't think I am. We have also been engaged in a fairly intensive effort in recent years to reexamine those assumptions. We have had two workshops that deal directly with this issue within the past 12 months. We are engaged in continuing conversations with the AMA. So while I think there is enormous flexibility and sensitivity in our system to the assessment of these kinds of arguments, we are always inclined to reassess and to continue a discussion with not simply the industry but with other interested groups to make sure we have got things right. And I look forward to continuing that discussion with the AMA, with other service providers and with others who are experts in following developments in the sector.

Chairwoman VELÁZQUEZ. Will the gentlelady yield for a second?

Ms. HIRONO. Yes.

Chairwoman VELÁZQUEZ. I would welcome your refreshing position about reconsidering, because in the past, people have said that they were not wrong and there were a lot of people who asked us to vote for the war based on weapons of mass destruction. Well, they were wrong. Maybe you are wrong. So I would like for you later on before you leave that you identify the member of your staff who will stay here to listen to the second panel.

Mr. KOVACIC. I would say there will be several of my colleagues who will be here to hear the second panel. I would offer one thing that I ask the Committee to think about; it is rare in the areas in which we enforce the responsibilities that you have given to us, that the people we sue, and in the mergers we seek to challenge, it is very rare for the parties in those transactions to say, ″my goodness, the FTC was right.″ They almost invariably say we are wrong. If the suggestion by any industry group or group of parties that we are wrong was ever taken to be a certifying mark of the correctness of their position, we would be out of business.

Chairwoman VELÁZQUEZ. Well, given the track record in terms of enforcement and the number of cases, that is an open question.

Mr. KOVACIC. I don't think for this agency it is, Madam. I say whether you are looking at numbers of cases, whether you are looking at outcomes, having watched my agency for the past three decades, I stack it up happily against any other.

Chairwoman VELÁZQUEZ. I yield back.

Ms. HIRONO. Thank you, Madam Chair.

I would like to continue. With regard to the physician collaboration of these kinds of arrangements, is FTC scrutiny based on Section 5 of the FTC Act or of Section 7 of the Clayton Act?

Mr. KOVACIC. We enforce both, Congresswoman.

Ms. HIRONO. With regard to these collaborations? Because Section 7 has to do with mergers and acquisitions.

Mr. KOVACIC. The framework in Section 7 also picks up contractual arrangements, what might be called joint ventures, that fall short of an actual combination of ownership. So we use both instruments. I would say the tendency over time has been for the analytical techniques used in both areas to converge so that, in many ways with slight variations, we are asking the same basic questions about likely competitive harm, market power, and procompetitive justifications.

Ms. HIRONO. So those are the three major issues that you are concerned with with these physician collaborations, because clearly they can't be engaging in any kind of a price fixing activity, is that correct?

Mr. KOVACIC. Generally speaking, there is a breathtakingly serious prohibition against efforts by direct rivals to set prices.

Ms. HIRONO. Yes, that is per se.

Mr. KOVACIC. Yes. But there are qualifications to that. And our antitrust jurisprudence and our policy have recognized them; we recognize them. There are instances in which restrictions which, if they were standing on their own with nothing else, might very well put you in front of a Grand Jury and send you to prison can be justified, and we take those justification arguments very seriously.

Ms. HIRONO. Well, having just read through the AMA testimony, it is a little difficult for me to understand how it is that a group of physicians who have to compete on the basis of price and other ways, that somehow these kinds of arrangements would not pass scrutiny. It is sort of hard for me to understand.

Mr. KOVACIC. But might we agree that if any group of service providers do nothing else but say, ″let's raise our rates,″ without anything else we would be very suspicious of those arrangements. So the real issue is, is there something else going on beyond just

the decision to raise rates? That is really the issue about which we have a disagreement with the AMA, but it is also precisely the focal point of the continuing discussion that we look forward to having with them.

Ms. HIRONO. I think with the concern that we have that the high cost of health care, that any reassessment on your part as to how you are going to enforce these kinds of arrangements I think is a welcome statement.

Mr. KOVACIC. I do pledge us to engage in that discussion, which I would say has been a characteristic of our practice for decades.

I would reiterate that, at the moment, yes, to the dismay of the AMA's statement, we think that we have things set in the right place, but we are neither arrogant nor stubborn to think that there is not always room to continue the discussion and reevaluate. When facts and knowledge change, so do we.

Ms. HIRONO. Thank you.

I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Ms. Clarke.

Ms. CLARKE. Thank you very much, Madam Chair and Ranking Member Chabot; and thank you, Mr. Chairman, for your insights today.

I wanted to sort of turn to some of the current financial crisis and its impact on minority and female-owned disadvantaged businesses and whether the Commission is monitoring what impact this is having on that sector of our economy in terms of its capacity to compete, whether you would share some of your insights with us.

Mr. KOVACIC. Congresswoman, a limiting condition for us with respect to most of the service providers that have been the focal point of the upheaval in recent weeks and months is that these institutions are beyond our jurisdiction. Congress decided in roughly a century ago and in subsequent legislation that our jurisdiction did not include the financial services sector. There are limited exceptions to that. So this is basically a sector we do not study, being faithful to the limitations in our statute.

Ms. CLARKE. I think maybe my question was misunderstood.

Mr. KOVACIC. I am sorry.

Ms. CLARKE. I understand there are jurisdictional issues, but, within your purview, there are going to be businesses that are going to be impacted by this. And I wanted to know whether the Commission has begun to take a look at that. Because, ultimately, everyone outside of the financial sector is going to have to readjust for competition, given the credit crunch. And these are also the major employers of so many Americans. So while we are up here rushing to the rescue, I am assuming everyone else is looking at what the ramifications are for their particular domain.

Mr. KOVACIC. Let me give you one I expect will be significant for us in exercising our authority to look at mergers, at questions of dominance, at questions of agreements. A major source of strength in our economy historically has been the strength of its capital markets. It is the capacity of individuals to raise funds by issuing stock, by getting loans and issuing debt. We make major decisions in individual cases depending upon how readily we think new firms

can enter the market or how existing entrepreneurs and organizations can expand.

To the extent that the turmoil and recent experience may adjust or dictate an adjustment in those assumptions about how capital markets operate, that is certain to affect the way in which we evaluate the significance of an individual merger and the possibility that new firms will be able to come into the market and challenge them. So I see that as being a fairly powerful implication.

Ms. CLARKE. Mr. Chairman, the concern is who ends up at the end of day at the table able to participate in those activities, which is why I turn to the most vulnerable sector of our small business environment, which is that of women-owned, minority owned disadvantaged businesses.

It would be helpful to make sure that, as you look at particularly joint ventures and globalization, where these companies have always been disadvantaged, that we take a look at what the impact is going to be or what we project what the impact will be so that we can look at the other vehicles we have through our purview to be of support to them in this time of financial instability.

I was wondering whether your Commission would be in fact highlighting or looking at that and sort of cautioning or sending out a warning so that we can react as quickly as possible.

Mr. KOVACIC. Congresswoman, this traditionally has not been part, this specific set of issues, especially the range of concerns about which individuals are able to participate in the market and to what extent are historically excluded groups able to get access to the market has not been part of the traditional antitrust analysis. For myself, I find this issue to be a compelling one, and the question of how historically disadvantaged groups do get access to the market and participate is one that interests me intensely.

I have in mind us doing some things that will look at these issues and especially the extent to which existing policies or programs impede the ability of people unnecessarily to get to the market. It is an issue that I would welcome discussing beyond the scope of this hearing. I would welcome the opportunity to discuss with you and your colleagues and with your staff perhaps more specifically how my own interest in making this a topic of research might coincide with some of your own concerns. I would be quite willing to do that on my own with you or with colleagues of yours who would like to explore this more fully.

Ms. CLARKE. Thank you very much.

I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Chabot.

Chairman, thank you so very much for being here this morning; and if you at least for the record name one of your staff persons who will be remaining in the room.

Mr. KOVACIC. Yes, I would be happy to. Would you allow me to glance back at them to make sure that the person I name will willingly nod and say yes.

Do we have a volunteer?

Ah, we have three: Kim Vandecar, who is with our Office of Congressional Relations and I think well-known to this office. We have David Narrow, who is from our health care group, Bureau of Com-

petition. We have Neil Averitt from our Policy and Evaluation Office in the Bureau of Competition.

That is an awesome contingent. Not only will they report faithfully on what you have to say, they will offer their own thoughtful interpretation, too. We will be in good hands.

Chairwoman VELÁZQUEZ. Thank you, and the gentleman is excused.

Mr. KOVACIC. Thank you, Madam.

Chairwoman VELÁZQUEZ. I ask the second panel to please come forward.

Gentleman, welcome.

WITNESS PANEL II: WILLIAM HAZEL, JR., M.D., JONATHAN RUBIN, SAID HILAL, AARON LOWE, and WILLIAM MacLEOD

Chairwoman VELÁZQUEZ. It is my pleasure to welcome Dr. William Hazel, Jr. Dr. Hazel is a member of the Board of Trustees of the American Medical Association. Dr. Hazel is an orthopedic surgeon in private practice from Northern Virginia. He is here to testify on behalf of AMA, which is an organization that advocates on issues vital to the Nation's health; and it is the United States' largest physicians group.

Chairwoman VELÁZQUEZ. Welcome. You will have 5 minutes.

STATEMENT OF WILLIAM HAZEL, JR., M.D., SECRETARY, BOARD OF TRUSTEES, AMERICAN MEDICAL ASSOCIATION

Dr. HAZEL. Good morning, Madam Chair, Ranking Member Chabot, members of the Small Business Committee and staff.

I am Dr. Bill Hazel. I am an orthopedic surgeon in practice over in Fairfax, Virginia, and a member of the board of the AMA; and I appreciate having the opportunity to testify this morning on small business competition policy.

The health care marketplace has changed dramatically over the past decade. Frankly, the FTC guidelines have not kept pace. Current antitrust policies are barriers that slow physician collaboration and hinder our ability to participate in a full spectrum of health care initiatives. They have also perpetuated an imbalance in the market so that health insurers are able to force physicians to accept contracts that often impede optimal patient care.

The health care antitrust environment has evolved in three significant ways.

Number one, current FTC policy discourages physician clinical integration efforts. The FTC guidelines and advisory opinions to date require a level of financial investment that is impractical for physicians in solo and small group practices, in other words, about 75 percent of the physicians in the country.

Number two, widespread health plan consolidation has eroded the market and severely limited our ability to advocate for ourselves and our patients. In the last decade, there have been 400 insurer mergers. Only three were challenged by the DOJ, only three of 400; and these mergers have benefited no one but executives and shareholders. And the proof is that premiums across the country have increased, out-of-pocket patient expenses have gone up, and physician payment has declined.

The third issue is that professional market and regulatory developments are encouraging physicians to collaborate, to collaborate on the purchase and use of health information technology and quality improvement initiatives.

Allowing a more flexible approach to physician joint contracting would address these market changes and, in fact, would be procompetitive. Allowing physicians to jointly contract would increase competition in the insurance market.

Creating physician panels is time consuming, and it is expensive. It can be a barrier to entry for new insurers through physician joint contracting new payers to gain access to panels of physicians with wide geographic and specialty distribution. When the physicians themselves undertake the initial task of the network formation, payers may substantially reduce their costs of entry and expansion.

Joint contracting would also lead to more equitable, better-informed contracts. Most physician practices simply don't have the resources to analyze payers' contracts. By pooling resources we can spread the costs associated with analyzing these contracts and negotiate for improved contracts for our patients.

Finally, joint contracting would allow physicians to create networks that would facilitate collaboration on health information technology and programs designed to monitor patient care and quality improvement that folks such as you are encouraging us to do even now.

Acquiring, implementing, sustaining information technology requires extensive financial investments by physicians, but the Congressional Budget Office has documented that health insurers are the entities that benefit from cost savings associated with these systems. Allowing physicians to negotiate jointly with payers would help us reallocate these cost savings appropriately and pay for the services.

Similarly, many physicians lack the ability to participate in quality improvement initiatives. By teaming up in networks, small and solo practices can gain the scale necessary for care coordination and appropriate data aggregation that allows us to implement these initiatives.

Now current antitrust policy is clearly out of step with the changing health care marketplace. This led to overly aggressive enforcement against physicians in certain cases, limited opportunities for physicians to collaborate in other cases, and it has permitted unfettered, unfettered health insurer consolidation.

The FTC must update these policies. As the chairman indicated, we are currently discussing with the FTC the guidelines on physician joint contracting, which we believe should allow small practices to collaborate on health information technology and health care quality improvement initiatives. Furthermore, the DOJ must challenge health insurer mergers more aggressively. These steps would restore balance to the health care market and ensure an innovative and efficient health care system.

Thank you, Madam Chair and members.

Chairwoman VELÁZQUEZ. Thank you, Dr. Hazel.

[The statement of Dr. Hazel is included in the appendix at page 70.]

Chairwoman VELÁZQUEZ. Our next witness is Dr. Jonathan Rubin. Dr. Rubin is a partner at the law firm Patton Boggs. Dr. Rubin concentrates in antitrust litigation and counseling. He is here to testify on behalf of the American Antitrust Institute. The AAI is an advocacy organization that seeks to increase the role of competition and assure that competition works and challenges abuses of concentrated economic power.

Welcome.

STATEMENT OF JONATHAN RUBIN, PARTNER, PATTON BOGGS LLP, ON BEHALF OF THE AMERICAN ANTITRUST INSTITUTE

Mr. RUBIN. Thank you, Chairwoman, Ranking Member Chabot and members of the Committee.

I am Jonathan Rubin. I am an antitrust lawyer with the firm of Patton Boggs here in Washington, D.C., and one of about a hundred members of the Advisory Board of the nonprofit organization, the American Antitrust Institute. The AAI's Web site is www.antitrustinstitute.org. I appreciate the opportunity to testify today.

My task is fairly limited. It is to present the major recommendations that appear in the upcoming report, entitled The Next Antitrust Agenda: The American Antitrust Institute's Transition Report on Competition Policy to the 44th President. The report will be published in October and will be provided to the Committee.

My remarks today reflect solely the position of AAI and not that of Patton Boggs or any of its clients.

The antitrust laws are among America's greatest contributions to the field of political economy. The AAI strongly believes that government ought to promote competition in free markets and that the Nation's antitrust laws can and do precisely that if they are aggressively and creatively employed.

Believing in competitive free markets is one thing however, but the facts on the ground may be very different.

Two opposing forces constantly pull on the economy. On the one side is the urge by the government to control the private sector through regulation, and on the other side is a strong belief that free markets and laissez faire policies foster efficient economic growth and protect the private sector from counterproductive governmental control.

Neither path provides a complete policy prescription.

Over-regulation protects inefficient competitors and operates as a drag on the economy, and complete laissez-faire risks a lawless jungle operating without regard for justice.

Antitrust occupies the middle ground between these polar possibilities and frequently offers nuanced instruments with which to steer markets back to an even keel when market failures occur. It is in this middle ground that opportunities for small businesses are often created—or destroyed.

This inherent need for balance in antitrust is reflected in the positions advocated in the AAI Transition Report, the most important recommendations of which are itemized in my written testimony. I will use my remaining time instead to characterize where we are and where we need to go in the view of AAI.

As a general matter, the AAI applauds and encourages deregulation in industries in which ill-advised and overly intrusive regulatory structures are less efficient than an unregulated market. In the view of the AAI Transition Report, however, current antitrust policy worries too much about intervening incorrectly, risking false positives, and not enough about failing to intervene when necessary, risking false negatives. Antitrust is about predicting market outcomes, and predictions will sometimes be proven incorrect. AAI sees no reason to suppose a priori that false positives are inherently more injurious to an efficient economy than are false negatives.

Current antitrust doctrine is also unabashed in its disdain for the capabilities of agencies, courts and lay juries to resolve antitrust disputes correctly, and expansive in its estimation of the costs of administering the resolution of such disputes. AAI believes that this lack of confidence in courts and juries is not justified. Limiting access to the courthouse often disadvantages private antitrust plaintiffs, who are frequently small and medium sized businesses.

The AAI also believes that viewing single-firm issues exclusively through the lens of neoclassical price theory and assessing competitive injury solely in terms of its effect on price or quantity imposes artificial limitations on the scope of the antitrust enterprise. Consumer choice, variety, diversity, quality, convenience and innovation, these are all also legitimate values worthy of protection in the defense of competition by the operation of the antitrust laws.

In short, current antitrust policy leads to an overly noninterventionist standard of contact that the AAI rejects.

As a case-by-case form of regulation charged not with promoting competition but with eliminating impediments to it, antitrust exerts an influence on business conduct even where no action is taken. And the mere threat of antitrust liability deters anti-competitive conduct.

No matter which party will control Congress or who the President will be, the AAI's advice to the next administration is the same:

Antitrust analysis should be brought more in line with a broader body of modern economic knowledge and made better equipped to deal with the realities of modern markets; more resources and personnel should be devoted to the skillful deployment of antitrust enforcement as a policy instrument to maintain competitive markets; and the institutions, substantive rules and procedures of antitrust should be rejuvenated, particularly as they pertain to the treatment of single-firm conduct.

I thank the Committee for your attention and would be pleased to answer any questions you may have.

Chairwoman VELÁZQUEZ. Thank you, Dr. Rubin.

[The statement of Mr. Rubin is included in the appendix at page 82.]

Chairwoman VELÁZQUEZ. Our next witness is Mr. Said Hilal. He is the President of the Applied Medical Resources Corporation in Rancho Santa Margarita, California. Applied Medical is a company dedicated to meeting the innovative needs of progressive surgeons and clinicians. He is here to testify on behalf of the Medical Device Manufacturers Association. Since 1992, MDMA provides education

and advocacy assistance to innovative and entrepreneurial medical technology companies.

Welcome.

STATEMENT OF SAID HILAL, PRESIDENT, APPLIED MEDICAL RESOURCES CORPORATION, RANCHO SANTA MARGARITA, CALIFORNIA, ON BEHALF OF THE MEDICAL DEVICE MANUFACTURERS ASSOCIATION

Mr. HILAL. Thank you, Madam Chairwoman.

Madam Chairwoman, Ranking Member Chabot and members of the Committee, I address this Committee on behalf of Applied Medical and the nearly 200 members of the Medical Device Manufacturers Association, as well as the countless other smaller medical device companies in this Nation who face significant challenges accessing the hospital market.

Innovation in the medical device arena is fueled by small companies working with clinicians, scientists and engineers to enhance the quality of care. Applied develops and sells devices for progressive, minimally invasive surgery.

Back in 1988, we set out to create a company that can improve both healthcare and the financial outcomes of new modalities; and we did. In the process, we invented and innovated many procedures and many devices that achieved these end targets. But clinicians do not have access to the best and most cost-effective innovation, mainly because of the anti-competitive practices of dominant suppliers and certain hospital group purchasing organizations, or GPOs.

Now, originally, GPOs were established to help small hospitals aggregate their purchasing power by combining them together, by banding together; and, instead, they have become the marketing arm of dominant suppliers and failed to achieve the intended goal of lower cost.

This is because back in 1986 Congress created a safe harbor from the Medicare anti-kick back statute and permitted suppliers to fund the GPOs. Until that time, GPOs functioned more like cooperatives funded by their own members. But once the GPOs began to rely on key suppliers, on giant suppliers for funding, they lost the ability to independently review products and, in many situations, GPOs contracted with the suppliers who paid the most fees, fees that are actually percentages of the total contract price. So the question, would a GPO go with a $20 million price or discounted price of say $10 million when they are collecting 5 percent on either? Or are we creating a conflict here?

Giant suppliers very quickly picked up on this and manipulated this situation to lock out smaller suppliers. We at Applied have had the good fortune to be able to fight back. We had the staying power. It cost us dearly, and it took 10 years to break into the market, before the market even opened up a little bit for us to get into it. But for every Applied there are countless small medical technology companies that continue to be totally foreclosed.

To start restoring competition in the healthcare industry, it is imperative that Congress repeal the GPO safe harbor and move GPOs back to the hospital-funded model independent of the large suppliers. According to Harvard's competition expert Michael Por-

ter, there is no valid reason for buying groups to accept financing or any payment from suppliers.

Speaking of those dominant suppliers, while ending the supplier kickbacks to GPOs would actually provide a better competitive landscape, it is but the starting step. Small companies in health care face monopolies and duopolies that engage directly in anti-competitive activities, including predatory pricing and bundling of related and unrelated products.

We have repeatedly suffered from the predatory market powers of giant companies, regardless of their respective market share in the contested arena. But Applied and hundreds of companies like Applied have suffered the most from the total absence of oversight and enforcement in certain areas. And in the face of the latest predatory approaches by large monopolies and duopolies, our antitrust laws have been watered down or shelved, while the new practices and tactics have taken hold.

At a time when the Department of Justice and the Federal Trade Commission should be taking a more proactive oversight role, the recent DOJ report takes the wrong direction and creates additional safe harbors, not less, for the monopolies at the expense of competition, consumers and innovation. This is not the direction the U.S. Government should be taking. Progressive European and Australian agencies are way ahead of us in these areas, and they are dealing with violators firmly. We can and must do better.

In conclusion, these practices by dominant suppliers and some GPOs individually and collectively damage open competition and increase the cost of health care. By repealing the GPO's safe harbor and providing proper oversight and enforcement over maintaining monopolies and large lock-step duopolies, I believe we can benefit patients, hospitals, customers, healthcare and providers.

Thank you very much.

Chairwoman VELÁZQUEZ. Thank you, Mr. Hilal.

[The statement of Mr. Hilal is included in the appendix at page 90.]

Chairwoman VELÁZQUEZ. Our next witness is Mr. Aaron Lowe. He is the Vice President of Government affairs for the Automotive Aftermarket Industry Association.

The motor vehicle aftermarket is a significant sector of the U.S. Economy, employing approximately 4.5 million people. The AAIA represents more than 100,000 repair shops, part stores and distribution outlets.

Welcome.

STATEMENT OF AARON LOWE, VICE PRESIDENT, GOVERNMENT AFFAIRS, AUTOMOTIVE AFTERMARKET INDUSTRY ASSOCIATION

Mr. LOWE. Thank you, Madam Chair; and thank you, members of the Committee. I am pleased to present this testimony on this very important issue.

As you said, our industry represents the independent aftermarket. It is everything that happens to a car once it leaves a new car showroom.

Since the invention of the vehicle, the U.S. has had the most competitive vehicle aftermarket in the world, as has already been

stated in this hearing. Americans currently have a wide array of choices in vehicle repair, whether it is going back to the dealer or to the thousands of independent repair shops that are in every community in this Nation. This competition has kept car owners and not the vehicle manufacturers in the driver's seat when it comes to making choices regarding vehicle repair destinations.

While we are proud of our service to the American motoring public, we are extremely concerned that the dynamics are changing and that our independent shops are being placed at a competitive disadvantage. This change has nothing to do with the efforts that our independents are investing in servicing the public, but rather the attempts, whether intentional or not, by manufacturers to use technology to obtain a competitive advantage for their dealer network, an advantage that dealers have been unable to gain through customer service or price. Left unchecked, we will soon see the car companies controlling decisions as to where cars are repaired and not by the person who has spent their hard-earned money to purchase that vehicle.

The U.S. Congress foresaw the role that technology would play in the repair market back in the late '80s when the Clean Air Act was being debated. Back then, the Act required that on-board diagnostic computers be put on every car to monitor the emission systems and to alert the car owner to an emissions defect. While it was anticipated these OBD systems would ensure that cars would operate more effectively in use regarding pollution, they were also concerned that car companies would use this technology to keep the independent aftermarket out by making access to these computers proprietary and forcing the independent service provider out of the market.

Therefore, provisions were added in the 1990 Act that would require on-board computers be accessible without the need for proprietary tools and that any information needed to repair the emission system be made available to the independent aftermarket. While this provision did permit car companies to retain trade secrets, the legislation specified that no information may be withheld if that information was provided either directly or indirectly to the new car dealer.

However, the gains made by the Act have been tempered in the last several years by the fact that the computers that are now being installed in vehicles that go well beyond emissions, monitoring and controlling nearly every function of the vehicle from safety to entertainment. Further, new technologies are coming quickly down the pike that could provide the vehicle manufacturers with even more competitive advantage when it comes to repairing a customer's vehicle.

It is with this in mind that AAIA and the Coalition for Auto Repair Equality and a number of consumer groups are strongly supporting passage of the Motor Vehicle Owners Right to Repair Act. Introduced by Edolphus Towns, right to repair ensures that all information and tools provided to the new car dealer by the car company are also made available to the independent aftermarket. The information would not be free but would be provided at, hopefully, a fair and reasonable price.

This bill would not prohibit new technology but rather, similar to the Clean Air Act, ensure that the use of technology on vehicles would not act to the detriment of competition in the aftermarket and, in the end, the consumer.

Car companies have strongly opposed passage of right to repair based on two contentions: one, that all the information is already available and, two, that this is a veiled approach by the independent aftermarket to obtain the trade secrets of the car companies.

AAIA and CARE do not dispute the fact that the car companies have done a better job in making information tools available to our industry. However, much of this progress does not come due to their willingness to ensure competition for customers but, instead, EPA service information rules and political pressure that has been brought on them by consideration of this right to repair legislation.

Should Congress ultimately decide not to enact right to repair legislation, we have little doubt that car companies will be under extensive commercial pressure to cut our industry out of access to information.

Why are we concerned? Car companies and dealer franchises are now making significantly more money on their parts and service industry part of the market. According to NADA, even though dealership parts and service department sales comprise 11.8 percent of a typical dealer's total sales, it contributes 48 percent of the total operating profit. New car sales make up 60 percent of total sales, but only contribute 35 percent to total profit. Absent legislation, the need by car companies and their dealers to maximize profits from parts and service will override, in the long run, any current cooperation we may be receiving.

As to the allegations that our industry is looking for access to trade secrets, one only needs to look at the composition of our industry to understand why this is not true. Many of the companies who have produced parts for our industry and the vehicle aftermarket are the same companies that supply car companies with the original equipment parts. In other words, the part in the aftermarket box may be the same as the part in the original equipment box, just the label is different. And, oh, yeah, the cost may be considerably less.

Further, maybe most importantly, the bill provides significant protections for the car company trade secrets, only requiring them to make available to the aftermarket, the same information they make available to the dealer network. This is similar to the Clean Air Act provisions protecting car company trade secrets.

It is important to note that since the promulgation of the Clean Air Act 1990 amendments, there has never been intellectual property dispute regarding an EPA requirements for emissions-related information or tools.

Madam Chairwoman and members of the Committee, America's car owners are already being hit with much higher fuel costs which are making it more difficult to use their vehicle for even the most basic necessities. Should the competitive market disappear, car owners will find the cost of car ownership shooting up even further. After all, they bought the car. They should be able to obtain the

repairs where they would like to get them accomplished, whether it is themselves or an independent shop or a dealer.

Thank you again for the opportunity to present this testimony, and I am open to respond to any questions that you may have.

Chairwoman VELÁZQUEZ. Thank you, Mr. Lowe.

[The statement of Mr. Lowe is included in the appendix at page 99.]

Chairwoman VELÁZQUEZ. Our next witness is Mr. William MacLeod. He is a partner at the law firm of Kelly Drye & Warren. His practice focuses on competition law, trade regulation, advertising privacy and security. He is also co-Chair of the Antitrust Practice Group.

Prior to that, he held positions such as Director of the Bureau of Consumer Protection at the FTC and advisor to the Assistant Attorney General Antitrust Division in the U.S. Department of Justice.

Welcome, sir.

STATEMENT OF WILLIAM MacLEOD, PARTNER, KELLY DRYE & WARREN LLP

Mr. MACLEOD. Thank you very much, Madam Chairman.

I am William MacLeod, and in addition to the experience you described I would also note that I represent many thousands of small businesses both directly and through their trade associations, but I am here today on my own. I am not speaking on behalf of them, which gives me the rare privilege of being able to say what I think on the basis of my experience, both inside and outside the Federal Trade Commission.

And, Madam Chairwoman, I commend you for calling this hearing today. I believe this is a most important subject for all of the constituents and the stakeholders around the FTC to remember and reassess on a regular basis. And that is, does the FTC have the power it needs and does the FTC have the wherewithal to exercise that power?

In the gist of my testimony on the first point, I believe that it is almost beyond dispute now that the FTC has probably the most powerful weapon that the government has given any authority to protect competition and consumers; and that is Section 5 of the Federal Trade Commission Act. This section is so broad and gives the Commission the kind of power to address almost any perceived anti-competitive problem, as well as any perceived consumer protection problem the agency might assess.

I believe that for the Federal Trade Commission it is in fact often ironically a detriment, a disadvantage when the Commission is given a specific authority to address some narrow character or some narrow aspects of the jurisdiction. And the reason why is because this broad power of the FTC Act that allows the Commission to basically assess whether the costs of some practice it sees in the marketplace outweigh the benefits. If the Commission stops using that power and starts enforcing narrow and specific grants of authority, that broad problem will begin to atrophy. I can give you some examples shortly.

I also made a point in my testimony that I think the most important limitation the Federal Trade Commission faces is the limita-

tion of resources, and this limitation of resources is something that we faced when I was there. And, of course, it is something that any government agency is always going to face because our government has limited resources.

I would add to that today, on the basis of the testimony that you have already heard, my concurrence with many of the comments that the other significant constraint the Commission faces is the constraint of exemptions and exclusions from its jurisdiction.

I myself on behalf of small businesses have occasionally gone to the Commission and asked the Commission to look into this particular anti-competitive activity or that anti-competitive activity only to be told by the Commission staff they were concerned this activity came too close to an exemption that had been written into the law or an exclusion from the exclusion jurisdiction.

I think that it is almost always a benefit to an industry and to a sector, even if it is regulated by some other particular agency of jurisdiction, for the Commission to have the ability to shine the light of its unfairness authority and its unfair methods of competition authority on the practices that may be going on in that sector.

On another point that is related to the restraints that the Commission faces on its budget, when I was a Director of the Bureau of Consumer Protection, we were occasionally tasked with the assignment of writing rules and regulations to implement various statutory mandates that the Commission received. I believe the Commission, if anything, is writing more rules and more regulations today; and to an enforcer of the consumer protection and competition laws, what that tells the Commission is that the cops that would otherwise be on the beat are going to be back at their desks and they are going to be deciding how to address comments and how to draft rules and how to respond to rulemaking proposals.

I would commend the Committee for calling the attention of the Commission to those areas that need attention and telling the Commission to get its cops out on the beat and start bringing the cases. I can tell you from my experience at the Commission and I can tell from you my experience since I have left the Commission that there are a number of senior and a number of energetic junior and a number of policymaking officials in between who are ready, willing and able to hear the complaint of a small business, of a medium-sized business, of an entrepreneur, of an innovator who is facing a barrier to compete. Those businesses will receive a very warm welcome at the FTC, and I believe they will also receive very warm welcomes if they are given the opportunity to reach outside the narrow scope of what the FTC may do.

Finally, I think that it is a very easy proxy for what the FTC should be doing to ask the FTC again, again and again, are you raising or are you lowering the barriers for small businesses and for entrepreneurs to compete and to enter into businesses? If your law enforcement action lowers barriers, you are likely helping competition. If you are raising barriers, and sometimes unfortunate FTC enforcement has raised barriers, but if you are lowering barriers you are almost certainly helping competition.

Madam Chairwoman, members of the Committee, that concludes my prepared testimony, I would be glad to answer any questions that you might have. Thank you very much.

Chairwoman VELÁZQUEZ. Thank you, Mr. MacLeod.

[The statement of Mr. MacLeod is included in the appendix at page 106.]

Chairwoman VELÁZQUEZ. Thank you all for your testimony. It was very enlightening.

I hope that the staff from the Commission is paying close attention because, apparently, we have two set of witnesses here, one from the Commission and the witnesses that are on the ground dealing with the lack of enforcement and a level playing field.

Dr. Hazel, you spoke in your testimony that the health care marketplace has changed dramatically in the last 10 years; and it was exactly in 1996 when the DOJ-FTC statement of health care antitrust policy was last updated. As a physician, how have you seen the medical marketplace change in the past 12 years? And how should enforcement policies of the DOJ and FTC be updated to reflect those changes?

Dr. HAZEL. Boy, how do you begin with a question like that?

We have changed in so many ways, but I think pertinent to this Committee a couple of things has happened, as pointed out in the testimony. Number one is that the insurers have grown larger, and they have consolidated. And you can begin to see evidence in places such as New Jersey where some of that happens. Premiums actually go up, instead of down; and there is evidence out there. I can present the Committee with evidence about the market consolidation.

We have seen the physicians have gone from being in a fairly strong position over the years to a fairly weak position in terms of negotiating on behalf of patients and making medical decisions and appealing concerns and complaints through processes. So we need the ability to have contractual discussions with plans.

But, even more, if you look at what I believe we all think now and recognize are the issues of health care costs, we need to look at how health information technology can help us as a tool. We need to look at the quality improvement initiatives, and those take a critical mass of physicians to actually be effective. Could you imagine being the first one to buy a fax machine? Somebody was, but without others involved in it, it wasn't particularly useful. So in order to do that and to make it effective, we have to have the ability for physicians to organize together and deal with insurers around the issues of health information technology and quality improvement.

Chairwoman VELÁZQUEZ. Mr. MacLeod, I know you mentioned that you deal with small businesses, but can you comment about the statement made by Dr. Hazel that there has been 400 mergers and only three antitrust cases have been brought up. How does that compare to the previous Commission?

Mr. MACLEOD. Well, the mergers, as I believe the chairman of the Commission mentioned, in the insurance industry are monitored by the Antitrust Division. However, I have seen some of the material that the American Medical Association has provided the Commission, and some of the concentration numbers that the AMA has pointed out are numbers that would be giving the antitrust authorities some cause for further concern and consideration.

A very important point to make, and this actually is part of my entry barrier test, I believe the American Medical Association makes a very good point when it notes that the antitrust enforcement against physicians should take into account the fact that if a few positions or a group of physicians gets together to accomplish some objective efficiently and it not creating any barrier to entry to other physicians, that should not raise serious antitrust concerns. There is a very good opportunity I think here for a little balancing of the playing field when it comes to looking at the physician combinations.

Under the antitrust laws, it is sometimes forgotten in the drive always to find a lower price for a service or a lower price for a good, the antitrust laws protect the sellers into a marketplace as well as the buyers from a marketplace. And the same economic implications, the same inefficiencies and the same distortions occur if prices are suppressed to a level where we see sellers leaving a marketplace or sellers simply refusing or finding it impossible economically to provide their services.

That is a very important part of what I heard from the American Medical Association, and I think that is a very worthwhile aspect for the antitrust agencies to consider.

Chairwoman VELÁZQUEZ. I am interested to hear from you what do you make of about the fact that FTC refused to sign the Justice Department's recent report on monopoly policy? So it is a clear indication that there is a split between the agencies. As a former bureau director at the FTC, have you ever seen this kind of disagreement before? And will this lead to an inconsistent antitrust enforcement policy between the agencies?

Mr. MACLEOD. That an a very ironic and timely question, Madam Chairwoman. Because when I started at the Federal Trade Commission, something very similar happened back in 1982 when the Antitrust Division first issued its merger guidelines and the guidelines were issued before the Federal Trade Commission had the chance to work out every potential disagreement that it might have over the substance of the guidelines. In the end, the agencies both were able to converge their enforcement policies and philosophies, and I expect we will something of the same thing here.

I don't expect to see different enforcement policies coming out of the agencies with respect to single firm conduct. However, it is pretty clear that over the last few years there has been more activity at the Federal Trade Commission with respect to non-merger and non-price-fixing behavior than there has been at the Department of Justice, and I think the FTC is still the primary source for that kind of adjustment.

Chairwoman VELÁZQUEZ. Thank you.

I will come back in a second round, so let me recognize Mr. Westmoreland.

Mr. WESTMORELAND. I thank the Chairlady.

Mr. Lowe, you represent the Automotive Aftermarket Industry Association. Do you also represent CARE?

Mr. LOWE. I am testifying on their behalf this time. I don't represent them as a paid lobbyist or anything.

Mr. WESTMORELAND. But you are testifying on their behalf. Do you know if the Automotive Aftermarket Industry Association or

CARE has ever ran any advocacy ads against any member of this Committee and maybe somebody that is here today?

Mr. LOWE. AAIA's has never done that. I could not speak for any other group.

Mr. WESTMORELAND. You could not speak for any other group. We are under oath today, right?

Chairwoman VELÁZQUEZ. No.

Mr. WESTMORELAND. Okay.

How many people are on your Board of Directors?

Mr. LOWE. I think we have 30, 35. I think it is a fairly large board.

Mr. WESTMORELAND. How many of those are in the automotive repair business, are repairers?

Mr. LOWE. On the board? We have one representative that is a repair shop owner, and then we have a separate division that just represents repair shops.

Mr. WESTMORELAND. How many Board of Directors?

Mr. LOWE. Just one.

Mr. WESTMORELAND. Just one out of thirty-five?

Mr. LOWE. We have distributors, manufacturers, reps. We have all different aspects of the industry. We are very vertically integrated.

Mr. WESTMORELAND. But this is called right to repair bill that you are interested in and you only have one repairer on the board of 35; is that correct?

Mr. LOWE. Right, but they also represent a division that has repair shops.

Mr. WESTMORELAND. I know. I am just talking about your Board of Directors.

How many independent repairers have ever been chairman of your board?

Mr. LOWE. I don't believe in—we have been—I don't remember having one.

Mr. WESTMORELAND. Do you know of any that you can recall?

Mr. LOWE. I said I didn't—I don't think we have had one.

Mr. WESTMORELAND. Let me ask you this. Do you use any third-party information providers? Or do you know if that one repairer has ever brought it up at a board meeting that they use any third-party information providers?

Mr. LOWE. I couldn't tell you if that has come up at a board meeting. I am sure that most repair shops use third-party information providers.

Mr. WESTMORELAND. Have you ever heard of any problems of them getting information from any of these third-party providers?

Mr. LOWE. Yes, not from that board member but other repairs shops.

Mr. WESTMORELAND. So other people have complained about being able to getting information from the third party?

Mr. LOWE. Yeah, they said the information might be missing, and they have faxed them and found that that information was not available from the OE so it couldn't be provided to them.

Mr. WESTMORELAND. Do you know if any of your members of your organization actually own the third providers, the third-party information providers?

Mr. LOWE. On our Board of Directors?

Mr. WESTMORELAND. No, anybody that belongs to your group.

Mr. LOWE. Our membership? Yeah, I think that, definitely, we have memberships from all aspects of the industry.

Mr. WESTMORELAND. How about AutoZone?

Mr. LOWE. Yes, they are a member of ours.

Mr. WESTMORELAND. They own Alldata?

Mr. LOWE. Correct.

Mr. WESTMORELAND. How about NAPA Auto Parts?

Mr. LOWE. Yes, they are a member of ours.

Mr. WESTMORELAND. Do they own any part of any of these third parties?

Mr. LOWE. I am sorry. I can't remember.

Mr. WESTMORELAND. They do.

Mr. LOWE. Okay.

Mr. WESTMORELAND. They do.

Let me ask you this, have they ever told you that any of these cannot obtain information to repair vehicles?

Mr. LOWE. They said the independent third parties have all run into problems obtaining information at one time or the other.

Mr. WESTMORELAND. Well, do you realize that these aftermarket providers, these information providers tell repairers that they can get them the information that they need to repair the vehicles?

Mr. LOWE. In a lot of cases they do. They provide a very cost-effective way for repair shops to get information. If they were to rely on simply purchasing information from the OEs, it would be way over their price level to try to compete. So, yeah, they do provide a very cost-effective solution for most independent repair shops.

Mr. WESTMORELAND. For most?

Mr. LOWE. A large—almost all of them, yeah.

Mr. WESTMORELAND. But if I understand correctly, there was a third-party group set up to handle something where they couldn't get this information and out of the 500 million repairs, only 100 people complained to that group. Do you think that number is correct?

Mr. LOWE. It is hard to know what the exact number is. I would say it is probably fairly low mainly because the source of information, the National Automotive Task Force, which is I guess what you are referring to, is made up or comprised of manufacturers. And what they do is they take information requests from an independent. They then funnel the request to the proper OE. It is up to the car company to respond to that independent repair shop.

Then, once they respond, which can take weeks or months, it could include the information or it could be, well, we are not going to provide that information.

The problem is an independent repair shop with the car in a bay doesn't have weeks or months, it has hours to try to repair that car. So I think what has happened is that there is a credibility issue with NASTF and they don't have time to spend to make that complaint to NASTF. I need to make sure the information is available now.

I think NASTF, as long as there are mandatory requirements to have information, can serve a role of discussing these issues. But,

without that, NASTF just is an information clearinghouse, but it doesn't resolve the issue of right to repair. It is a step in the right direction, but it doesn't resolve the issue.

Mr. WESTMORELAND. But out of the 500 million repairs done, 100 complaints have gone to that group. Do you know how many of those have not been satisfied?

Mr. LOWE. Well, the way they count it, as I understand it, is that a resolution is an answer but not necessarily the answer that resolves the issue. We have sent complaints to NASTF, and it took weeks before they even acknowledged they even got them. And then they sent it back to us saying they weren't provided in the proper format, and they had to be reformatted.

This is not the answer. These are companies, small businesses that operate in a very tight time frame. If you bring your car in to get it repaired, you want it back the next day. You don't want to wait to have it repaired.

Mr. WESTMORELAND. No, I understand. I completely understand that, but I had that iPod that I haven't gotten repaired yet.

Mr. LOWE. If you find a place to get iPods repaired, let me know.

Mr. WESTMORELAND. I will, brother.

Now, let me ask you this. I asked my staff to look into this because I think this is important and it is something I looked into, although I don't serve on the Energy and Commerce Committee. One of the organizations that you are testifying for here today ran ads against me, and I was hoping that you knew about it, because I was going to get some clarification on some of them. You do represent the parts distributor; is that correct?

Mr. LOWE. Yes, that is correct.

Mr. WESTMORELAND. Has any part distributor filed a complaint with an NASTF about not being able to get any information that you are aware of?

Mr. LOWE. Not that I am aware of. But I don't see every complaint, so I couldn't tell you.

Mr. WESTMORELAND. Has it been something brought up at the board meetings? Is there a big problem that you all have had?

Mr. LOWE. Parts manufacturing is not the issue. The issue is at the service end. The parts distributors are concerned with making sure that they have a customer left at the end of the day.

Mr. WESTMORELAND. From what I have read of your proposal, or at least the bill, you want the purchaser to make a decision at the point of sale as to who is going to repair his car. Have you read the bill?

Mr. LOWE. Yes.

Mr. WESTMORELAND. Is that an accurate statement?

Mr. LOWE. At the point of sale of the car?

Mr. WESTMORELAND. Yes.

Mr. LOWE. No, that is not our intention. Our intention is when the car owner is on the road and he has had it for a while—I mean, for warranty repairs he or she will go back to the dealer. After that point, we want the car owner just to have a choice of where to go to have it repaired.

Mr. WESTMORELAND. I understand. But if this computer is supposed to be speaking between the owner of the car and the dealer, I am assuming, who sold them the car, if he says you need a brake

job, you need to call your repair agent at so-and-so, he's got to know where to get that information to that person; is that not correct?

Mr. LOWE. Are you talking then about telematic systems; is that correct?

Mr. WESTMORELAND. That was in your testimony.

Mr. LOWE. Oh, okay, I am sorry. What I am referring to is the telematic systems. And, yeah, I guess at that point somewhere down the line we would like the car owner to make that decision, but we would like them to have the decision of where that information goes and not have the manufacturer determine that.

Chairwoman VELÁZQUEZ. Time has expired.

Mr. WESTMORELAND. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Ms. Hirono.

Ms. HIRONO. Thank you, Madam Chair.

Mr. MacLeod, I agree with you that Section 5 of the FTC is a very, very broad mandate that the FTC can use. So in your testimony you indicated that, as we are concentrating on helping the small businesses, that one area that the FTC should really look at is focusing on barriers to entry for small businesses. And I think—I'll get back to you—but, Mr. Rubin, is that what you were referring to when you said that the AAI report and its emphasis on looking at vertical relationships and the impact that vertical relationships can pose to barriers to entry? Are you kind of on the same page of looking at barriers to entry as a way that we can—the FTC enforcement can really help small businesses? Are you talking about the same things here?

Mr. RUBIN. With the caveat that I don't think there is any particular concentration on which portion of the antitrust laws ought to be employed.

The main thrust of the idea is that vertical relationships as a problem for entry, as an anti-competitive problem, have pretty much fallen by the wayside. Whether it is Section 5, Section 2, even Section 1 has traditionally been used in vertical problems. I don't think that matters much. The important thing is that vertical relationships deserve, in the view of the AAI report, to be revitalized as a subject.

Ms. HIRONO. And vertical relationships—to look at vertical relationships, that is within the purview of the FTC Act, is it not?

Mr. RUBIN. Certainly.

Ms. HIRONO. So with regard to small businesses both of you would agree that the enforcement by the FTC should focus on those kinds of relationships, vertical relationships as a barrier to entry? Mr. MacLeod?

Mr. MACLEOD. Yes, I think that a good way from a competitive standpoint to look at vertical relationships is to ask the question whether a vertical relationship begins to foreclose small businesses and entrants into a market from access to the channels of distribution. And if it does, the antitrust laws are very well-equipped to take care of those.

The antitrust laws are less likely, obviously, to look at a vertical relationship between a small seller and a small buyer. There does need to be some sort of market effect of these things. But, beyond that, the antitrust laws and especially the Federal Trade Commis-

sion Act are well-equipped to investigate and prosecute areas where the competition is being harmed.

Ms. HIRONO. Is resale price maintenance per se a violation of the FTC laws?

Mr. MACLEOD. It is not a per se violation of the FTC laws. And, indeed, the Federal Trade Commission Act doesn't typically apply the pro se rule. That is typically considered under the Sherman Act.

But just last month the Supreme court—a little bit longer ago now—in the last term the Supreme Court had decided to return resale price maintenance to a rule of reason approach, and that means that for future prosecutions and for a practical matter this is what the agencies have been doing for years. The agencies will look to see whether or not the resale price maintenance involved is on balance benefiting or harming competition.

And the answer I think you can think of in very simple terms. If I were to start a small business tomorrow baking cookies and I had a couple of distributors to sell those cookies on the mall, there would not be a real issue to be concerned about if I were asking my distributors to charge a dollar a cookie. It is a very different issue if one is comprising virtually an entire market and is fixing for that entire market the price their retailers would charge.

Ms. HIRONO. So based on the competitive strength of whoever is imposing the resale price maintenance—basically, it would be, I guess, the supplier—would you agree that it should be pro se—once that determination is made, that resale price maintenance should be per se a violation? Would both you agree with that?

Mr. MACLEOD. No, I think at that point we are out of the realm of per se and we are asking ourselves, if there was a market effect, would we condemn the practice? And I think the answer there is very easily reached under the rule of reason.

So the pro se rule, there are areas where the courts have adopted, modified pro se rules, and they very seldom enhance the antitrust analysis. It is much easier to say something is either always wrong or something will be wrong when we can identify there is a competitive harm done from it.

Ms. HIRONO. I think I am getting a little too esoteric here. We are talking about FTC enforcement, and I would like to ask the two of you, with regard to the current FTC enforcement that supports small businesses and lowers barriers to entry, do you think the kinds of actions that they have been taking over, say, the last 10 years promote, help small businesses because they are looking at barriers to entry?

Mr. RUBIN. If I may respond, Congresswoman, the key event with respect to resale price maintenance is the Supreme Court decision in Leegin of a couple months ago wherein the Court ruled that the correct analysis for resale price maintenance was under the rule of reason, rather than per se unlawful as it had been theretofore.

The problem as the AAI sees it in their report is that this is an open-ended analysis and requires more structure. They advocate that there should be a presumption that resale price maintenance is inherently suspect. And if there is a mechanism to reign in the

otherwise open-ended analysis of the rule of reason we believe that would be more helpful in ameliorating resale price maintenance.

Ms. HIRONO. I appreciate that discussion. Actually, my question was whether the current FTC enforcement addresses what you were talking about, Mr. MacLeod, barriers to entry. Because we're here to try to support and help small businesses. So is that the kind of enforcement that the FTC is engaging in the entire realm of enforcement that they can engage in? Are they placing enough emphasis on stopping barriers to entry and thereby helping small businesses?

Mr. MACLEOD. I would like to see more, and I think the Federal Trade Commission itself has said that it would like to do more as well. It has set very ambitious goals for itself in bringing these kinds of cases. They have a brand new director in charge of the Bureau of Competition branch that investigates these cases, and I think we can expect to see from the FTC some more activity in this regard.

It is very hard—I also make this point in my statement—for us sitting on the outside to know exactly in any individual case whether the FTC got it right or got it wrong. The last case the FTC brought in the non-merger area, at least the last significant controversial one, the commissioners themselves disagreed. So it is sometimes difficult to know whether or not the FTC is following the rule to go where the harm is worse and try to address that harm, but that is exactly where I think they are trying to head.

Chairwoman VELÁZQUEZ. Time has expired.

Mr. Shuster.

Mr. SHUSTER. Thank you, Madam Chair.

My first question to Mr. Rubin and Mr. MacLeod, the FTC operates under laws that, some of them, are 100 years old or maybe older. Is there a need for an update in these laws? Because society has changed. Technology has changed. Mr. Rubin, I am afraid you are going to give me a dissertation on it, but are there needs to update the rules and regulations the FTC operates under?

Mr. RUBIN. I didn't realize my reputation was quite that bad.

Mr. SHUSTER. You had a doctor in front of there, so I figured there was a Ph.D. Behind it.

Mr. RUBIN. The AAI report and I would point out that the Antitrust Modernization Commission report as well does not see any need for textual revision of any major sort to the antitrust laws. It is a judicially implemented body of law. Because markets change, because conduct changes, the world changes very fast, this is an appropriate use in the view of the AAI.

Mr. MACLEOD. Let me see if I can make that shorter, no.

Mr. SHUSTER. I appreciate that.

The other question, Mr. MacLeod, you said, and I think this is accurate, that when Congress puts narrowly defining laws, laws that are very narrow, that is something you believe diminishes the FTC's ability, is that accurate?

Mr. MACLEOD. I think so. When the Commission has a strength that it stops using and instead becomes an agency looking at a narrow mandate, that strength begins to atrophy.

Mr. SHUSTER. Mr. Rubin?

Mr. RUBIN. Yes, I concur with that statement.

Mr. SHUSTER. I don't know how familiar you are with the right to repair law, but is that a law narrowly defining the issue for the FTC?

Mr. RUBIN. I don't believe that the AAI report specifically addresses that proposal. I believe that the AAI as an organization does support the right to repair bill as it stands. As far as whether that is narrow enough, I am not sure I can give an opinion on that.

Mr. SHUSTER. Mr. MacLeod.

Mr. MACLEOD. Well, I am not familiar with that law, but the question I would have about the law is whether it really would give the Commission more power to address anti-competitive or unfair acts and practices than the FTC Act already gives the Commission.

Mr. SHUSTER. Mr. Lowe, you say there is a problem out there, but the facts don't seem to bear that out. I am looking at reports that the National Automotive Service Task Force in 2006 received 32 service information requests; in the year 2005, 48; in 2006 of those 32, 31 were resolved. And we are talking about 500 million automotive service repair events. That doesn't seem to me that that is a big problem.

As a former automobile dealer, it was frequent that my service manager would call the auto manufacturer up and say, hey, we need to get some information here. There is always information problems. But that to me seems minuscule. And yet you are proposing legislation you say is going to correct the problem that really don't seem to exist to me. Can you expound upon that?

Mr. LOWE. Well, I think the discussion I had with Congressman Westmoreland kind of highlights the problem in that I really don't see that NASTF has an accurate measure of the repair problem out there that we are seeing when we talk to our members in the field.

I think, you know, this is what we see happening right now in the industry. Our industry, when they run into a problem repairing the car, they don't want to tell their customer they can't fix that car. They either find some way, either a friend at the dealership or they have a relationship with the dealership over the table or under the table, but they find a way to repair that car.

Our members are problem solvers. They are not people who like to whine. That is my job. They like to make sure they get that car repaired without the customer knowing. Because once that customer loses trust in that repair shop, they are going to start going to the dealer, and that is a big, big concern to every individual small shop. These guys they have been building these shops and they are family owned shops. They might be in it for generations. They are running into more and more roadblocks. They are still in there and fighting, but we are concerned it is going to be in the long term a losing battle. So we do see a problem, but we only see the problem growing in the future.

Mr. SHUSTER. I guess that is my problem with what you are saying. You say that folks—and I know, many, many service repair operators and owners and have the greatest respect for them. This is not about me being against them. It is me being against what I think you are trying to say to us. I hear you are whining, but it is not coming from the automotive repair people. Because, in fact, you have very few members on your board or association who actually repair cars or automobiles.

The Automotive Service Association is really the institution or association that represents the thousands and thousands of people who actually fix cars in this country and are opposed to your legislation. So I do hear whining, and I think it is coming from the big part manufacturers, the NAPAs and the AutoZones.

And so, again, I think I know where you are coming from here. In fact, you—

Chairwoman VELÁZQUEZ. Time has expired.

Mr. LOWE. Can I respond to his statement?

Chairwoman VELÁZQUEZ. The time has expired.

Ranking Member Chabot.

Mr. CHABOT. Thank you, Madam Chair.

I will limit my time to 5 minutes. I will let the gentleman continue, if he'd like to.

Mr. SHUSTER. I'd appreciate that.

AutoZone—and, again, I have to tell you I know NAPA distributors and have great regard for them, but I don't hear them requesting this. They haven't requested this to me in this legislation.

But you have AutoZone which owns AllData repair, which is a service that you talked about with Mr. Westmoreland. And you have an ad here. First it says the number one OEM source of information—online repair information, and you have an automotive garage, a guy by the name of Jeff Cosand: I couldn't get by without AllData. I have used it for over 10 years, and it is rare that I can't find what I need on OEM information—that I need. OEM information is the gold standard. That's especially true for wiring designs.

I mean, you have AutoZone out there saying, we are advertising. We have a system that we can provide you, the small repair people, with all the information you need. It is rare. It is successful.

So, again, knowing many, many people in the repair business and someone who has owned a dealership and worked in automotive repair, most technicians don't want to mess with wire schematics. Because it is time consuming. It is not profitable. They would rather put brakes on. They'd rather put a muffler on. They would rather do those kinds of jobs that they can turn quick and be more efficient in their timing.

So, again, it is pretty clear to me that you are not representing the repair industry. You are representing the manufacturers and the distributors of automotive parts.

So, again, the facts don't bear it out. The industry that I know that repairs them, they don't support it. So, again, I think this is not a very good piece of legislation. And there is tremendous competition out there for this business. So I just don't think the facts bear out your position on this.

Mr. CHABOT. Reclaiming my time, and I will allow you to answer.

Mr. LOWE. Sir, the Automotive Service Association certainly represents some repair shops. I think out of hundreds of thousands of repair shops around the country they do represent 12,000. Six thousand of those are body shops, and so half of those are mechanical shops. Our membership is around 20,000 repair shops. Most of the State groups, repair associations, a great many of them support right to repair. In fact, I think the Automotive Service Association is the only group that doesn't support right to repair.

I would say that some of our members do repair, do brakes and mufflers, as you say. But a lot of them do very sophisticated repairs and are very interested in getting repair information, of course, so I am not sure I agree with your characterization of our industry.

Mr. CHABOT. Thank you.

Dr. Hazel, I know there has been for quite some time criticism of the antitrust laws relative to how it has impacted physicians and their inability to join together and negotiate so that you arguably don't have the clout to negotiate with the health care insurance companies, et cetera. Would you like to comment on that or elaborate in any way?

Dr. HAZEL. Yes, sir, I would, as the representative of the human aftermarket industry here. I am glad that we have broadened this conversation again.

Actually, sir, we are not here to talk about a change in the law. We are here to talk about a change in the guidelines, in the enforcement policy. And what we are looking for is a situation where there is clarity for physicians in how these rules are going to be enforced, when you see what happens when the rules are not clear as to what is okay and what is not.

There have been two approval levels. Let's look at two groups that have gone to the FTC to get approval for collaboration. One is GRIPA in Rochester, New York. These are large organizations that took lots of money and a long time to go through their approval process, and that is not likely to happen most places. And where there is doubt on the part of physicians we are going to opt generally. And what you have seen, the reason there are so few of these, is we don't want the government in whatever capacity coming into the offices. We are worried about that.

So what we are looking for is FTC to work with us to clarify the guidelines so that we can collaborate in getting health information technology and you do quality improvement, but we are not looking at this point for a change in the law.

Mr. CHABOT. Thank you.

Madam Chair, I yield back.

Chairwoman VELÁZQUEZ. Mr. Hilal, for more than 20 years now group purchasing organizations have been exempt from the anti-kickback statute of the Social Security Act. How does the special legal status of GPOs make it difficult for entrepreneurs to compete for business from hospitals? And I will ask that Mr. MacLeod or Dr. Rubin, if you have any comments regarding the same question.

Mr. HILAL. Thank you. It has distorted the purchasing process. Any company that has kickbacks in its decision making is going to miss on choosing the best product at the best price. This is why anti-kickback laws were there, and this is why they are especially needed in health care.

So by carving this out, by introducing a third factor, which is how much commission is the third party going to make on the way of that decision, and if that commission is based on the volume or the size of the contract, then you can see the distortions that can come in.

The example I gave in my introductory comment was $20 million or $10 million, 5 percent on one or the other can distort some opin-

ions and some decisions. And in so doing, if we go back to the large manufacturers and large suppliers, they usually have the higher market share and wider product offering. So if we are here to see how that impacts entrepreneurs and their companies, there is no doubt that they will be crowded out. They have been crowded out, and they continue to be.

Chairwoman VELÁZQUEZ. Mr. MacLeod.

Mr. MACLEOD. Yes, I think the antitrust concern is potentially related, but it is, of course, different as well. Under the antitrust laws, if a particular health care organization, whether it is a hospital or some other entity, chooses to buy one device or one drug over another drug, even if it is a bad decision or a mistake, there is not much the antitrust laws have to say about that.

What raises concerns about GPOs, of course, is that large numbers potentially reaching a significant share of a market would make the same mistake; and we have seen many reports of that kind of decision thereby preventing the ability of a new manufacturer of a device or a company offering a new therapy or a new drug or a new service to be foreclosed from an entire market.

I actually represented a physician in a case in which—it wasn't a GPO, but it was the same kind of situation—where the physician believed that there was a combination among the hospitals and physicians in an entire area that prevented him from providing his radiology services.

It becomes a serious antitrust problem when the market begins to close down to someone who has a better mousetrap to offer, with apologies to the marvelous devices and other services that the health care industry provides.

Chairwoman VELÁZQUEZ. So do you think there is a basis for FTC to look into it?

Mr. MACLEOD. Oh, I would think that if there is a free road for the FTC to look into this area that the Commission, both from the commissioners down to the staff, would be delighted to do so. Of course, I don't speak for them, but I can tell you when I was there I would have loved to have had my hands on this.

Chairwoman VELÁZQUEZ. Dr. Rubin.

Mr. RUBIN. I don't think I have that much to add to what Mr. MacLeod said, other that when the government is involved in large purchasing decisions we don't need a competition agency necessarily to consider competition issues. I think that is the point that the AAI report makes, that competition is an American policy, and it deserves to be considered by everyone.

Chairwoman VELÁZQUEZ. Mr. MacLeod, I understand that you have experience in international antitrust policies. I would like to get your perspective regarding which antitrust regulatory regimes around the world do you think are the most effective to keeping markets open to entrepreneurs and what can we learn from them?

Mr. MACLEOD. I think the most effective one is still right here in the United States, Madam Chairwoman; and I think that it has done a remarkable service around the world. As Chairman Kovacic testified, he himself has been one of the ambassadors of the United States in explaining antitrust laws to emerging economies, as well as to more mature market economies. And that the provisions that we have under the Sherman Act, the Federal Trade Commission

Act and our other antitrust laws are the same sorts of provisions that other countries can adopt very beneficially for their own market economies.

Mr. HILAL. My comment on this from the trenches, please.

Three years ago, venture capital went on notice, put us all on notice they are no longer going to invest in entrepreneurial start-up companies, if they can no longer get these companies to the marketplace. So, yes, we are the bastion of free markets. We are the bastions of entrepreneurship. But let's not bruise something that is really working for this Nation. We lead the world in medical device and innovation, but we are stifling it.

Chairwoman VELÁZQUEZ. Dr. Hazel, you know we are in the midst of a Presidential election; and health care is one area where both candidates are offering their vision to reform health care. But a particular area is IT. Everyone talks about how IT has the great potential to improve the quality of care for patients, as well as reduce costs. However, the adoption of health IT requires a degree of cooperation among the provider community. Are FTC policies discouraging physicians from getting together to cooperate on health IT?

Dr. HAZEL. Yes, ma'am. The answer to your question is, I believe, yes.

Chairwoman VELÁZQUEZ. How is that?

Dr. HAZEL. Clearly, we think that health information technology has a lot of promise, as mentioned earlier, as a tool for looking at outcomes, improving efficiencies and so forth. The issues that we face—I both have been president of a practice that has 35 physicians in Northern Virginia and also chair a regional health information organization in Northern Virginia, so I am one of the believers.

The issue is really one of partly expense and the savings that accrue from the things that we are trying to do and trying to promote. For instance, in your Medicare budget, you have a 3-year payment of 2 percent for e-prescribing in an effort to reduce medical errors. You have to have systems that work to do that. You have to have it on the physicians side and on the pharmacy's side and so forth. So the point being is they take some investment. They have to be maintained, updated, operated. And the savings accrue to payers. In the case of Medicare, theoretically, it is to the government. And what we don't have is an equivalent.

You were kind enough to put a 2 percent kick in the Medicare payments for you prescribing for 3 years. We don't have a similar thing in the private sector side. So as we use some of the savings to afford the technology, we have to work with payers to do that.

Does that answer your question?

Chairwoman VELÁZQUEZ. Yes.

Mr. Chabot, do you have any other questions?

Mr. CHABOT. No further questions.

Chairwoman VELÁZQUEZ. I want to thank all of you. This has really been a very interesting hearing. I was pleased to see Mr. Westmoreland. I guess that I have to bring another witness that has done any kind of political campaign intervention to get them to come here.

But, in any case, this antitrust issue is very important for this Committee, especially at a time when we see how the economy is struggling. And in this case we are all asking that, based on the law, that the agencies do what is right to make sure that we all have a level playing field specifically for small businesses that are the drivers of our economy and that are creating the jobs that we need to get this economy growing again.

With that, I ask unanimous consent that members will have 5 days to submit a statement and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned. Thank you.

[Whereupon, at 12:27 p.m., the Committee was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

STEVE CHABOT, OHIO
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
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STATEMENT
of the
The Honorable Nydia Velazquez, Chairwoman
House Committee on Small Business
"Small Business Competition Policy: Are Markets Open for Entrepreneurs?"
Thursday, September 25, 2008

Competition is the crux of our economy. It not only drives innovation and development, but it also spurs invention. After all, you don't often see new products originating in unchallenged industries. Rather, they come from diverse sectors that promote a wide range of options.

In a free market economy, it is crucial that all businesses--large and small--have a level playing field. The FTC is charged with making sure that happens. With this in mind, it is important for the commission to be engaged and prevent industries from isolating themselves. A lack of competition does not benefit the economy, and it certainly does not benefit the tax payer.

In recognizing this fact, the FTC already has a number of antitrust provisions in place. The commission's Bureau of Competition, for example, uses both administrative and judicial means for enforcing regulations. In this morning's hearing, we will discuss the FTC's efforts to promote competition and its role in spurring small business development.

Competition is a powerful catalyst for financial growth. This is particularly true for America's entrepreneurs, who thrive in an open economy. Competition is the key that allows small businesses to unlock new markets and expand existing industries. It lowers prices and raises the bar for quality, largely because it forces other companies to step up to the plate and elevate their standards. At the end of the day, an entrenched business has little incentive to offer competitive values. Small firms, on the other hand, have every motivation to do so.

On top of lowering consumer costs, competition also promotes invention. Startups have historically led the lion's share of industry innovation. From the tech boom of the mid 1990's to the Green Energy revolution of today, entrepreneurs are the business world's best innovators. They are always looking to meet emerging needs and offer fresher, better choices. In order to remain competitive, big brands are then forced to either innovate on their own, or otherwise increase values. Either way, consumers enjoy more choices.

Competition does more than level the playing field. It stimulates the economy. This is particularly true for America's small businesses, whose survival depends on access to an open marketplace. If monopolies are permitted to dominate entire industries, then they have little incentive to innovate or contribute to economic expansion. That is why it is so important that competition be protected for entrepreneurs. Without the opportunities that it affords, these small firms will not be able to do what they do best-- drive innovation, create jobs and spur financial growth.

I look would now like to thank today's witnesses in advance for their testimony. I look forward to hearing their thoughts on the issue.

U.S. House of Representatives
SMALL BUSINESS COMMITTEE
Thursday, September 25, 2008
Representative Steve Chabot, Republican Leader

Opening Statement of Ranking Member Steve Chabot

"Small Business Competition Policy: Are Markets Open for Entrepreneurs?"

"I would like to thank the Chairwoman for holding this important hearing examining the antitrust laws of the United States. Enforcement of the antitrust laws play a key role in maintaining open competition – an environment in which small firms thrive because of their attention to customer service and nimbleness in making business decisions.

"The Committee has a longstanding interest in examining the competitiveness of markets and the impact of the Sherman Anti-Trust Act and Federal Trade Commission Act on small businesses. However, the Committee has not examined these matters in nearly two decades. In light of the report issued last year by the Antitrust Modernization Commission, it seems timely for the Committee to turn its attention to aspects of market competition that fall within the confines of the antitrust laws.

"The Supreme Court has stated that 'that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality, and the greatest material progress....' In short, competitive free markets represent the cornerstones of American progress and the success of our democracy.

"The antitrust laws were established to protect these precious values. By providing a mechanism to ensure that competition is not unreasonably hindered, the antitrust laws can be seen as further bracing the competitive foundation of this country.

"The Antitrust Modernization Commission was created by Congress to examine whether laws written more than 100 years ago were appropriate for a modern economy. The Commission's conclusion that the antitrust laws are basically sound is one I fully support.

"That being said does not eliminate the possibility for improvements, either in the actual legislative language of the laws or more rational enforcement of the existing laws. An issue that may not have raised competitive concerns twenty years ago might be one for the agencies charged with antitrust enforcement to reexamine.

"For example, the joint guidelines issued by the Department of Justice and the Federal Trade Commission on healthcare have not been evaluated in nearly twenty years. If this Committee can examine changes in the health care market and the impact of mergers on industry concentration, then it may make sense for the antitrust enforcement agencies to reassess their guidelines on antitrust enforcement. As with the Antitrust Modernization Commission, they may that these guidelines are sound but periodic review certainly may be warranted.

"Of course, such reevaluations need not result in any modifications to antitrust law enforcement by the Federal Trade Commission or Department of Justice. However, good management suggests that standards developed by the government should be reevaluated on a periodic basis. Otherwise, it is conceivable that government enforcement of the antitrust laws may not serve their purpose of ensuring competition given the changes in market conditions.

"I look forward to a thoughtful discussion from the witnesses and their ideas on how to ensure that small businesses will face a free, competitive market."

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Prepared Statement of the Federal Trade Commission

"Small Business Competition Policy: Are Markets Open for Entrepreneurs?"

Presented by William E. Kovacic

Chairman

Before The

Committee on Small Business
United States House of Representatives

Washington, D.C.
September 25, 2008

I. Introduction

Thank you for the invitation to discuss small businesses and the antitrust work of the Federal Trade Commission ("Commission" or "FTC"). Competition is the lifeblood of the American economy; protecting open and competitive markets for businesses and consumers is one of our most important tasks.[1]

The FTC is a law enforcement agency with a statutory authority that covers a broad spectrum of the American economy, as well as businesses of all sizes. We have two distinct but related missions: to preserve competition in the marketplace, and to protect the consumer.[2] Through its Bureau of Competition the Commission enforces two main antitrust laws, the FTC Act[3] and the Clayton Act.[4] Under section 5 of the FTC Act, the Commission addresses "unfair methods of competition." This includes, among other things, conduct violating the standards of the Sherman Act. The Commission shares jurisdiction with the Department of Justice under section 7 of the Clayton Act in prohibiting mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly."[5] The agency's other litigating bureau, the Bureau of Consumer Protection, enforces the second part of the FTC Act, which prohibits "unfair or

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[1] My written statement presents the views of the Federal Trade Commission. My oral remarks represent my own views, and not necessarily the views of the Commission or any other Commissioner.

[2] The agency's two main enforcement bureaus, the Bureau of Competition and the Bureau of Consumer Protection, supported by a third bureau, the Bureau of Economics, all work to fulfill our mission.

[3] 15 U.S.C. § § 41-58.

[4] 15 U.S.C. § § 12-27.

[5] 15 U.S.C. § 18.

deceptive acts or practices." The Commission also shares its expertise by examining and reporting to the public on important issues in competition and consumer protection, and by providing advice and guidance to states and other policymakers.

The Commission's goal is to ensure an honest and open marketplace where all businesses can compete for the consumer dollar. The Commission does not give preference to either large firms or small ones. Consumers choose the companies, products, and services they prefer. Our task is to help protect the competitive framework in which those choices can be made. These neutral actions nonetheless benefit small businesses in two specific ways. First, in a number of cases and through advocacy, the Commission has made it easier for small business to compete on the merits. Second, by protecting competition in industries that affect the operating costs of small firms, such as health care for employees, we help reduce their costs of doing business.

The work of our Bureau of Consumer Protection is also relevant to ensuring competitive opportunities for entrepreneurs. To the extent that the Commission brings law enforcement actions against deceptive or unfair practices engaged in by businesses, large or small, this assists the honest small businesses that compete in the same marketplace. Moreover, by policing the marketplace in this fashion the Commission helps to develop consumer confidence in small businesses generally.

This testimony addresses a number of topics. The first section reviews the factors that make small businesses important to a competitive marketplace. The second section – and the main part of the testimony – reports on recent antitrust activities of the FTC that have had a particular impact on small firms. The third section briefly mentions how the work of our Bureau of Consumer Protection is relevant to small businesses, including those that are planning to enter

new markets. The final section describes the FTC's study and advocacy programs, which have been useful in, among other things, reducing unnecessary barriers to entry so that markets will be more open to all businesses.

II. The Goal of Consumer Welfare and the Role of Small Business

The FTC's core concern is protecting the economic interests of consumers. We believe that competition serves a wide range of consumer interests. The Supreme Court observed "ultimately competition will produce not only lower prices, but also better goods and services."[6]

Small businesses are a key part of a competitive economy. They account for about half of all private sector employees, provide more than 45 percent of the total private payroll, and generate about 70 percent of new jobs.[7] They are also a driving force for innovation and technological change. According to the SBA, small firms produce 13 times more patents per employee than their larger counterparts.[8] Small businesses' importance even transcends their direct economic impact. In a society where equal opportunity is an important social goal, small businesses have provided a route to financial independence for many members of minority groups.[9]

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[6] National Society of Professional Engineers v. United States, 435 U.S. 679, 695 (1978), *quoting* Standard Oil Co. v. FTC, 340 U.S. 231, 248 (1951).

[7] *See* U.S. Small Business Administration, Office of Advocacy, *FAQs: Advocacy Small Business Statistics and Research, available at* http://app1.sba.gov/faqs/faqindex.cfm?areaID=24.

[8] Id.

[9] Hispanic-owned firms comprise the largest minority business community in America; and firms owned by African Americans have had the highest rate of growth among small businesses in both the total number of enterprises and in their total receipts. U.S. Small Business Administration, Office of Advocacy, *The Small Business Economy 2007* (Dec. 2007). The figures for the growth of African American businesses are based on the period between 1997 and

A successful competitive economy requires open markets – markets that are open to new ideas, and to succeeding waves of innovation and entrepreneurs that will challenge old ideas and outdated ways of doing things. Small businesses can be an important vehicle for these competitive forces, but only if the antitrust laws protect, and require, open markets and competition for all. It is the Commission's mission to do this – to protect competitive markets so that innovative and efficient businesses, whether large or small, can offer consumers the best goods and services at the best prices.

III. FTC Antitrust Initiatives Affecting Small Business

Even though the Commission's mission is to protect consumers by ensuring competitive markets, rather than any particular class or size of market participants, some of our cases inevitably have a greater impact on small businesses. In some markets and industries, even some dominated by large corporations, innovative small firms play an important role. Other markets and industries, notably those with low capital requirements and few economies of scale, are characterized by competition dominated by small firms. The Commission considers competition in industries populated by small firms to be every bit as important as competition in industries populated by large, multinational corporations. Our enforcement activity reflects that commitment.

A number of our recent actions, both in litigation and policy initiatives, have involved these kinds of markets. They have addressed real estate brokerage, health care, the business practices of professionals, slotting allowances in the grocery industry, and legal guidance for small businesses.

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A. Real Estate Brokerage

Real estate brokerage is an example of a competitive industry populated by many small firms. To prosper, these firms must be able to enter, innovate, and serve their customers. Some have sought to do this by offering different services or lower commission rates – just what they should be doing in a competitive market. But their ability to act has frequently been harmed by larger or incumbent competitors and by the institutions that those competitors control. One key tool in real estate markets is the local multiple listing service ("MLS") – an essential source of information and referrals. Without access to the MLS, a small brokerage firm may be unable to compete effectively. Commission investigations have shown that established brokerage firms have sometimes used MLS rules to exclude or disadvantage small firms that are offering innovative services or reduced prices.

The FTC has brought actions to address this kind of conduct. Most typically, we challenge direct attempts by incumbent firms to exclude discount brokers. Discount brokers commonly use "exclusive agency" listings – a special type of listing that allows property owners to save money on brokerage fees if they find the buyer for their home themselves. In a recent case involving a large association in Michigan, we charged that the association members had simply agreed not to allow exclusive agency listings on the MLS at all.[10] The association eventually agreed not to prevent its members from posting these kinds of listings; and that consent helped open the door to discount brokerage in the area. In recent years we have had to confront increasingly subtle tactics for keeping innovators at a disadvantage. In late 2006, the

[10] *See* MiRealSource, Inc., File No. 0610266 (press release March 23, 2007) (consent order). The FTC has a long history of challenging this particular practice. *See, e.g.*, Orange County [New York] Board of Realtors, 106 F.T.C. 88, 90, 93 (1985) (consent order).

Commission brought seven cases against different local associations, alleging that they had a practice of keeping information about inexpensive, less-than-full-service listings from being transmitted from the MLS to popular Internet real estate sites.[11] Six of these associations have entered into consent agreements, and the last one continues in adjudication.[12] We continue to actively monitor this industry.

B. Protecting Competition in Health Care

Rising health care costs hurt small business. The Small Business Administration reports that firms with under 100 employees paid $50 billion in health premiums for their workers in 1997. By 2002, that amount had increased by 38 percent to $65 billion.[13] Similarly, the Kaiser Family Foundation reports that in each year between 1999 and 2006, health insurance premiums for firms with under 200 employees grew faster than premiums for firms with 1,000 or more employees.[14] Rising health care costs raise the cost of doing business for small firms and make it more difficult for them to attract employees.

By promoting competition in health care, the Commission helps ease the costs of providing health care coverage, which helps small businesses become more competitive in their own marketplaces. For example, the Commission has devoted substantial resources to ensuring

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[11] Realcomp II Ltd., et al. (press release October 12, 2006).

[12] In re Realcomp II Ltd., Docket No. 9320, *schedule established for briefs to the Commission* (Jan. 4, 2008).

[13] *See Cost of Employee Benefits at Large and Small Business,* SBA Office of Advocacy (Aug. 2005), at 16, *available at* http://www.sba.gov/advo/research/rs262tot.pdf.

[14] *See Employer Health Benefits: 2007 Annual Survey*, at 27, Exhibit 1.10, *available at* http://www.kff.org/insurance/7672/.

that consumers receive the benefits from lower-cost generic products and has challenged so-called "pay for delay" settlements – in which the brand pharmaceutical company actually pays its generic competitor not to compete[15] – to ensure that consumers and small businesses have appropriate access to less expensive generic alternatives. Similarly, the Commission has challenged hospital mergers that it believes will lead to higher prices for consumers and will raise the premiums that all employers, including small businesses, have to pay.[16]

C. Advertising and Other Business Practices of Professionals

A third area in which the Commission has been active involves the business practices of professionals. The professional offices involved – doctors, lawyers, accountants, and others – are usually small firms. Like other small firms, these offices have found that advertising and other innovative business techniques can be a useful competitive tool to help grow their practices. Sometimes, however, these initiatives have encountered barriers that have concerned the Commission.

Advertising may be particularly important for new entrants who are not yet well known in the community. Although restricting false or deceptive advertising improves the marketplace, unnecessary restrictions can impede the ability of small businesses to compete and succeed.

The Commission has a long history of challenging advertising bans imposed by private professional associations. The modern history of this activity began with the agency's

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[15] *See, e.g.*, Schering-Plough Corp., Docket No. 9297 (Dec. 8, 2003), *rev'd*, 402 F.3d 1056 (11th Cir. 2005).

[16] *See, e.g.*, Inova Health System Foundation, Docket No. 9326 (May 2008) (press release of May 9, 2008) (transaction subsequently abandoned); Evanston Northwestern Healthcare Corp., Docket No. 9315 (Aug. 2007) (press release of Aug. 6, 2007).

complaints against the American Dental Association and the American Medical Association in the mid-1970s.[17] Those cases and their successors eliminated most broad, near-total advertising bans. Since then we have built on that foundation, with our focus shifting, as it did with real estate brokers, to addressing more subtle attempts to restrict competition. A current issue involves distinguishing between association rules that appropriately prevent false or misleading advertising,[18] and those that suppress advertising in an unreasonably broad way and are merely cast in the form of rules against deception.[19]

The analysis changes when state licensing boards impose the restraints rather than private associations. The law then takes into account principles of federalism and the state's authority to regulate its own economy. State governmental bodies are allowed to regulate without being limited by the federal antitrust laws, provided that the state has clearly expressed an intent to

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[17] American Dental Ass'n, 94 F.T.C. 403 (1979) (consent order), *order modified,* 100 F.T.C. 448 (1982) and 101 F.T.C. 34 (1983); American Medical Ass'n, 94 F.T.C. 701 (1979), *aff'd as modified,* 638 F.2d 443 (2d Cir. 1980), *aff'd by an equally divided Court,* 455 U.S. 676 (1982).

[18] Because deceptive advertising distorts the operation of market forces, it has long been recognized that the proper regulation of such material can serve to promote competition.

[19] Commission enforcement action resulted in removal of advertising restraints in Virginia Board of Funeral Directors (press release Aug. 16, 2004) (consent order). The Commission's case against the California Dental Association illustrates the concern that professional societies may sometimes take an overly broad view of what is deceptive. California Dental Ass'n, 121 F.T.C. 190 (1996), *aff'd,* 128 F.3d 720 (9th Cir 1997), *vacated and remanded,* 526 U.S. 726 (1999), *rev'd and remanded,* 224 F.3d 922 (9th Cir. 2000). The Court of Appeals agreed with the Commission that the Association's suppression of various categories of price and non-price advertising was not justified on grounds of deception, although a narrowly divided Supreme Court held that a more thorough inquiry into the effects of the Association's restraints was required before reaching a conclusion that those restraints were anticompetitive.

displace competition with regulation with respect to the conduct in question.[20] These boards also have the potential for anticompetitive conduct, however, since they are sometimes dominated by members of the regulated profession. The Commission has, in several instances, challenged state boards that imposed restrictions on nondeceptive advertising that had not been clearly authorized through state legislation. Over twenty years ago the Commission brought such a challenge against the Massachusetts Board of Registration in Optometry. That board had banned the advertising of all discount offers without regard to whether they were truthful and non-deceptive.[21] The Commission ruled against the Board, finding its restraints were unlawful because they were not authorized by the state legislature, were anticompetitive, and were not justified by any countervailing public benefits. This ruling enabled new or innovative growing businesses to make greater use of truthful, nondeceptive advertising.

In subsequent years the Commission has challenged other state board restraints that are relevant to small businesses. A recent example involves the South Carolina State Board of Dentistry. In that case a dental board had, without proper authorization from the legislature, limited hygienists' ability to provide preventive care in school settings to low-income schoolchildren. The board eventually entered into a consent agreement acknowledging that such businesses could legally operate in the state.[22]

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[20] *See* Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985); Parker v. Brown, 317 U.S. 341 (1943).

[21] 110 F.T.C. 549 (1988).

[22] Docket No. 9311. During the proceeding the Board made an unsuccessful interlocutory appeal to the Fourth Circuit on state action grounds, which the court dismissed on the grounds that the issue did not involve an immediately reviewable collateral order. No. 04-2006, 2006 WL 1134136 (4th Cir. May 1, 2006). The Board then entered into a consent with the

D. Slotting Allowances and Shelf Space

A fourth area in which the FTC is active involves the slotting allowances that food manufacturers pay to grocery stores. Slotting allowances are one-time payments a supplier makes to a retailer as a condition for the initial placement of the supplier's product on the retailer's store shelves or for initial access to the retailer's warehouse space.[23] Some small manufacturers complain that these charges raise the costs of entry[24] and are therefore exclusionary. To explore these concerns the Commission held a two-day workshop in 2000, and issued a report in February 2001.[25] The Commission staff subsequently conducted a followup study that examined five selected product categories, and issued a further report on those findings in November 2003. The retailers that participated in this study suggested that slotting allowances legitimately help defray the costs and risks associated with introducing a new product into their systems.[26]

Workshops and studies of this sort are an important tool for educating the Commission and its staff, as well as for communicating information about emerging areas of interest to the

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Commission (press release, June 20, 2007).

[23] Federal Trade Commission, Staff Study, *Slotting Allowances in the Retail Grocery Industry: Selected Case Studies in Five Product Categories* (Nov. 3003), at i (Introduction and Executive Summary).

[24] Costs vary, but the introduction of a single new grocery product nationwide "could range from a little under $1 million to over $2 million, depending on the product category." FTC Staff Study, *supra*, at vii-viii. A new product line could involve several such products.

[25] *See* Federal Trade Commission, *FTC Staff Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry* (Feb. 2001).

[26] *See* FTC Staff Study, *supra,* at 9-11.

industry and the public. We used the knowledge gained from this workshop and study to evaluate a number of slotting complaints that have been the subject of non-public investigations, and the Commission remains alert for potential antitrust problems.

The FTC's case against McCormick & Co. involved issues related to shelf space in the grocery industry. The Commission alleged that McCormick typically required its customers to allocate the large majority of the spice shelf to its products; in some instances this requirement covered 90 percent of the supermarket's spice shelf space. McCormick also allegedly engaged in discriminatory pricing. The Commission challenged the firm's differential pricing practices in this context of high market share and apparent market power, reasoning that disadvantaged purchasers would not have a good alternative available. McCormick eventually entered into a consent agreement,[27] in which it agreed not to engage in improper discriminatory pricing in general, and also to keep detailed records of any facts on which it relied to justify particular discounts it thought necessary to meet competition. In this way we have helped ensure that smaller manufacturers have access to the market, and that smaller grocery stores receive the prices to which they are entitled.

E. Outreach and Education

A final ongoing antitrust initiative involves business guidance. The Commission tries to provide guidance on the main points of antitrust law, so that firms wanting to know their rights, or to voluntarily comply with their duties, can understand the basic factors involved and keep out of trouble without the expense of lawyers. To do this the Commission produced and posted on

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[27] McCormick & Co., Docket No. C-3939 (press release of March 8, 2000) (consent agreement).

our website the *FTC Guide to the Antitrust Laws*.[28] This publication was specifically designed for the needs of small business. It is succinct and addresses a number of practical, recurring questions. These include how to respond to manufacturer-imposed display requirements, exclusive dealing arrangements, and refusals to supply.

The Commission also offers a number of additional, more detailed antitrust guidelines on particular topics. One that might be particularly useful to small business is the Competitor Collaboration Guidelines, produced in cooperation with the U.S. Department of Justice, Antitrust Division.[29] Small entrepreneurs sometimes have to adapt creatively in order to function in a market that has grown accustomed to looking at larger firms. They may wish to carve out specialized niches for themselves, or enter into joint ventures to reach a scale that their customers demand. The enforcement agencies encourage procompetitive joint ventures by offering guidance on how the agencies enforce antitrust laws with respect to collaborative conduct. Our collaboration guidelines address joint ventures generally, and other, more specialized guidelines address various types of collaborations in, for example, the healthcare field in particular.[30]

F. Little Need For Antitrust Exemptions

There is one kind of initiative that we do not recommend. The Commission generally opposes proposals for legislative exemptions from the antitrust laws. Those proposing such

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[28] The guide can be found at http://www.ftc.gov/bc/antitrust/index.shtm.

[29] Federal Trade Commission and U.S. Department of Justice, *Antitrust Guidelines for Collaborations Among Competitors* (April 2000), *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

[30] U.S. Department of Justice and Federal Trade Commission, *Statements of Antitrust Enforcement Policy in Health Care* (August 1996), *available at* http://www.ftc.gov/bc/healthcare/industryguide/policy/intro.htm.

exemptions frequently suggest that they are needed to make competition more fair. But the general antitrust laws are already sufficient to protect fair competition. Special-interest legislation often comes at a significant cost to consumers[31] and could eventually balkanize the national competition policy on an industry-by-industry basis. Because exemptions are generally sought by and benefit entrenched firms, giving one to a particular industry might also tend to harm the small businesses that deal with that industry.

In short, the Commission's varied antitrust activities, all aimed at protecting competition, frequently benefit the small business community.

IV. FTC Consumer Protection Initiatives Affecting Small Business

The FTC is the only federal agency that combines both antitrust and consumer protection responsibilities over broad sectors of the economy. Our consumer protection efforts complement our competition mission by ensuring that consumers have sufficient access to truthful and nondeceptive information about the marketplace. Markets work best when they operate free from fraud and deception. Some of the agency's consumer protection activities are specifically helpful to small business competition, particularly to those entrepreneurs who are acquiring the tools necessary to enter and compete in new markets. We highlight here three of our initiatives that have an important impact in this way – the Franchise Rule, suppression of Internet fraud, and the Commission's program of small business guidance.

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[31] Just last year the congressionally-created Antitrust Modernization Commission also urged Congress to exercise caution, noting that antitrust exemptions typically "create economic benefits that flow to small, concentrated interest groups, while the costs of the exemption are widely dispersed, usually passed on to a large population of consumers through higher prices, reduced output, lower quality, and reduced innovation." U.S. Antitrust Modernization Commission, *Report and Recommendations* at 335 (April 2007), *available at* http://govinfo.library.unt.edu/amc/report_recommendations/toc.htm.

A. The Franchise Rule

Many entrepreneurs set out to establish small businesses, not from scratch, but by buying a franchise. This can have many advantages when confronting a new market, especially one composed of well established competitors. The business model has already been worked out and the brand name popularized. But not all franchise offers are equally promising. The goal of the Commission's Franchise Rule[32] is to help purchasers, including small businesses, to make an investment with greater knowledge and confidence. Our rule requires the franchisor to disclose certain critical information before finalizing a contract.[33] This includes data on the background of the franchisor, any previous bankruptcies, the costs and fees associated with the franchise, restrictions on suppliers and sales territories, and the names of other current and former franchisees. Franchisors are not required to provide information on potential income or sales, but any claims they do make must have a reasonable basis and must be backed up with written substantiation provided to the franchisee.

B. Attacking Internet Fraud

A second consumer protection initiative involves policing the Internet. The Commission is keenly aware of the development of the Internet as one of the transforming events of our time, with the potential to deliver goods and services more conveniently, faster, and at lower prices than traditional marketing methods. This development offers particular potential to small

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[32] Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. Part 436.

[33] *See* Federal Trade Commission, "Buying a Franchise: A Consumer's Guide," *available at* http://www.ftc.gov/bcp/edu/pubs/consumer/invest/inv05.shtm.

businesses, since it brings national and even global access to potential customers – necessary for viability of some small businesses – within their reach.

Yet the sound development of this medium requires consumer confidence that it is not also a vehicle for fraud. Fraud on the Internet is an enormous concern for the Commission, and it has prompted a vigorous response using all the tools at the Commission's disposal, including both law enforcement and education.[34] Consumer confidence in the ability to conduct transactions fairly is the lifeblood of e-commerce, as e-commerce can be the lifeblood of a small business. The FTC has challenged a wide variety of Internet-related threats, including deceptive claims delivered through spam[35] and distributors of adware and spyware.[36] Additionally, the Commission has challenged websites making allegedly deceptive health claims,[37] Internet-based

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[34] *See, e.g.* Prepared Statement of the Federal Trade Commission On the Commission's Law Enforcement and Consumer Education Efforts To Address Spyware and Other Malware (June 11, 2008) *available at* http://www.ftc.gov/os/2008/06/P024522testimonyspyware.pdf; Prepared Statement of the Federal Trade Commission On Peer-To-Peer File-Sharing Technology Issues (July 24, 2007), *available at* http://www.ftc.gov/os/testimony/P034517p2pshare.pdf.

[35] *See, e.g.*, FTC v. Sili Neutraceuticals, *LLC*, No. 07C-4541 (N.D. Ill 2008) (Court orders spammers to pay more than $2.5 million); *United States v. ValueClick, Inc.*, No. CV08-01711 (C.D. Cal. filed March 13, 2008) (stipulated permanent injunction imposes a $2.9 million civil penalty).

[36] *See, e.g.*, In the Matter of Zango, Inc. f/k/a 180 Solutions, Inc., FTC Dkt. No. C-4186 (Mar. 7, 2007); FTC v. Odysseus Marketing, Inc., No. 05-CV-330 (D.N.H. Oct. 24, 2006) (stipulated permanent injunction).

[37] *See, e.g.*, FTC Press Release, *FTC Sweep Stops Peddlers of Bogus Cancer Cures* (Sept. 18, 2008) (announcing 11 law enforcement actions against marketers of unsubstantiated cancer-treatment products), *available at* http://www.ftc.gov/opa/2008/09/boguscures.shtm.

pyramid schemes,[38] and websites promoting business opportunity schemes.[39] In many of these cases the FTC has worked cooperatively with its consumer protection counterparts across the globe. The FTC's goal in bringing these cases has been to help ensure that consumers are free from deceptive practices that undermine the promise of the Internet and the opportunities available to the honest firms that market on it.

C. Business Guidance

A third consumer protection program improves the competitiveness of small businesses by giving readily understandable guidance on a variety of topics. Just as the business guidance program on the competition side walks small firms through the antitrust laws, the consumer protection guidance program helps businesses understand how to comply with consumer protection laws. The Commission distributes more than 70 brochures on a broad range of topics of interest to small business – everything from *Complying with the Telemarketing Sales Rule* to *Advertising & Marketing on the Internet: The Rules of the Road.* These publications are available at www.ftc.gov.[40] Small businesses can order these materials for their employees or customers at the FTC's bulk order site.[41]

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[38] *See, e.g.,* FTC v. BurnLounge, Inc., No. 2:07-CV-03654-GW-FMO (C.D. Cal. Filed June 8, 2007).

[39] *See, e.g.,* FTC Press Release, *Federal, State Law Enforcers Complete Bogus Business Opportunity Sweep* (Dec. 12. 2006) (announcing a coordinated sweep of more than 100 law enforcement action challenging business opportunity schemes), *available at* http://www.ftc.gov/opa/2006/12/falsehopes.shtm

[40] The publications are also available by phone at (877) FTC-HELP.

[41] www.ftc.gov/bulkorder.

To get information into the hands of small businesses who need it, the Commission has used many creative channels of communication. It has coordinated outreach programs with Chambers of Commerce, associations of minority and women business owners, and other groups that have the ear of entrepreneurs. Virtually all FTC publications are now available from the website of the national Better Business Bureau. We also offer a series of one-day workshops called *Green Lights & Red Flags.* These offer guidance to local businesses on complying with truth-in-advertising standards, and are typically co-sponsored with state Attorneys General, bar associations, and other community organizations.[42] The FTC also uses more high-tech channels. For example, we offer a new 20-minute online tutorial that allows business owners to educate themselves – and to train their employees – about fighting identity theft by keeping consumer information secure.[43] The Bureau also posts alerts about the latest frauds and scams that are directed at entrepreneurs,[44] and litigates against such scams when they take place.[45]

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[42] Close to 3,000 business executives have attended *Green Lights & Red Flags* events hosted in Atlanta, Boston, Chicago, Cincinnati, Cleveland, Columbus, Dallas, Denver, Houston, Louisville, Minneapolis, Nashville, Phoenix, Raleigh, Santa Clara, St. Louis, and Seattle.

[43] *Protecting Personal Information: A Guide for Business*, available at www.ftc.gov/infosecurity. More than 25,000 visitors have watched the tutorial and the Bureau has distributed 250,000 copies of the accompanying 24-page brochure.

[44] *See* http://www.ftc.gov/bcp/menus/business/fraud.shtm (FTC site containing information alerting businesses to scams directed at them, including office supply scams and business directory scams); http://www.ftc.gov/charityfraud (information about charity frauds directed to businesses).

[45] *See, e.g.,* FTC v. Merchant Processing, Inc., No. CV07-0533 (D. Or. 2007), *available at* http://www.ftc.gov/os/caselist/0523162/index.shtm (defendants entered into a stipulated final order settling charges that they falsely promised small businesses that they would save hundreds to thousands of dollars per year in processing fees); FTC v. Websource Media, LLC, No. H-06-1980 (S.D. Tex. 2006), *available at* http://www.ftc.gov/os/caselist/websource/index.shtm (defendant who allegedly "crammed" unauthorized charges for website services onto the phone

V. Competition Advocacy and Competition Studies

Finally, the Commission maintains programs of advocacy and competition studies. These serve complementary missions in informing policymakers and the public. The FTC's advocacy to federal, state, and local governments shares the antitrust and consumer protection knowledge of the agency with those who are making policy decisions elsewhere. The FTC's competition studies work to expand the stock of knowledge available for this and other purposes.

Through the advocacy program the agency responds to invitations and requests from policymakers to comment on proposed laws or regulations. Because our advocacy promotes consumer interests and competition, we often support outcomes that also benefit small businesses.

Commission and staff advocacies have provided analysis on a wide range of regulatory proposals, including mandatory operating permits, advertising restrictions, and licensing restrictions,[46] across a wide range of industries, including automobiles, alcoholic beverages, optometry practice, legal practice, contact lenses, dentistry, health care, real estate, and others.[47]

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bills of hundreds of thousands of small businesses and non-profit organizations agreed to pay $4.1 million) (consent order).

[46] Recent examples of Commission competition advocacy filings include FTC Staff Comment Before the Department of Housing and Urban Development Concerning the Real Estate Settlement Procedures Act ("RESPA") (June 2008), *available at* http://www.ftc.gov/os/2008/04/V080009florida.pdf; and FTC Prepared Statement Before the Florida Senate Concerning Florida Certificate of Need Laws (Apr. 2008), *available at* http://www.ftc.gov/os/2008/04/V080009florida.pdf.

[47] For a complete list of FTC advocacy materials, please visit http://www.ftc.gov/opp/advocacy_subject.shtm.

FTC advocacy letters often address the subject of professional services. When regulations distinguish, for example, between activities that require certain qualifications and licenses, and those that do not, competition is affected. Legislators who are asked to tighten licensing requirements may be told by proponents that stronger regulations will better protect consumer interests. We seek to inform their consideration of such issues by analyzing the extent to which the measures may also exclude or limit competition – often from small businesses – raise prices, and limit consumer choice. These tradeoffs should be recognized and the true extent of any benefits ascertained before such restrictions are put in place. We urge policymakers to avoid restricting competition unless there has been a clear showing that the restraint is necessary to provide consumers with something they value more than the benefits of the competition that will be lost.

The Commission recently offered this kind of analysis in the area of real estate settlement services, a business that involves the preparation and signing of certain home-sale closing documents. Much of this is fairly routine work. Most states allow non-attorney settlement firms to provide these services, and studies have shown that this results in substantial consumer savings with little if any additional risk of errors.[48] Despite the clear benefits from this competition, however, there have been efforts in a few states to require consumers to obtain such

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[48] *See, e.g.*, Joyce Palomar, *The War Between Attorneys & Lay Conveyancers – Empirical Evidence Says "Cease Fire!,"* 31 CONN. L. REV. 423, n.5 at 520 (1999) ("[t]he only clear conclusion" is "that the evidence does not substantiate the claim that the public bears a sufficient risk from lay provision of real estate settlement services to warrant blanket prohibition of those services under the auspices of preventing the unauthorized practice of law"). *See also In re Opinion No. 26 of the Committee on the Unauthorized Practice of Law*, 654 A.2d 1344, 1349 (N.J. 1995) (evidence indicated that buyers and sellers in areas of New Jersey where lay-assisted closings were prevalent paid on average $350 and $450 less for closings, respectively, than did buyers and sellers in parts of the state where lay-assisted closings were less common).

services solely from lawyers and to prohibit non-attorney settlement providers. In 2006 and again in 2007, a state legislator in New York invited the FTC and Justice Department to comment on a bill that would have placed such restrictions on non-attorney providers.[49] The agencies sent a joint letter recommending that the bill be rejected, and the New York legislature ultimately declined to pass it. Our advocacy has supported similar decisions against restrictive legislation in Hawaii, North Carolina, and Kansas.[50]

The second part of this activity – competition studies – works to expand the total base of knowledge on competition issues. These studies serve several purposes: to support possible advocacies; help the agency decide what matters to target in litigation; suggest the best remedies to use; provide guidance to businesses; and encourage informed public discussion.

In recent years the Commission has conducted workshops and hearings, and has engaged in studies on such diverse topics as payments for shelf space, e-commerce, real estate, and health-care delivery.[51] Those studies, together with our experience in litigated cases, give us a factual

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[49] *See* two letters from the Justice Department and the FTC to the Committee on the Judiciary of the New York State Assembly (June 21, 2006 and April 27, 2007), *available at* http://www.ftc.gov/os/2006/06/V060016 NYUplFinal.pdf and http://www.ftc.gov/be/V070004.pdf.

[50] *See, e.g.*, letter from the Department of Justice and FTC to the Hawaii Supreme Court (January 25, 2008) *available at* http://www.ftc.gov/os/2008/01/V080004letter.pdf; letter from the Justice Department and the FTC to Executive Director of the Kansas Bar Ass'n (Feb. 4, 2005) *available at* http://www.ftc.gov/be/v050002.pdf; letter from the Justice Department and the FTC to President of the North Carolina State Bar (July 11, 2002) *available at* http://www.ftc.gov/os/2002/07/non-attorneyinvolvment.pdf; letter from the Justice Department and the FTC to Ethics Committee of the North Carolina State Bar (Dec. 14, 2001), *available at* http://www.ftc.gov/be/V020006.shtm.

[51] For example, the workshop on Innovations in Health Care Delivery considered innovations that affected the opportunities for small providers as well as larger health care systems. *See* http://www.ftc.gov/bc/healthcare/hcd/index.shtm.

basis for comments that can be considered by state authorities before they embark on a program that restricts competition in a local market.

A particularly important subject for empirical study has been e-commerce. With the growth of the Internet over the past fifteen years, many new opportunities opened up for web-based small businesses, as discussed above. Many small startups have become household names, and the convenience and variety of Internet shopping has also empowered consumers.

Commission studies have helped identify unnecessary industry-specific regulation of e-commerce. As the Internet began to connect distant sellers and buyers, concerns arose that legally restricted products might be bought by people who were not authorized to have them, or that products might be unethically sold online when they actually required an in-person fit before they would work properly. Many jurisdictions adopted regulations limiting consumers' ability to buy certain goods and services online. The question these regulations posed was where to strike the balance between regulation and restraints on competition that affect consumers. To help answer this question the FTC organized several studies into how regulatory restraints in e-commerce actually affect competition and consumer safety. In 2003, the Commission produced a report entitled *Possible Anticompetitive Barriers to E-Commerce: Wine,*[52] followed by a report

[52] Federal Trade Commission, Staff Report, *Possible Anticompetitive Barriers to E-Commerce: Wine, available at* http://www.ftc.gov/os/2003/07/winereport2.pdf (hereinafter "Wine Report").

on the online sale of contact lenses.[53] The FTC and the Antitrust Division jointly conducted a workshop and prepared a report on real estate brokerage services, including online services.[54]

Internet wine sales are a good example of the Commission's work in this area, and a relevant one for this Committee because many winemakers in America are small businesses. The Internet proved particularly beneficial to this group. Smaller vineyards, with limited distribution networks, gained the ability to market their wines directly to consumers around the country, and consumers became able to shop for a wider variety of products at competitive prices. But many states limited or prohibited direct wine sales over the Internet, ostensibly to advance temperance or prevent alcohol sales to minors. Our study found, however, that states could significantly enhance consumer welfare by allowing the direct shipment of wine to consumers. Further, we found that many states had adopted measures less restrictive than outright bans, and those still reported few or no problems with intemperance or direct shipment to minors.

In 2005, relying heavily on the FTC's Wine Report, the Supreme Court in *Granholm v. Heald* – a case initiated by "small wineries that rely on direct consumer sales as an important part of their businesses" – struck down several states' prohibitions on the direct shipment of wine by out-of-state wineries but not in-state ones.[55] This type of regulation discriminated against

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[53] *See* Federal Trade Commission, Staff Report, *Possible Anticompetitive Barriers to E-Commerce: Contact Lenses, available at* http://www.ftc.gov/os/2004/03/040329clreportfinal.pdf; *The Strength of Competition in the Sale of RX Contact Lenses: An FTC Study, available at* http://www.ftc.gov/reports/contactlens/050214contactlensrpt.pdf.

[54] Federal Trade Commission and U.S. Department of Justice, Staff Report, *Competition in the Real Estate Brokerage Industry, available at* http://www.ftc.gov/reports/realestate/V050015.pdf.

[55] 544 U.S. 460, 468 (2005).

interstate commerce and was a presumptive violation of the commerce clause. In their defense the states claimed that they needed particularly tight local control in order to properly collect taxes, prevent underage drinking, and serve other compelling social goals.[56] The Court, however, relying in large part on the FTC's study, rejected that argument, finding there was no evidence of harm that required discrimination against out-of-state producers, and thus that there was a commerce clause violation.[57] The Court then struck down the prohibitions at issue.

VI. Conclusion

The Commission does not have programs that specifically favor small businesses. Our mission, instead, is to maintain a neutral marketplace for all participants, so that competition will determine the winners and losers, thus maximizing consumer welfare.

As part of fulfilling that mission, however, the Commission takes many actions that are of practical benefit to the small-business community – challenging anticompetitive conduct, educating both large and small businesses, promoting good practices that share truthful and nondeceptive information with consumers, encouraging policymakers to allow more competition, and studying issues that are of particular interest to the small business community. With that assistance, small business has the opportunity to thrive.

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[56] They also claimed that the Twenty-first Amendment, which gave states broad powers to regulate liquor sales within their borders, also gave them special latitude to discriminate against out-of-state suppliers. The Court rejected that argument.

[57] 544 U.S. at 490-91.

Statement

of the

American Medical Association

to the

Committee on Small Business
United States House of Representatives

RE: Small Business Competition Policy: Are Markets Open for Entrepreneurs?

Presented by William A. Hazel, Jr., MD

September 25, 2008

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Re: Small Business Competition Policy: Are Markets Open for Entrepreneurs?

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The American Medical Association (AMA) appreciates the opportunity to present testimony to the Committee on Small Business regarding Small Business Competition Policy. We commend Chairwoman Velazquez, Ranking Member Chabot, and Members of the Committee for your leadership in recognizing that important changes in the health care market warrant new approaches to health care antitrust policy.

Current health care antitrust enforcement policy unduly restricts physician collaboration, especially among small physician practices. As such, it has chilled physician attempts at joint contracting,[1] hindered physicians' ability to participate in the full spectrum of health care initiatives, and perpetuated a severe imbalance in the market whereby dominant health insurers that have enjoyed unfettered consolidation force physicians to adhere to contracts that create obstacles to providing optimal patient care and unduly restrict their autonomy. We believe that the Federal Trade Commission (FTC) should provide for more flexibility on physician joint contracting in order to allow small practices to collaborate on Health Information Technology (HIT) and health care quality improvement initiatives. In addition, the Department of Justice (DOJ) must more aggressively challenge health insurer mergers. These steps would restore balance to the health care market and help to ensure an innovative and efficient health care system.

ANTITRUST LAW AND POLICY

Current Antitrust Policy

Despite recent developments and changes in the health care market, enforcement policy—embodied today in the *Statements of Enforcement Policy in Health Care* (the Statements)

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[1] Since April 2002, the FTC has brought at least 25 cases against physician groups based upon contracting arrangements with health insurers. All but one of the groups chose to settle with the FTC rather than engage in a protracted, financially devastating legal battle.

developed jointly by the FTC and the DOJ during the 1990s—casts an overly suspicious eye on physician collaboration through network arrangements. Specifically, the Statements give too little credence to the benefits of physician collaboration that do not fit within the agencies' rigid models of allowable "integration"—attributes that make a joint arrangement sufficiently likely to generate efficiency such that application of a reasonableness standard in evaluating the joint arrangement is appropriate—and overestimate the anticompetitive potential of physician collaborations that lack market power and therefore lack the ability to restrain trade. Arrangements that have benefits to the health care system while posing little risk of anticompetitive injury should be embraced so that physicians may engage in pro-competitive joint arrangements that result in efficiencies and improved patient care and coordination.

The initial version of the Statements was released in September 1993. They reflected efforts to provide clarity to medical professionals and companies by articulating policies that had emerged previously only in advisory letters, speeches, and consent decrees. As originally issued, the Statements contained eight separate policy statements, including one on "Physician Network Joint Ventures."[2] Statement 8 identified two features of particular importance: (1) the network's percentage or "share" of the physicians in each physician specialty practicing in the relevant geographic market; and (2) whether the physicians had integrated their practices by sharing "substantial financial risk."[3]

According to the Statements, sharing "substantial financial risk" could be accomplished in one of two ways: (1) by accepting "capitated" or "per-member per-month" payments, or (2) by incentivizing physicians to contain costs through the use of a substantial withhold from payments. The existence of either of these examples of substantial financial risk meant that the physician collaboration, if challenged, would be evaluated under the rule of reason standard.[4] The absence of any evidence of substantial financial risk would result in summary condemnation as *per se* illegal price fixing.[5]

With the rapid expansion of managed care in the 1990's, the requirement of financial risk-sharing as the defining feature of a legitimate physician network proved to be unduly restrictive. Contrary to early predictions, in most areas of the country physician capitation proved to be an unpopular and highly controversial payment methodology. Employers

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[2] The FTC declared in Statement 9, that networks that are not substantially integrated can instead use a "messenger model" arrangement to facilitate their individual contract negotiations with health plans and avoid price fixing. Essentially, proper implementation of the messenger model is achieved when the messenger shuttles between health care professionals and payers, carrying offers on reimbursement rates in a back-and-forth process that eventually will yield a rate acceptable to both the professional and the plan.

[3] In the specific context of physician contracting networks, only the sharing of "substantial financial risk" was embraced as sufficient to allow a network to be evaluated under a reasonableness standard. Other forms of integration—structural, functional, or transactional—were not considered adequate.

4 The so-called "rule of reason" has been the hallmark of judicial construction of the antitrust laws. Under its aegis, the anticompetitive consequences of a challenged practice are weighed against the business justifications upon which it is predicated and its putative pro-competitive impact, and a judgment with respect to its reasonableness is made.

[5] *Per se* illegality conclusively presumes the challenged practices to be unreasonable. In other words, when a per se offense (such as price fixing among competitors) is charged, all the government must establish is that the defendant has, in fact, engaged in the proscribed practice; illegality follows as a matter of law, no matter how slight the anticompetitive effect, how small the market share of the defendants, or how proper their motives.

wanted broad networks that allowed patients a significant choice among physicians, without perceived incentives to ration care. Yet the definition of "substantial financial risk" adopted by the agencies raised a substantial barrier to the participation of physician-led contracting networks.

In the 1996 version of the Statements, the agencies recognized a second type of integration that could qualify a physician network for rule of reason treatment—"Clinical Integration." Clinical integration, as defined in the Statements, is evidenced "by the network implementing an active and ongoing program to evaluate and modify practice patterns by the network's physician participants and create a high degree of interdependence and cooperation among the physicians to control costs and ensure quality."[6] Clinical integration as so defined represented a sort of "as if" standard: A physician network that acted "as if" its members shared financial risk—by instituting the types of efficiencies associated with financial risk sharing—might qualify for rule of reason treatment despite the absence of "substantial financial risk." For several years following the publication of the 1996 Statements, the agencies gave no further guidance on the meaning of clinical integration.

In 2002, however, the FTC issued a staff advisory letter to MedSouth, Inc., an Independent Practice Association (IPA) based in Denver, Colorado with over 400 physicians.[7] And in 2007, the FTC issued a staff advisory letter to the Greater Rochester Independent Practice Association, Inc. (GRIPA), a network based in Rochester, New York with over 600 physician members.[8] The MedSouth and GRIPA letters demonstrate how high the bar has been set for physician networks seeking to clinically integrate. While the MedSouth and GRIPA proposals are not identical, they bear significant similarities.[9] Both MedSouth and GRIPA made significant investments in capital and resources, using myriad consultants, lawyers, and technology experts to assist in the effort. Both networks invested in electronic medical records and tracking technology to share information on their patients and to monitor data relating to utilization and medical outcomes. Both networks developed clinical practice guidelines and procedures for monitoring their compliance, and both networks were "non-exclusive," meaning that payers choosing not to support the clinically integrated program would not lose access to any desirable physicians who were participating in the network.

Importantly, in both instances, the FTC advisory letters noted no apparent anticompetitive motivation for the physicians' efforts. Despite this lack of anticompetitive motivation and the significant time and resources employed, however, neither MedSouth nor GRIPA achieved agency approval easily or without significant caveats. Both advisory letters reflected intensive agency investigation of the networks' history, purposes, contracting mechanisms, disciplinary methods for non-compliant physicians, and strategies for producing efficiencies. Each involved a searching examination of the so-called

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[6] U.S. Department of Justice & Federal Trade Commission, *Statements of Antitrust Enforcement Policy in Health Care* (Aug. 1996) ("*Health Care Statements*" or "*Statements*"), at 72-73.

[7] Letter from Jeffrey W. Brennan, Asst. Director, Bureau of Competition, to John J. Miles (Feb. 19, 2002) ("*MedSouth*").

[8] Letter from Markus H. Meier to Christi J. Braun & John J. Miles, (Sept. 17, 2007) ("*GRIPA*").

[9] Notably, both networks were originally built for capitation, but needed to adapt in the face of market resistance. Thus, both MedSouth and GRIPA were constructed "as if" the physicians were sharing substantial financial risk. Only when risk contracting proved to be commercially infeasible did the networks see FTC approval for their clinical integration programs.

"ancillarity"[10] of the networks' pricing mechanisms to its efficiency-enhancing potential. And each left the agency plenty of room to bring a later enforcement action if the networks' operations could not later be shown to produce significant efficiencies.

The MedSouth and GRIPA advisory letters reflect the extremely high level of clinical integration required by the FTC. Absent vast resources, such as those available to MedSouth and GRIPA, most physicians are effectively barred from forming physician networks. Without such networks, physicians cannot work collaboratively on costly and involved health care quality initiatives or participate in balanced negotiations with health insurers. We believe that where such collaborative efforts have no ability to restrain trade, there should be more flexibility for physicians to jointly contract.

Current Antitrust Law

As their name attests, the Statements of Antitrust Enforcement Policy in Health Care represent enforcement policy rather than law. As such, the Statements do not necessarily stand at the outer boundaries of what antitrust law permits. Indeed, the Statements impose restrictions tighter than required either by the law itself or by sound enforcement policy in the current market environment.

Outside the health care context, courts and the Agencies themselves apply a more flexible analysis than is found in the Statements. For example, in the Agencies' Guidelines on Competitor Collaboration, there is no mention of financial or clinical integration. Instead, the Competitor Collaboration Guidelines ask more generally whether a joint venture involves "an efficiency-enhancing integration of economic activity" and whether any restraints are "reasonably related to the integration and reasonably necessary to achieve its pro-competitive benefits."[11] The Supreme Court, too, in its joint venture cases has eschewed any fixed formulation of what may constitute integration sufficient to warrant rule of reason treatment.[12]

RECENT CHANGES IN THE HEALTH CARE MARKET

Over the past several years, health care market conditions have changed in significant ways that suggest a need to revisit the antitrust landscape. Health plan consolidation has severely limited physicians' ability to advocate on behalf of themselves and their patients. Also, market and regulatory developments are encouraging physician integration for the purposes of purchasing and using HIT and measuring and improving medical care. Rather than protect potential physician clinical integration efforts, current enforcement agency policy discourages them. They have only recognized as lawful, efforts that are out of reach for small and solo physician practices.

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[10] Ancillarity refers to whether a price mechanism is "reasonably related to the integration and reasonably necessary to achieve its pro-competitive benefits." *See, e.g., NCAA v. Board of Regents of the Univ. of Oklahoma,* 468 U.S. 85 (1984).

[11] *Antitrust Guidelines for Collaborations Among Competitors* (April 2000) (*"Competitor Collaboration Guidelines"*) at § 3.2.

[12] *See generally Arizona v. Maricopa County Medical Society,* 457 U.S. 332 (1982)

Uncontrolled Health Insurer Market Power and Consolidation

The health insurer market has also changed significantly due to a wave of mergers among large HMOs and health insurers over the past decade, steadily eroding the competitive payer market.[13] In the last decade, over 400 health insurer mergers, only three of which have been challenged by the DOJ, have resulted in an increasingly consolidated payer market.[14] This consolidation has resulted in the steady increase of premiums, even as patient co-pays and deductibles have expanded, effectively shrinking the scope of coverage, and an extreme imbalance in insurer-physician contracting that threatens all aspects of patient care.

The power garnered by health insurers through rapid, large-scale consolidation has not been used to the advantage of patients or physicians. Patient premiums have soared in this increasingly consolidated market and physician reimbursement has decreased. As premiums have risen, many employers have stopped providing coverage, reduced the scope of benefits provided, and/or asked employees to pay a higher share of the overall premium. As of 2006, premiums for employer-based health insurance rose more than twice as fast as overall inflation and wages for the seventh straight year.[15] Since 2000, the amount that workers pay toward family health care coverage has skyrocketed 84 percent[16] and five million fewer workers were receiving job-based coverage in 2006 than in 2000.[17] During the same period, average wages have increased only 20 percent.[18] These skyrocketing costs have directly contributed to an increase in the number of uninsured. Research shows that a one percent increase in premiums results in a net increase in the uninsured of 164,000 individuals.[19]

Like America's patients, physicians have not been the beneficiaries of these increases either. Powerful insurers have depressed physician revenues.[20] The median real income of all U.S.

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[13] In 2000, the two largest health insurers, Aetna and UnitedHealth Group (United), had a total combined membership of 32 million people. Due to aggressive merger activity since 2000, including United's acquisition of California-based PacifiCare Health Systems, Inc., and John Deere Health Plan in 2005, United's membership alone has grown to 33 million. Similarly, WellPoint, Inc. (Wellpoint), the company born of the merger of Anthem, Inc. (originally Blue Cross Blue Shield of Indiana), and WellPoint Health Networks, Inc. (originally Blue Cross of California), now owns Blue Cross plans in 14 states. In 2005, WellPoint acquired the last remaining Blue Cross Blue Shield plan, the New York-based WellChoice. Consequently, in 2005, WellPoint covered approximately 34 million Americans. Most recently, United acquired Sierra Health Systems in Nevada, allowing United to acquire over 50 percent of the Nevada market, including a 90 percent share of the health maintenance organization (HMO) market. Irving Levin Associates, *supra*.

[14] American Medical Association, *Competition in Health Insurance: A Comprehensive Study of US Markets* / 2007 Update, 1

[15] The Kaiser Family foundation and Health Research Educational Trust; *Employer Health Benefits 2006 Summary of Findings.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] Chernew, M., Cutler, D., and P. Keenan, "Increasing Health Insurance Costs and the Decline in Insurance Coverage," Health Services Research, August 2005.

[20] Depressed physician reimbursements contribute to higher costs to patients. That lower physician fees paid by insurers may result in higher prices to patients was emphasized by R. Hewitt Pate, a former Assistant Attorney General of the Antitrust Division, in a statement before the Senate Judiciary Committee:

> A casual observer might believe that if a merger lowers the price the merged firm pays for its inputs, consumers will necessarily benefit. The logic seems to be that because the input purchaser is paying less, the input purchaser's customers should

physicians remained flat during the 1990s and has since decreased.[21] Health plan executives and shareholders, on the other hand, are reaping enormous monopoly profits.[22] Recent reports on health insurer profits show that the profit margins of the major national firms have experienced double-digit growth since 2001.[23] United and WellPoint, specifically, have had seven years of consecutive double-digit growth that has ranged from 20 to 70 percent year after year (through 2003).[24]

In addition to effecting costs, payments, and profits, consolidation has given way to an environment in which health plans are able to dictate important aspects of patient care and material contract terms to physicians.[25] Physicians have little to no ability to influence insurer contracts that touch on virtually every aspect of the patient-physician relationship.[26] This means that physicians must agree to contracts that often include provisions that make it difficult, if not impossible, for them to promote what they deem to be the highest quality patient care. For example, many contracts define "medically necessary care" in a manner that allows the health plan to overrule the physician's medical judgment and require the lowest cost, but not necessarily optimal, care for the patient. Others require compliance with undefined "utilization management" or "quality assurance" programs that often are nothing more than thinly disguised cost-cutting programs that penalize physicians for providing care they deem necessary.

These contracts also often dictate material terms. They may refer to "fee schedules" that are never provided and can be revised unilaterally by the health insurer. Many contracts, in fact, allow the health insurer to change *any* term of the contract unilaterally. These contracts also frequently contain such unreasonable provisions as "most favored payer" clauses—clauses requiring physicians to bill the dominant health insurer at a level equal to the lowest amount the physician charges any other health insurer in the region[27]—and "all products" clauses—

> expect to pay less also. But that is not necessarily the case. Input prices can fall for two entirely different reasons, one of which arises from true economic efficiency that will tend to result in lower prices for final consumers. The other, in contrast, represents an efficiency-reducing exercise of market power that will reduce economic welfare, lower prices for suppliers, and may well result in higher prices charged to final consumers.

Lower input prices for physician services do not lead to lower consumer output prices for health premiums. Peter J. Hammer and William M. Sage, "Monopsony as an Agency and Regulatory Problem in Health Care, " 71 Antitrust L.J. 949 (2004).

[21] Ha T. Tu, Paul B. Ginsburg, "Losing Ground: Physician Income, 1995-2005," Center for Studying Health Systems Change Tracking Report No. 15 (June 2006).

[22] James C. Robinson, "Consolidation and the Transformation of Competition in Health Insurance," Health Affairs, Vol. 23 No. 6 (2004).

[23] See id. at 19-20

[24] See id.

[25] *See generally* American Medical Association, Competition in Health Insurance: A Comprehensive Study of U.S. Markets, 2007 Update, at 5.

[26] Many contracts, in fact, are essentially "contracts of adhesion"—standardized contracts that are submitted to a weaker party on a take-it or leave-it basis and do not provide for negotiation.

[27] This permits the dominant health insurer to guarantee that it will have the lowest input costs in the market, making it that much more difficult for new payers to enter the market.

clauses requiring physicians to participate in all products offered by a health insurer as a condition of participation in any one product.[28]

Despite the improper restrictions and potential dangers of these contracts, current imbalance in the market dictates that physicians typically have no choice but to accept them. Any alleged "choice" is illusory given that choosing to leave the network often means terminating patient relationships and drastically reducing or losing one's practice. Because medical services cannot be stored or exported, physicians have limited options for selling their services. If physicians were to refuse the terms of the dominant health plan, they would likely suffer an unrecoverable loss. Consequently, a physician's ability to terminate a relationship with a health plan depends on that physician's ability to make up for the loss by switching to an alternative insurance coverage plan. Where alternatives are lacking, physicians are forced to accept unfair contracts.[29] Furthermore, even where there are alternatives, physicians are limited in their ability to encourage patients to switch plans, as patients can only switch employer-sponsored plans once a year during open enrollment, and even then, they have limited options and could incur considerable out-of-pocket costs.[30]

In this environment, the antitrust enforcement agencies need to do more to protect competition in health insurer markets. They should also acknowledge that their present antitrust policies on physician networks incur the considerable cost of discouraging important forms of physician clinical integration. Therefore, these policies require revision.

Insufficiency of Integration models

Integration, as currently envisioned by the FTC, does not provide a viable option for the vast majority of physicians hoping to contract jointly. Financial risk sharing, as described in the Statements, has largely fallen out of favor. Employers and other purchasers of health care coverage have largely rejected payer-provider risk sharing arrangements. While clinical integration provides a nominal alternative, as noted above, the MedSouth and GRIPA letters suggest a level of investment that for small physician practices is at best an enormous obstacle and at worst a complete bar to physician collaboration. Likewise, the messenger model, the alternative to integration, is not adequate. It is confusing and complex and has proven to be a minefield for many physicians who have attempted to make use of it.

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[28] This often includes the health insurer reserving the right to introduce new plans and designate a physician's participation in those plans. Given the rapid development of new products and plans, the inability of physicians to select which products and plans they want to participate in makes it difficult for physicians to manage their practices effectively.

[29] The DOJ, in its 1999 challenge of the Aetna/Prudential merger recognized that there are substantial barriers to physicians expeditiously replacing lost revenue by changing health plans. It also noted that this imposes a permanent loss of revenue. *United States v. Aetna*, Revised Competitive Impact Statement, Civil Action 3-99CV1398-H (N.D.Tex, 1999), available at: http://www.usdoj.gov/atr/cases/f2600/2648.htm. The DOJ reiterated this position in its challenge to the UnitedHealth Group/PacifiCare merger. *See United States v. UnitedHealth Group Inc.*, Case No. 1:05CV02436 (D.D.C. Dec. 20, 2005), *available at* http://www.usdoj.gov/atr/cases/f213800/213815.htm.

[30] *See id.*

Recent Health Care Initiatives

Another significant change in the health care market is the desire to implement HIT and the rise of quality and consumer directed health care initiatives. There are increasingly focused efforts on developing methods of promoting and measuring quality. At the same time, the federal government is seeking to encourage physicians and other providers to invest in HIT to facilitate the collection and sharing of clinical data. On the payer side, employers are favoring plans that put increasing responsibility on patients to participate actively in choosing (and paying for) care. For physicians, who still practice predominantly in small groups, network arrangements provide one way of achieving the economies of scale necessary to participate in these initiatives.[31]

The shift towards performance-based reimbursement provides a good example of the strong incentives for physicians to collaborate with one another to collect and analyze quality data. "Pay-for-performance" (P4P) reimbursement is "now routinely used by both private and public payers in the U.S. health care system."[32] A majority of commercial HMOs use P4P, and recent legislation requires Medicare to adopt performance-based incentives.[33] As the adoption of P4P spreads and its use expands, physicians in small practices will be increasingly motivated to align in networks in order to have the capability to participate in these programs. Such arrangements will have a strong potential to enhance efficiency, but will not necessarily rise to the level of clinical integration recognized by the agencies.

PHYSICIAN COLLABORATION WILL IMPROVE HEALTH CARE

Joint contracting by physicians in a network can result in significant cost savings for both payers and physicians. On the payer side, joint contracting can make it possible for a payer to obtain ready access to a panel of physicians offering broad geographic and specialty coverage.[34] Because physicians still practice predominantly in solo practices or in small groups[35], creating a physician panel can be a very time-consuming and expensive task and can be a barrier to entry or expansion for new or less significant insurers. In its complaint in *United States v. Aetna*, the Justice Department noted that, "effective new entry for an HMO or HMO/POS plan in Houston or Dallas typically takes two to three years and costs

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[31] *See* H. Pham and P. Ginsburg, "Unhealthy Trends: The Future of Physician Services," 26 Health Aff. 1586, 1590 (2007) ("widespread adoption [of HIT] will occur only when ... [most physicians] practice in large networks that have adequate capital and can both make unified decisions regarding the investment in and optimal use of the integrative potential of the technology.").

32 M. Rosenthal, B. Landon, et al., "Climbing Up the Pay-For-Performance Learning Curve: Where Are the Early Adopters Now?," 26 Health Aff. 1674 (2007).

33 M. Rosenthal, R. Dudley, "Pay-for-Performance: Will the Latest Payment Trend Improve Care?," 297 J.A.M.A. 740 (2007).

[34] *See* F. Easterbrook, "Maximum Price Fixing," 48 U. Chi. L. Rev. 886, 898-99 (1981) (noting transactional efficiencies of joint contracting by physician network).

[35] Almost three-quarters of physicians in solo or small-group practice settings *See,* Solo and Small Group Physician Practices Can Reap Benefits from Electronic Health Records, But Face Challenges, The Commonwealth Fund News Release, Sept. 12, 2005, can be found at http://www.commonwealthfund.org/newsroom/newsroom_show.htm?doc_id=296456

approximately $50,000,000."[36] When the physicians themselves undertake the initial task of network formation, payers may substantially reduce the costs of entry and expansion.[37] Joint contracting thus has the potential both to reduce costs for payers and to increase competition in payer markets. These are cognizable benefits, with real potential to lower premiums and expand coverage for America's patients.

Joint contracting can also make physician contracting more efficient and lead to better-informed contract decisions. Most physician practices are simply too small to afford to hire businesspeople and lawyers to review their contracts with payers. Such practices do not have the resources to analyze complex contracts. Whereas payers have sophisticated actuarial and financial resources that enable them to structure and evaluate complex contract proposals, physicians are often in the dark when they consider a contract. By pooling their resources, physicians can spread the costs associated with the analysis of payer contracts, and develop appropriate counter-offers that can benefit patient, physicians, and payers. The effect is to enhance the efficiency of the physicians' practices and make them more responsive to the demands of competition.

Likewise, joint contracting can provide the resources physicians need for creating networks that will facilitate collaboration on HIT. Currently, however, physicians are unable to capture the financial returns or significant benefits from HIT that are necessary to offset the daunting implementation costs. Instead, those benefits and financial returns accrue mainly to health plans or patients, rather than physicians. The benefits of HIT fall into two basic categories. First, the system may reduce the costs of running a medical practice. It is unlikely, however, as noted by the Congressional Budget Office, that a solo practitioner or a small group practice will realize any real, internal cost savings from information technology systems.[38] Second, these systems can create cost savings by increased availability of patient data and reducing things such as duplication in services provided to patients. For instance, HIT may reduce the frequency of primary and specialty physicians ordering the same test.

This is a common problem recognized in economics—the problem of externalities. An externality arises when an individual cannot recover the costs of investing in an asset because most of the benefits fall to an individual whom the investor has no way of charging for the benefit.[39] In the health care context, the benefits of costly HIT systems[40] do not produce the necessary incentives for physicians to invest in them. For this reason, only 14

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[36] *United States v. Aetna*, No. 3-99CV1398-H (N.D. Tex.) (complaint filed June 21, 1999).

[37] Any doubt concerning the intrinsic efficiency of physician networks should be eliminated by the thriving rental network business that has emerged to supplement inadequate networks.

[38] *See* Congressional Budget Office, "Evidence on the Costs and Benefits of Health Information Technology," (May 2008) (hereinafter "CBO Report") at 19-20.

[39] Building roads is a good example, as is putting air filtration systems on factories. When the externality is large and the upfront costs for the investment are significant in relation of the expected recoverable benefit, a market failure occurs. This market failure means the investment is not made and consumers are made worse off.

[40] Acquiring and implementing an Electronic Health Record (EHR) system, for example, entails a significant financial investment. One study examining such acquisition costs for solo or small group practices estimated that "[i]nitial EHR costs were approximately $44,000 per full-time equivalent (FTE) provider per year, and ongoing costs were about $8,500 per FTE provider per year." R.H. Miller, et al., "The Value of Electronic Health Records in Solo or Small Group Practices," 24 *Health Aff* 1127, 1130 (2005).

percent of physicians have minimally functional Electronic Health Record (EHR) systems.[41] Solo or single partner practices, accounting for about half of all doctors, had the lowest level of comprehensive EHR use—7.1 percent of solo practitioners and 9.7 percent of those with a partner.[42]

While joint negotiation may have an impact on costs for physician services, it will reduce overall system costs. HIT systems will create efficiencies that will improve care and likely reduce costs. According to the CBO report, HIT has the potential, if adopted widely and used effectively, to save the health care sector about $80 billion annually (in 2005 dollars).[43] Thus, gains in the form of market efficiencies, reduced utilization, and increased availability of patient data will offset higher costs for networks to implement HIT. The FTC recognized this in its GRIPA advisory letter:

> Higher unit prices may be of little concern to a customer if they occur within integrated programs that result in lower total costs (e.g., through elimination of unnecessary and inappropriate utilization of services) and higher quality (e.g., better medical outcomes).[44]

How well HIT lives up to its potential, however, depends in part on how effectively financial incentives are realigned to encourage the optimal use of the technology's capabilities.[45] In the current environment, health insurers, the entities most likely to benefit from cost savings, have demonstrated little interest in implementing these systems and are unlikely to make substantial investments in HIT in the future. Given the expense of HIT implementation and the inability of physicians, the group to which the burden of implementation has fallen, to capture the majority of benefits and returns, physicians should be permitted to negotiate jointly with payers to properly allocate cost savings. Without the ability to recoup some of the expense of these systems by joining a network and achieving increased contracting efficiencies, it will be difficult, if not impossible for many physicians across the country to make the significant investments in time and money that the adoption of such a system would require.

Joint contracting is also essential for those physicians in small or solo practices who wish to participate in performance-based payment initiatives. The data and coordination required for these programs is out of reach for the majority of physicians. The FTC in its GRIPA advisory letter recognized this when it noted that implementing a program in which different subsets of physicians are participating in different payer contracts "could interfere with the network's ability to effectively gather data and monitor and evaluate physician performance under the program." Currently, most performance-based payment initiatives are specifically targeted at medical groups or networks rather than small practices. As a Commonwealth Fund study on P4P recently noted:

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[41] Office of National Coordinator for Health Informational Technology (July 2007).
[42] *Id.*
[43] CBO Report, at 18
[44] *GRIPA* at 27
[45] CBO Report at 7.

> Smaller groups generally have few incentives for care coordination, as they usually do not receive payment beyond the evaluation and management fees they are able to bill for acute visits. However, by banding together under the umbrella of organizations, and becoming eligible for performance payments through [the Medicare P4P Demonstration Project] or similar incentive programs, they have more motivation and support for care coordination.[46]

Physicians, who still practice predominately in small groups, lack the scale to participate in quality and HIT programs. By teaming up in a network, small practices may gain the magnitude for the care coordination, aggregation of data, and purchasing power required for the implementation of these initiatives.

CONCLUSION

The health care antitrust landscape has changed. FTC and DOJ policies that have led to aggressive antitrust enforcement actions against physicians, unfettered consolidation of health insurers, and limited opportunities for physicians to collaborate on important initiatives should be re-examined. Physician joint contracting provides ready access to physician panels, fair, efficient, and informed contract negotiations, and economies of scale to participate in HIT and quality programs. In addition, most physician networks pose no threat to competition. Rather than restraining trade, a more flexible approach to joint contracting will have a pro-competitive result—promoting and rewarding efficiency and innovation in the health care system. Thus, we encourage the FTC to revisit the Statements to accommodate the needs of the changing health care market.

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[46] M. Trisolini, G. Pope, et al., "Medicare Physician Group Practices: Innovations in Quality and Efficiency," The Commonwealth Fund (2006), available at www.commonwealthfund.org/usr_doc/971_Trisolini_Medicare_physician_group_practices_i.pdf.

Testimony
United States House of Representatives, Committee on Small Business
"Small Business Competition Policy: Are Markets Open for Entrepreneurs?"
September 25, 2008

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PREPARED STATEMENT

Before the

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

by

Jonathan L. Rubin*

Washington, D.C.
September 25, 2008

I. Introduction

Madam Chairwoman, Ranking Member Chabot, and members of the Committee, I am Jonathan Rubin, an antitrust lawyer with the firm of Patton Boggs here in Washington, D.C. and one of about a hundred members of the Advisory Board of the non-profit organization, American Antitrust Institute. For information about the American Antitrust Institute, visit www.antitrustinstitute.org. I am pleased to appear before you to consider U.S. competition policy as it affects the opportunities for entrepreneurial small businesses.

My task today is limited to presenting the major recommendations of relevance that appear in the upcoming report of the American Antitrust Institute ("AAI"), entitled "The Next Antitrust Agenda: The American Antitrust Institute's Transition Report on Competition Policy to the 44th President." The report will be published as a 430-page paperback approximately October 1, 2008 and will be provided to the Committee. The

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* These remarks reflect the position of the author or the American Antitrust Institute only, and not Patton Boggs LLP nor any of its clients.

AAI Transition Report sets forth a series of antitrust and competition policy recommendations for consideration by the next administration.

The antitrust laws are among America's greatest contributions to the field of political economy. The AAI is made up of a diverse and bipartisan group of antitrust practitioners, academics, former government officials, and interested citizens and businesses, folks that work in, write about, and follow antitrust. I can assure you that they are almost never in complete agreement on a particular issue, but that they share a conviction that government ought to promote competition and free markets, and that the nation's antitrust laws can and do precisely that, if they are aggressively and creatively employed.

I am honored to have been asked by the AAI to appear before you today to discuss the AAI Transition Report and those of its recommendations that are most vital for opening markets for entrepreneurs and to the nation's community of small businesses, what Chairwoman Velazquez has called, "the lifeblood of the American economy."[1]

II. A Centrist View of Competition

Believing in competitive free markets is one thing, but the facts on the ground may be very different.

Two opposing forces constantly pull on the economy. On one side is the urge by government to control the private sector through regulation. On the other side is the strong belief that free markets and laissez faire policies foster efficient economic growth and protect the private sector from counterproductive governmental control.

Neither path provides a complete policy prescription.

Over-regulation protects inefficient competitors and operates as a drag on the economy.

Complete laissez faire risks a lawless jungle operating without regard for justice.

Antitrust occupies the middle ground between these polar possibilities, and frequently offers nuanced instruments with which to steer markets back to an even keel when market failures occur. It is in this middle ground that opportunities for small business are often created—or destroyed.

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[1] Statement of the Hon. Nydia M. Velazquez, Chairwoman, United States House of Repetitives, Committee on Small Business, Full Committee Hearing: "The Role of Small Businesses in Stimulating the Economy," (April 24, 2008).

As the equilibrating force between over-regulation and blind faith in an unregulated free-market, antitrust is most effective when evenhandedly applied. It functions best as a lighter, case-by-case form of market regulation that is neither too tolerant of anticompetitive restraints nor too burdensome on productive commercial activity.

III. A Competition Manifesto for Small Business

This inherent need for balance in antitrust is reflected in the positions advocated in the AAI Transition Report. The report embarks from an introductory "Manifesto for Competition," the most important precepts of which for maintaining the openness of markets for entrepreneurs are that

- Competition promotes allocative efficiency by driving prices toward the cost of production;
- Competition on the merits—free of anticompetitive impediments—creates opportunities for entrepreneurs to enter markets and promotes self-determination for all Americans;
- Competitive markets allow for and encourage the rapid introduction of innovation into the stream of commerce;
- Competition gives consumers choice and variety and increased control over their day-to-day lives; and,
- Competition yields even greater consumer benefits when markets are served by more than a few large oligopolists, but also include numerous small businesses.

Many kinds of anticompetitive conduct proscribed by the antitrust laws foreclose opportunities for would-be entrepreneurs with meritorious products, services or innovations. The preservation of our nation as "the land of opportunity" is and should continue to be, therefore, an important foundational goal of antitrust.

IV. The Report's Organization and Recommendations

The AAI Transition Report consists of three main sections. The first section discusses the topics of cartels, monopoly, buyer power, mergers, institutions, and private litigation.

The second part deals with four specific sectors of the economy in greater depth—media, food and agriculture, health care, and energy.

The last part summarizes the report's 127 major recommendations.

The AAI recommendations bearing most on the prospects for open markets for entrepreneurs are these:

1. The enforcement agencies and courts should adopt a more aggressive posture against exclusionary conduct by dominant firms and employ and revitalize the anti-monopolization provision of Section 2 of the Sherman Act;

2. Antitrust analysis should recognize the real conditions in commercial markets by accounting for the economic effects of oligopoly, dominant firm exclusionary strategies, informational asymmetries, consumer lock-in, and impediments to competitive after-markets;

3. The scope for dominant firms with control over essential inputs to refuse to deal with their rivals should be limited according to the sound antitrust principles embodied in Section 2 jurisprudence and an appropriately limited but nonetheless viable essential facilities doctrine;

4. Abandon the intellectually bankrupt cost-based tests for antitrust liability for such exclusionary strategies by dominant firms as bundling and loyalty discounting, which make it difficult or impossible for single-line sellers to compete with multi-line sellers, or smaller capacity sellers to compete with larger capacity rivals;

5. Sharpen the analysis of exclusive agreements by dominant firms that block access by small businesses to territories or supply chains; and,

6. Recognize the concept of vertical market power, and that

    a. Resale price maintenance (RPM) should revert to be unlawful per se, or a structured rule of reason procedure should be employed that recognizes that intrabrand vertical restraints, exclusive dealing, and RPM, are frequently anticompetitive;

    b. Vertical *buyer* power can be exerted up the chain of distribution to manufacturers (as was the case in *FTC v. Toys-R-Us*); and

    c. Vertical *seller* power can be exerted down the chain of distribution (as occurred in *Dentsply, Inc.*).

Scrutiny of RPM and buyer market power—what the report calls "the new kid on the block"—are especially relevant issues for retail businesses.

One unique contribution of the AAI report of special importance to small and middle size businesses is its emphasis on vertical relationships in which dominant firm market power is projected up or down the chain of distribution.

Rejecting the current mantra that only interbrand competition is worthy of antitrust attention, the AAI believes that in multi-stage distribution chains competition on any level of distribution warrants antitrust protection.

V. The Debate over Section 2

I will conclude with a brief summary of the perspectives of the AAI report on the current issues regarding Section 2 and single-firm conduct.

As a general matter, the AAI applauds and encourages deregulation in industries in which ill-advised and overly intrusive regulatory structures are less efficient than an unregulated free market.

As direct economic regulation is replaced by aspirationally competitive markets, however, antitrust should fill the resulting void, and not be constrained by vestigial immunities and doctrines left over from prior regulated regimes.

Thus, legacy monopolists operating in newly deregulated sectors generally should be subject to monopolization law. In the wake of deregulation, however, the Department of Justice has been stepping down its enforcement of Section 2 and monopolization cases (having brought none in this century) and stepping up its advocacy for a narrower role for Section 2.[2] An attitude that emanates from many quarters these days is that monopoly, far from being an evil, should be defended as the mother of invention and the motivator of risk-taking and hard work. This conflates the concepts of harmful *durable* monopoly, which locks up markets and stifles entry, with temporary *quasi*-monopoly, which motivates firms with temporary monopoly rewards for being innovative or first-to-market, until the natural course of competition brings in rivals and prices are again driven toward competitive levels.

[2] See U.S. Department of Justice, "Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act," (September, 2008), available at: http://www.usdoj.gov/atr/public/reports/236681.pdf. See also Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice (September 8, 2008), available at: http://www.ftc.gov/opa/2008/09/section2.shtm.

In its current posture,[3] U.S. competition law grants broad freedom to private firms in matters of pricing, product development, and marketing. But, antitrust analysis today constrains itself by relying exclusively on effects based analysis and regarding economic efficiency as its sole legitimate goal, while other putative goals for antitrust policy, such as promoting egalitarian, distributional, or small-business values, are rejected. Under current Section 2 enforcement norms, enforcers stay out of firms' way, and presuppose that in time markets will self-correct, ultimately even ameliorating anticompetitive effects of exclusionary conduct by dominant firms (thereby rendering so-called false positives inherently more costly than false negatives).

Current policy also inhibits itself by taking a dim view of the institutional capacities of the competition authorities, courts, and juries, and regards the demands of administering complicated antitrust rules as overly costly for both institutions and private parties, particularly where intervention is improvidently initiated.

In the view of the AAI Transition Report, the current view worries too much about intervening incorrectly (risking a false positive) and not enough about failing to intervene when necessary (risking a false negative). Antitrust is about prediction, and predictions will sometimes be proven incorrect. AAI sees no reason to suppose *a priori* that false positives are inherently more injurious to an efficient economy than are false negatives.

Finally, current antitrust doctrine is unabashed in its distain for the capabilities of agencies, courts, and lay juries to resolve antitrust disputes correctly, and expansive in its estimation of the costs of administering the resolution of such disputes. AAI believes that this lack of confidence in courts and juries is not justified. Limiting access to the courthouse often disadvantages private antitrust plaintiffs, who are frequently small and medium sized businesses.

In short, current antitrust policy leads to a noninterventionist standard of dominant firm exclusionary conduct that the AAI rejects.

The AAI believes that viewing single-firm issues exclusively through the lens of neoclassical price theory and assessing competitive injury solely in terms of its effect on price or quantity imposes artificial limitations on the scope of the antitrust enterprise. Consumer choice, variety, diversity, quality, convenience, and innovation are all also

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[3] See Statement of Federal Trade Commission Chairman William E. Kovacic, "Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act," (Sept. 8, 2008), available at: http://www.ftc.gov/opa/2008/09/section2.shtm.

legitimate values worthy of protection in the defense of competition by the operation of the antitrust laws.

The AAI also advocates a consumer surplus standard, which, in contrast to the aggregate welfare standard advocated by many adherents of the Chicago School, requires some positive economic benefit for consumers before welfare may fairly be said to be improved, in addition to the enhancement of allocative efficiency gained by eliminating or reducing monopoly dead-weight loss.

Although the AAI believes in the resourcefulness of private enterprise and the tendency of markets to approach a competitive equilibrium, market failures do arise, and this is sometimes the result of dominant firms engaging in strategies that maintain monopoly. The antitrust tool to address durable monopoly acquired or maintained by improper means—Section 2—is available, but it needs to be sharpened and put back into service.

As a case-by-case form of regulation charged not with promoting competition but with eliminating impediments to it, antitrust exerts an indirect influence on business conduct even where no action is taken. The mere threat of antitrust liability deters anticompetitive conduct. And when litigation does arise, AAI believes that courts and juries take their responsibilities to resolve antitrust cases seriously and that juries in particular bring considerable wisdom to resolving even complex business disputes.

VI. Conclusion

The AAI report sees the 2008 political transition as an opportunity to reassess the present posture of antitrust policy and to make adjustments to it. Many of the issues in the 2008 election boil down to values promoted by the antitrust laws: maintaining fair competition, ensuring equal opportunity for all Americans, and stimulating economic growth at home and competitiveness abroad.

No matter which party will control Congress or who the President will be, the AAI's advice to the next administration is the same:

- Antitrust analysis should be brought more in line with a broader body of modern economic knowledge beyond the narrow application of neoclassical price theory and made better equipped to deal with the realities of markets in a new, digital and globalized millennium;

- More resources and personnel should be devoted to the skillful deployment of antitrust enforcement as a policy instrument to maintain competitive markets; and,

- The institutions, substantive rules and procedures of antitrust should be rejuvenated, particularly as they pertain to the treatment of single-firm conduct.

I thank the Committee for your attention, and would be pleased to answer any questions the Committee may have.

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Hearing Testimony

Mr. Said Hilal
President and Chief Executive Officer
Applied Medical Resources Corporation

On Behalf Of
The Medical Device Manufacturers Association (MDMA)

Before the United States House of Representatives
Committee on Small Business

"Small Business Competition Policy:
Are Markets Open for Entrepreneurs?"

September 25, 2008

Introduction

As the Chief Executive Officer of Applied Medical Resources Corporation ("Applied") of Orange County, California and a member of the Medical Device Manufacturers Association ("MDMA"), I appreciate the opportunity to discuss the predatory and anti-competitive practices that exist in the healthcare system today.

Applied Medical was established in 1987 to develop products that can improve both clinical outcomes and financial outcomes for hospitals and patients. We did. Today, we develop, manufacture and market specialized devices that enhance clinical outcomes of minimally invasive procedures while reducing costs.

MDMA is a national trade association representing nearly 200 innovative, entrepreneurial medical technology companies across the country. Our mission is to ensure that patients have timely access to the latest advancements in medical technology, most of which are developed by small, research-driven medical device companies.

Today's hearing is entitled, "Are Markets Open for Entrepreneurs?" Unfortunately, the answer for many smaller companies in the medical device industry is no.

The U.S. medical technology market is controlled by large hospital group purchasing organizations ("GPOs") and dominant suppliers that exclude smaller companies with better products at a better price from the market. The result is that patients and caregivers are often denied access to innovative, cost-effective technologies that have the ability to improve care and reduce costs. As a result, substantial savings afforded by true competition are often completely missed. Further exacerbating these problems is that fact that the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") have done little to protect consumers or competition.

In order to open markets for all medical suppliers and improve competition, federal agencies must engage in more vigorous oversight and enforcement of antitrust laws. In addition, the perverse incentives that exist within the current supplier funded GPO model must be eliminated by Congress.

Taking these measures will restore competition, improve the quality of care, reduce costs and promote innovation.

The Need to Reform Hospital Group Purchasing Organizations (GPOs)

GPOs were initially established to help small hospitals aggregate their purchasing power to negotiate lower prices with suppliers. However, in many cases they have morphed into marketing arms for the dominant suppliers. This is due to the fact that in 1986, Congress created a "safe harbor" from the Medicare anti-kickback statute that permitted suppliers to fund the GPOs. Until that time, GPOs functioned like other cooperatives and were funded by their member hospitals. Being paid by the hospitals better ensured that they acted in the interest of hospitals. The purpose of the GPO safe harbor was to reduce costs

and assist rural hospitals in their purchasing needs. However, the current model perpetuates the opposite effects.

Once the GPOs relied on suppliers to fund their operations, they no longer had any reason to independently review products or the proper incentive to negotiate for the best products at the best price. Dominant suppliers started bundling unrelated products together and pay a higher "fee" (aka kickback) to the GPO in exchange for promoting the bundle, and the GPO's disincentives (financial penalties) to the hospitals for buying any product included in the bundle from a competitor.

In addition, given that the GPOs collect fees based on a percentage of the total contract price, there is no incentive to negotiate lower prices. For example, a GPO generates twice the amount of revenues collecting 5% on a $20M contract ($1,000,000) than it would collecting 5% on a $10M contract ($500,000). The current supplier-funded GPO model actually creates an incentive to increase costs and decrease the number of companies they interact with.

For the most part, only those companies who have had the ability to testify before Congress have seen any relief from these behaviors. Applied had the good fortune to testify before Congress and pressed the GPOs to reform, so these markets have been opened somewhat to us. However, there are countless other smaller companies without these resources and the market is foreclosed. In our case, we have had some success in pockets, but comprehensive and lasting reforms for GPOs and dominant suppliers must occur if the markets are to be truly opened to small companies in general.

Therefore, in order to restore competition in the hospital marketplace, it is imperative that Congress repeal the GPO "safe harbor" from the Medicare anti-kickback statute, reverting back to a hospital funded model that worked for decades before. As renowned Harvard competition expert Michael Porter states in his book, *Redefining Health Care: Creating Value-Based Competition on Results*, "There is no valid reason for buying groups to accept financing or any payments from suppliers: if a buying group adds value, the customers (hospitals) should voluntarily pay for it."

Anti-competitive Activity of Dominant Suppliers

While ending the supplier kickbacks to GPOs would provide a more competitive landscape for smaller companies, additional action is needed to address the anticompetitive practices of dominant suppliers. In today's healthcare system, small companies face markets as closed as a fortified castle, with some GPOs looming as the most treacherous of moats. And, similar to how castles have concentric lines of defense, dominant suppliers have these GPOs as the outermost line closing the way to the market. However, they also engage directly in anticompetitive activities, including predatory practices and bundling. These practices have increased dramatically as the GPOs received some small amount of added scrutiny.

Applied has firsthand experience in being locked out of markets by large conglomerates using predatory practices, even while we offered higher quality and less expensive products. For years, we experienced what it is like to compete against a maintained monopoly that is leveraged to prevent competitive products, related and unrelated, from reaching the customer. We have repeatedly experienced the predatory market powers of giant companies, regardless of their respective market share in the targeted area. Applied and hundreds of other companies have suffered the most from the total absence of oversight and enforcement, while we have been denied access and faced exclusive-dealing arrangements disguised as price discounts.

In the medical device arena, the large players are creating buckets of products that effectively exclude any competitor that doesn't offer exactly the same mix of products, even though these competitors have higher quality and substantially less expensive products competing with individual products in the bundle. And, while it may be true the shoes without shoelaces may be at a competitive disadvantage, shoes without a laptop computer would not be. Let me briefly recount an actual example from the medical device market.

> The eventual monopolist first grouped together all types of surgical sutures – from ophthalmic to cardiovascular and skin sutures, and positioned them into a monolithic "sutures" offering. Initially, this seemed to the customer to reduce prices on sutures. As the monopoly took hold, one entity grew to control in excess of eighty-five percent of all sutures used in U.S. hospitals. I am not contending that creating a monopoly is illegal, but the follow-up predatory practices immediately followed. The creation and maintenance of this particular monopoly was but the starting point.
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> With sutures secure as a monopoly, the list prices of sutures rose to two and three times the average selling price. Following that, the company offered "better prices" (similar to those in effect previously) on the sutures if the customer also agreed to a bundled deal, where unrelated and loosely related products are bundled together. No volume discount is involved, simply a deal where as long as the customer buys virtually all of its requirements for the bundled products, the customer gets the "better prices."
>
> The company argues that the customers can buy laparoscopic instruments, trocars or stapling products anywhere else they choose – but a customer choosing to do so, can see the cost of sutures climb up to twice that of the average selling price, or even three times.
>
> And, here the statistics can be deceiving. By examining the company-wide average selling price, punitive pricing can hardly ever be detected. On the financial statements, the company is certainly making a profit on the whole bundle. Thus, to suggest that one must actually conduct predatory pricing to have an anticompetitive effect is simply nonsense.

> The one behemoth with this monopoly position in sutures was able to propel its position in the non-suture market of trocars from a few percentage points to their monopoly position of 75 percent of trocars, by leveraging its suture business and punishing anyone daring to buy trocars elsewhere with higher prices on sutures.

Interestingly, academicians and regulators, courts and jury, seem to expect the monopolist to be dropping prices to drive competition out. Instead, the monopolist raises the prices of the monopoly product, to effectively punish the customer into submission. Notably, the majority of customers don't feel punished. The nature of the bundle is deceiving, and the customers often think they are getting a great discount.

From the standpoint of the academicians, this monopolist did nothing wrong. After all, the monopolist did not sell sutures at below cost. And, with a cursory look, it appeared they had not sold the bundled products, trocars, below cost. If anything, the monopolist charged more. The shear fact that academicians can look at the situation of "shoes and laptops", where laptops are sold by causing the customer heavy pain with shoe costs, and see no predatory nature, or damage to free markets demonstrates how failure-prone the interpretation of the antitrust laws have become.

If the economists have so dismally failed to see the larger picture, can one expect a lay jury to understand? Can one sincerely expect a younger and smaller competitor to articulate what caused its effort to penetrate the market against the giant to fall flat?

And, in case one may think duopolies are slightly or considerably better than monopolies, it is important to point out that, where duopolies covertly lock steps, the situation is considerably worse than monopolies, mainly because the laws and casual academic observers view the situation as one of fully open competition and free choices. But it is not. Lockstep Duopolies are as insidious as monopolies, and untenable when tied into *quid pro quo* and the lack of enforcement. (For an illustration see Appendix II)

Lack of Oversight and Enforcement

The point here should be clear: our antitrust laws do not anticipate many of these situations, let alone address them. It seems that the economists, often with studies well funded by the dominant firms, and the DOJ do not comprehend this or have been persuaded by the dominant companies. It is true that maintaining or leveraging a monopoly is against the law. But regardless of whether or not we have laws that address these situations, without sophisticated, well financed enforcement, free competition is at risk. The likelihood of successfully explaining such convoluted practices to juries in a court of law is low. Even without the DOJ's accommodating declarations and safe harbors, small businesses have had an impossible time fighting back predatory approaches by monopolies and lockstep duopolies. The new declarations by the DOJ only raise the bar further. A smaller company attempting to expose predatory and anticompetitive practices by a much larger predator finds itself, its record, strategies, financing and product offering under attack. Too often, the victim becomes the accused,

receiving the blame for being smaller and, therefore, presumably less capable and less useful to the consumer. University economists make millions of dollars "studying" the presumed damages or supplying rebuttals to the hypothetical situations.

The current interpretation of antitrust laws indicates that more oversight and enforcement is necessary to achieve a fair, competitive marketplace for hospital purchasing. There are clear-cut situations where the DOJ could have identified and prosecuted violators. Instead, it stood by passively. The *qui tam* cases that have been brushed aside are amazing by themselves. The outing of *qui tam* reporters, as part of the rejection process, is exceptionally alarming. The handling of *quid pro quo* cases through purely financial settlements and deferred prosecution is analogous to a license to steal – pay only a fraction of the take, but only if caught in the act.

Yes, the country, economy, open competitiveness and, most importantly, consumers and patients can benefit from updated laws to deal with antitrust and predatory practices. But that should not mean a continuation of the hiatus on enforcement. To the contrary, enforcement needs to go into overdrive.

Our antitrust laws have been watered down or ignored as present-day approaches instigated by large monopolies and duopolies took hold. The DOJ and FTC must take a more proactive oversight role to protect consumer and promote competition. Unfortunately, the recent DOJ report, *Competition and Monopoly: Single-Firm Conduct Under Section Two of the Sherman Act*, attempts to create additional "safe harbors" for monopolists at the expense of competition, consumers and innovation. This is not the direction the government should be moving. MDMA agrees with the FTC's dissent that the DOJ's position "prescribes a legal regime that places these firms' interests ahead of the interests of consumers." Progressive European and Australian agencies are well ahead of us on these issues, and are often dealing with violators promptly and firmly. Indeed, many MDMA member companies now find Europe to be, in many respects, a much more open and competitive market than in the U.S. We can and must do better moving forward.

Conclusion

The practices outlined above by GPOs and dominant suppliers, individually and in the aggregate, favor and promote the dominant vendors and deprive patients and caregivers access to innovative and lower cost medical technologies, increasing costs of health care. As a direct result, hospitals and the federal government (as a primary funder of health care services) continue to pay more than necessary for often inferior healthcare products and medical services.

By repealing the GPO safe harbor and providing proper oversight and enforcement of dominant firm conduct with consumers interest in mind and not the dominant vendors' interest in mind, we can make great strides in promoting competition, protecting consumers and fixing our healthcare system.

Appendix I

APPLIED IS AN INNOVATOR IN SEVERAL SURGICAL FIELDS

Founded in 1987 and headquartered in Orange County, California, Applied designs, develops, manufactures, licenses, markets, and sells seventeen lines of specialized devices for general, colorectal, obstetrics, urology, laparoscopy, cardiovascular and vascular surgery. Our products are 99 percent manufactured in the United States.

At its inception, Applied recognized that the national trend of rapidly escalating healthcare costs would reach 20 percent of GDP within a decade. This presented a serious national problem and an opportunity for innovative companies that could affect improved clinical and financial outcomes concurrently. Accordingly, Applied's business strategy has been to develop products and practices that enhance performance while reducing the cost of products and procedures. Since 1988, Applied has evolved as a prolific developer of products and technologies that fulfill this dual requirement, resulting in over 650 pending and issued medical device patents worldwide.

Our products have been safely, successfully, and satisfactorily used in many hospitals throughout the globe and for many years. Millions of our devices have been sold and used as testament to their acceptance and performance. Our outstanding record with the FDA also attests to the quality and performance of our products.

Applied maintains one of the highest commitments to innovation and quality in its industry. Over the past decade, Applied has spent 20 percent of its revenues on R&D, resulting in impressive clinical results and financial savings. One example of the results of Applied's investment is our device named GelPort® System, used in advanced laparoscopic procedures to reduce the trauma of open surgery in colorectal procedures. The GelPort product is rapidly expanding the field of minimally invasive hand access surgery. We were awarded Innovation of the Year 2002 by The Society of Laparoendoscopic Surgeons. The Acucise® product is another proud innovation for dealing with ureteral strictures. Peer-reviewed clinical papers attest to the fact that the Acucise® product eliminated hospital stay, reduced costs by $14,000 per procedure and replaced a 210-minute surgery under anesthesia with a 42-minute minimally invasive procedure under sedative and achieved a hundred percent success rates in secondary procedures. Applied also has introduced new generations of atraumatic, minimally invasive surgical devices for occluding blood vessels and grasping tissue, and has eliminated sometimes life-threatening latex from its products.

Applied's trocar seal technologies set the standard for seals used in minimally invasive surgery and are utilized in the majority of trocars currently on the market. The Applied trocars were the first to accommodate instruments with a wide range of diameters to traverse the seal without adaptors, leakage or excessive friction. The patented seal technologies developed by Applied have resulted in real improvements in patient care in minimally invasive surgery by reducing time in the operating room and improving surgeon control during the procedure.

Applied introduced the Separator™ product, a new generation of access products that uniquely separates the abdominal wall layers along their natural lines without the use of traumatic plastic or metal blades.

Appendix II

One may believe duopolies are slightly or considerably better than monopolies. However, it is important to point out that, where duopolies covertly lock steps, the situation is considerably worse than monopolies because the laws and casual academic observers view the situation as one of fully open competition and free choices. This is, however, not the case. Lockstep Duopolies are as insidious as monopolies, and untenable when tied into *quid pro quo* and the lack of enforcement. Here's an illustration:

> Assume that Duopoly A will grant the customer 60 percent discounts off its exaggerated list price for buying 70 percent of volumes from Duopoly A. Suppose also that Duopoly B penalizes the same customer by charging its exaggerated list price for the customer's remaining 30 percent of volume. In such a situation, Duopoly A makes a good sale, capturing 70 percent of the units. So does Duopoly B, making perhaps 70 percent of the dollars spent by that customer, while providing only 30 percent of the volume. The customer is often in a terrible situation of being caught between the two duopoly providers.
>
> Can the hospital switch from Duopoly A to Duopoly B? Of course, but now, 30% or more is purchased at the inflated list price from Duopoly A instead of Duopoly B. Can the hospital standardize on one supplier? Of course, except that, in some situations, *quid pro quo* and surgeons pounding the table to demand their product from their sponsoring buddies makes such unanimity next to impossible in most cases.
>
> In some cases where Applied earned the trocar business, Covidien (previously Tyco Corporation, Bahamas) raised the prices on stapling products anywhere from 17 percent to 366 percent above the previous price. This is supposedly while facing severe competition from the other duopoly player who claims the balance of the market share in stapling products. Volumes and volume efficiencies in no way justify such fluctuations in pricing. The other half of the duopoly obviously did not present any relief to the beleaguered customer.

TESTIMONY SUBMITTED

BY

AUTOMOTIVE AFTERMARKET INDUSTRY ASSOCIATION

And

COALITION FOR AUTO REPAIR EQUALITY

REGARDING

SMALL BUSINESS COMPETITION POLICY: ARE MARKETS OPEN FOR ENTRPRENEURS

BEFORE THE HOUSE SMALL BUSINESS COMMITTEE

September 25, 2008

The Automotive Aftermarket Industry Association (AAIA) and Coalition for Auto Repair Equality (CARE) are pleased to submit the following testimony for your September 25th hearing entitled Small Business Competition Policy: Are Markets Open for Entrepreneurs.

AAIA is a Bethesda, Md.-based association whose more than 23,000 members and affiliates manufacture, distribute and sell motor vehicle parts, accessories, service, tool, equipment, materials and supplies. Through its membership, AAIA represents more than 100,000 repair shops, parts stores and distribution outlets.

CARE is a national, nonprofit organization representing the automotive aftermarket. CARE's underlying role is to ensure that consumers nationwide receive safe, affordable and convenient vehicle repair and service. CARE's membership is comprised of approximately 20,058 vehicle repair facilities and 14,762 auto supply and accessory retail locations nationwide.

The aftermarket represents everything that happens to a car once it leaves the new car showroom. While not as well known as the vehicle manufacturers, our industry had over $285 billion in sales in 2007, contributed 2.2 percent to the nation's gross domestic product annually and employs nearly 5 million people. However, more importantly, our industry helps keep America on the road by providing car owners with affordable, effective and convenient vehicle repair. Not only are our services important so that Americans can get to work or take their kids to soccer games; but we also help keep our highway's safe by maintaining a vehicle's critical safety systems and reduce global warming emissions by ensuring that today's complex engines are operating at their peak efficiency.

Since the invention of the vehicle, the U.S. has had the most competitive vehicle aftermarket in the world. Americans currently have a wide array of choices in vehicle repair, whether it's going back to the location where they purchased the vehicle or to thousands of independent vehicle repair shops that are in every community in the Nation. This competition has kept car owners and not the vehicle manufacturer in the driver's seat when it comes to making choices regarding vehicle repair destinations.

Thus far, car owners have overwhelmingly chosen the independent service industry once their warranty has expired. Most surveys indicate that 70 to 75 percent of car owners prefer independent service facilities over new car dealers based on price, trust and convenience. In their May of 2008 issue, Consumer Reports reported that "independent shops generate a higher level of overall satisfaction than dealerships." The publication cited a nationwide survey that found 71 percent of respondents who took their vehicle only to independent shops for repair service were very satisfied with the experience. This compared with just 53 percent who were very satisfied using new car dealers for repairs. I have included the article as an attachment to our testimony.

While we are proud of our service to the American motoring public, we are extremely concerned that the dynamics of the market are changing and that our independent shops are being placed at a competitive disadvantage. This change has nothing to do with the efforts that our independents are investing in servicing the public, but rather attempts by car companies to use technology to obtain a competitive advantage for their dealer network, an advantage that dealers have been unable to gain through customer service or price. Left unchecked, we will soon see the car companies controlling the decision as to where a car is repaired and not the person who purchased the vehicle, further squeezing consumers.

The U.S. Congress foresaw the role technology would play in the repair market back in the late eighties when the Clean Air Act was being debated. The Act required that car companies equip their vehicles with on-board diagnostic (OBD) systems that would monitor the emissions system and alert the car owner to an emissions defect. While it was anticipated that these OBD systems would ensure that a vehicle would pollute less while they were on the road, then Senator Albert Gore (D-TN) and Rep. Henry Waxman (D-CA) were concerned that car companies would keep access to this technology as proprietary, using it to prevent independent service facilities from competing for the repair of late model vehicles. Therefore, provisions were added by Senator Gore and Rep. Waxman into the 1990 Clean Air Act Amendments that would require that the on-board computers be accessible without the need for proprietary tools and that any information needed to repair the emissions system be made available to the independent aftermarket. While this provision did permit car companies to retain their trade secrets, the legislation specified that no information may be withheld if that information had been provided directly or indirectly to the new car dealer.

The regulations promulgated by the U.S. Environmental Protection Agency as a result of the Clean Air Act service information provisions have required the development by car companies of web sites that contain valuable emissions related service information. In addition, the law has required that the car companies make emissions related diagnostic tools available to independents that are critical to the proper repair of late model computer controlled vehicles. However, the gains made by the Act are tempered in the last several years by the fact that the computers, now being installed on vehicles, go well beyond emissions--monitoring and controlling nearly every function of the vehicle from safety to entertainment. Further, new technologies are coming quickly down the pike that could provide vehicle manufacturers with even more of a competitive advantage when it comes to repairing a customer's vehicle.

Of particular concern for the future is the advent of telematics. Utilizing wireless technology, telematics will permit a vehicle to transmit information from OBD systems to the car company while the vehicle is moving down the road. Information could include fault codes, vehicle mileage and location of the car. Armed with this data, new car dealers will be able to inform the car owner of the need for a particular service such as a brake repair, and set up an appointment to have that service undertaken at their service bay. The dealer further would have advance knowledge of the vehicle fault, the ability to diagnose that fault and have the tools, parts and information ready to go—

before the vehicle has even arrived at the dealer facility. Not only will telematics give the dealer a major marketing advantage, but they also will be able to maximize the efficiency of their service bays.

Please be clear, that we are not attempting to stop the use of this technology or any technology that improves the car owner's experience, safety or reduces harmful emissions. However, once a car owner spends his or her hard earned money to purchase a car, they should have the right to decide where it is serviced and where any information that is transmitted from the car regarding vehicle diagnosis or repair is sent, whether its the dealer or the shop near their home or business where they prefer to go.

It is with this in mind that AAIA, CARE and a number of consumer groups have strongly supported passage of the Motor Vehicle Owners Right to Repair Act (HR 2694). Introduced by Rep. Edolphus Towns (D-NY) on June 13th, 2007, right to repair ensures that all information and tools provided to the new car dealer by the car company is also made available to the independent aftermarket. The information would not be available for free, but would be provided by the car company at a fair and reasonable price. This bill would not prohibit new technology, but rather, similar to what Rep. Waxman and then-Senator Gore were attempting achieve in the Clean Air Act, ensure that use of advanced technologies on vehicles would not be used to the detriment of competition in the aftermarket and in the end the car owner as well.

Car companies have strongly opposed passage of right to repair based on two contention: one, that all of the information is already available and that "this is a solution in search of a problem"; and two, that this is a veiled approach by the independent aftermarket to obtain the trade secrets of the car companies.

AAIA does not dispute the fact that car companies have done a better job in making information and tools available to our industry. However, much of this progress has not come due to their willingness to ensure competition for their customers, but instead EPA's service information regulations and the political pressure that has been brought on them by consideration of right to repair legislation.

Should Congress ultimately decide not to enact right to repair legislation, we have little doubt that the car companies will be under extensive commercial pressure to cut the aftermarket out of any access to information. Car companies and their dealer franchises are now making significantly more money through the sale of parts and service than they are through the sale of new vehicles. According to the National Automobile Dealers Association (NADA), even though dealership parts and service department sales comprise just 11.8 percent of typical dealer's total sales, it contributes 48 percent of the total operating profit. New car sales make up 60 percent of total sales, but only contribute 35 percent of total profit. Absent legislation, the need by the car companies and their dealers to maximize profits from parts and service will override, in the long run, any current cooperation we have been receiving.

Car companies have pointed to the establishment of the National Automotive Service Task Force (NASTF) which they claim is aimed at resolving any issues related to the availability of service information or tools to our industry. However, this is a voluntary organization and it is important to remember that there is no legal requirement that the car companies must comply with any determinations made by NASTF. In fact, all NASTF does is take information requests from our industry and funnel them to the appropriate car company. Once the request is with the manufacturer, it is totally at the discretion of the car company as to whether to make that information available to the independents. Further, the time necessary for the car companies to respond to the information request of an independent varies considerably, often taking weeks and months. If a shop has a car in its service bays, they normally do not have the luxury of waiting that long to resolve a compliant. Therefore, currently NASTF is not used extensively by the industry and is not, in our opinion, the answer to the right to repair issue.

Considering the commercial interests at stake and the need to preserve competition, Congress must consider right to repair legislation that would legally bind car companies to make all information and tools available to independents. Any other voluntary agreement with no legal ramification will put the small independent shop at the mercy of the large vehicle manufacturers and their powerful new car dealer franchises.

As to their allegations that the industry is looking for access to their trade secrets, one only needs to look at the composition of the vehicle aftermarket to understand why this is not true. Many of the companies that produce parts in the vehicle aftermarket are the same companies that supply the car companies with their original equipment parts. In other words, the part that is in the aftermarket box may be the same as the part that that is in the original equipment box, just the label is different and the cost can be up to 50 percent less. In fact, the independent aftermarket often has the ability to improve on the part sold by the car companies based on the in-use experience of that part on the vehicle.

Further, and maybe most importantly, the bill provides significant protections for the car companies trade secrets, only requiring them to make available to the aftermarket the same information that they make available to their dealer network. This language is similar to provisions protecting car company trade secrets in the service information requirements in the Clean Air Act. It is important to note that since their promulgation in the late nineties, there has never been an intellectual property dispute regarding EPA's requirements for emissions related information or tools. We do not see this situation changing with the implementation of right to repair legislation.

Madam Chairwoman and members of the Committee, America's car owners are already being hit with much higher energy costs which are making it more and more difficult to use their vehicle for even the most basic necessities, such as going to work and shopping for the families. Should a competitive repair market disappear, car owners will find the cost of car ownership shooting up event further, with little benefit to the economy, the air, or our dependence on foreign oil. While it is unlikely that this current Congress will take action on HR 2694, AAIA and CARE stands ready to work with this committee to

further increase awareness in Congress as to the impact these issues will have on the Nation's small businesses and ultimately on the consumer.

Thank you again for the opportunity to submit testimony and we are open to respond to any questions that the committee might have regarding this issue.

Auto service Owners prefer independents

Many drivers wonder whether to take their cars to a dealership or to an independent shop for repairs and maintenance. Dealerships tout that they're specialists and trained specifically for a certain brand of car. But independents are generally less expensive. How to decide?

New information shows that independent shops generate a higher level of overall satisfaction than dealerships. According to a recent survey of car owners by the Consumer Reports National Research Center, 71 percent of respondents who took their vehicle only to independent shops for repair service were very satisfied with their experience. This compares with just 53 percent who were very satisfied using new-car dealers for repairs.

While the overall gap in satisfaction between the two was 18 percentage points, it varies dramatically by auto brand. The difference for Infiniti and Lexus owners was eight percentage points. By contrast, Volkswagen owners preferred independents by a whopping 27 percentage points.

Among dealers, Acura and Lexus tended to generate the most satisfying repair experiences. Still, even those owners were happier with independent shops. At the other end of the scale, Volkswagen and Mitsubishi owners were much less satisfied with their dealers' repair service.

Respondents we followed up with cited better, more personal service from independents.

"When I first moved to the area, I went to the dealer and felt I was told I needed a lot of work that wasn't necessary," said Philip LaBella, of Stockerton, Pa., who participated in the survey. But when he drove his 2003 Jeep Liberty and 1999 Oldsmobile Intrigue to a small shop, he said he was given advice such as, "This is what you need. Maybe you can wait on that."

Michael Burandt, of Cleveland, another survey respondent, says he has been unhappy taking his 2003 Chrysler PT Cruiser to a dealership. "I think they charge a really high rate compared to other places." Burandt says he goes to independent shops but will make an exception and go to the dealership for recall or warranty work.

There were bigger differences in satisfaction between dealers and independent shops for repair work as compared with routine maintenance. That's probably because repairs can be more costly, complex, and aggravating than maintenance.

How satisfied?

For every car make in our survey, respondents were more satisfied with independents than dealers for repairs. Data are based on almost 100,000 vehicles taken to new-car dealers and almost 46,000 taken to independent shops in the 12 months prior to the spring 2007 survey. When comparing dealer scores, differences of fewer than 8 points aren't meaningful. Ranked by dealer score.

Very satisfied with repair work

Make	New-car dealer	Independent mechanic
Acura	64%	74%
Lexus	64	72
Scion	61	[1]
Buick	61	75
Cadillac	61	74
Honda	58	73
Infiniti	58	66
Saturn	58	72
Porsche	58	[1]
Pontiac	57	72
Mercury	57	70
Saab	55	68
Lincoln	55	74
Chevrolet	55	71
Subaru	54	72
Toyota	54	72
Hyundai	53	68
Volvo	53	73
GMC	52	70
BMW	51	70
Jaguar	50	[1]
Mini Cooper	50	[1]
Ford	50	69
Mercedes-Benz	49	69
Mazda	49	67
Dodge	48	71
Chrysler	48	72
Audi	48	67
Nissan	47	69
Jeep	47	69
Kia	46	66
Land Rover	46	[1]
Mitsubishi	44	66
VW	42	69
Overall	**53**	**71**

[1] *Insufficient data.*

7 tips for service satisfaction

Shop around. Service prices can vary dramatically, even among dealerships of the same make.

Check your manual. When taking in your car for routine maintenance, use your owner's manual to see which services need to be performed at specific mileage intervals. Make sure the dealer or shop doesn't add extras to pad the bill.

Get a quote. Don't allow a shop to do any work without you first approving an estimate for the job.

When a dealer is best. Go to a dealer for warranty repairs, recalls, and "service campaigns," in which the automaker offers to correct a defect. Also consider a dealer for a system that's exclusive to the car's brand—especially electronics.

Look for a specialist. Independent shops that specialize in your vehicle's make are more likely to have the proper training and equipment.

Does the shop get updates? Make sure the shop gets the automaker's service bulletins, which tell mechanics how to fix common problems with a model.

Be specific. Tell the service writer or mechanic when the problem started, whether it happens only in certain conditions, and any associated noises, smells, or vibrations.

ILLUSTRATION BY MICHAEL KLEIN

Section 5 of the Federal Trade Commission Act:
The Most Powerful Weapon Against Competitive Threats

Testimony of William C. MacLeod
Kelley Drye & Warren LLP
Before the U.S. House Committee on Small Business
September 25, 2008

Chairwoman Velázquez, Ranking Member Chabot and Members of the Committee, I thank you for the opportunity to testify today on ***"Small Business Competition Policy: Are Markets Open for Entrepreneurs?"*** My name is William MacLeod, and in my legal practice I represent many thousands of small businesses, both directly and through their trade associations, throughout the United States. I am also a veteran of the Federal Trade Commission, where I served as Director of the Midwest Regional Office and the Bureau of Consumer Protection. I am not testifying today for any client. Instead I am offering this statement for what benefit these may be from my experience outside and inside the agency.

Even if no other witness has said this directly, the record of this hearing should make one point abundantly clear – the most sweeping authority to protect competition in the United States belongs to the Federal Trade Commission with its power to prohibit unfair methods of competition and unfair acts and practices. This authority has been characterized as the power to intervene in the economy wherever three Commissioners believe they can improve the performance of a market. The Commission has wielded this authority against both titans of industry and corner stores. Big oil companies and small car dealers have felt the sting of Section 5.

The Commission's authority to prohibit unfairness has inspired some commentators to call the Commission the second most powerful legislature in the country. The Commission's more controversial initiatives under Section 5 have raised questions whether the agency had gone beyond protecting consumers and competition, and was pursuing some other objective instead. Getting it right is important, because interventions in markets are seldom neutral for competition; if the intervention does not help, it could do damage. It could hurt small businesses, consumers, and the competition that the Section 5 is intended to protect.

Not surprisingly, the Commission's exercise of its authority has been the subject of frequent Congressional oversight and occasional statutory limitations. The Committee should be commended for continuing this review during this hearing today. If I could distill my testimony to three main points they would be these, and I list each with an important implication:

1. Section 5 gives the Commission more than enough power and flexibility to confront conceivable threats to free and competitive markets that are critical to the vitality and growth of small businesses.

    (a) Grants of specific authority to the Commission ironically can undermine its effectiveness.

2. The size of the Commission's staff is the most binding limitation on its ability to protect entrepreneurs and small business.

   (a) Attorneys tied up in rulemaking proceedings are not out there prosecuting the bad actors.

3. The primary challenge to the Commission is to focus its attention on the worst threats, and the worst threat to entrepreneurs and small business is the barrier to entry.

   (a) Good Section 5 enforcement lowers those barriers; bad enforcement can raise them.

A Brief Background

During my nearly eight years at the Commission, I had the privilege and the responsibility to see that the Commission applied Section 5 where it was needed, and to resist the use of Section 5 where it could get in the way of healthy competition. We brought some of the more conventional and some of the more controversial cases in the Commission's history. We used our authority to open up long-protected taxi systems to new entrants and competition.[1] We invoked Section 5 to stop the sale of equipment that stole television signals,[2] and we used it to stop a company from breaching contracts with thousands of consumers.[3] My tenure at the Commission was called the era of unfairness by one prominent scholar.[4] Since then, the Commission has used its authority in many other ways, as previous witnesses have described. The wide range of cases stems from an extraordinary grant to authority.

The landmark case that confirmed the Commission's latitude to determine what was unfair was the Supreme Court decision against the company that distributed the popular S&H trading stamps. The Commission found S&H's distribution practices to be unfair methods of competition. When S&H appealed and the case reached the Supreme Court, the agency argued that it did not have to find that the conduct in question violated the letter or spirit of the antitrust laws – competition could be unfair under Section 5 *independently.*[5] The Court agreed, holding that unfairness depended on these factors:

> (1) "Whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law ... or other established concept of unfairness;"
>
> (2) "whether it is immoral, unethical, oppressive, or unscrupulous;" and

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1 *City of New Orleans*, Dkt. 9179, 105 FTC 1 (1985); *City of Minneapolis*, Dkt. 9180, 105 FTC 304 (1985).

2 *C&D Electronics* (Docket No. C-3212) 1986.

3 *Orkin Exterminating Co., Inc.*, 108 FTC 263 (1986); aff,d., *FTC v. Orkin*, 849 F.2d 1354 (11th Cir. 1988).

4 Stephen Calkins, FTC Unfairness: An Essay, 46 Wayne L. Rev. 1935 (2000).

5 *FTC v. Sperry & Hutchinson Co.,* 405 U.S. 233 (1972).

(3) "whether it causes substantial injury to consumers (or competitors or other businessmen)."[6]

A decision like this would invigorate any agency, and it lit a fire under the Commission.

Adding to the fuel of *S&H,* Congress gave the Commission new authority to write rules, and the Commission proposed over two dozen industry-wide rules from 1971 through 1980.[7] One Chairman of the agency hinted at potential rules to prohibit businesses from hiring illegal aliens, to prevent companies from cheating on taxes, and to require companies with repeated environmental violations to place an environmentalist on their Boards.[8] The most notorious rulemaking of all was one to ban advertising to children. It was not long before members of Congress were hearing from many of the small businesses in their districts – all complaining about new rules and proposals that would make it more difficult for them to compete and make it more difficult for consumers to get what they wanted. In short, the Commission had managed to alienate the constituencies it was supposed to protect.

I arrived at the agency when it was still recovering from a hangover of wild experiments enforcing its unfairness authority. In addition to the proposed rules, the Commission had tried to use Section 5 to dismember cereal companies because they allegedly shared a monopoly, whatever that means.[9] Wisely, the agency abandoned that case. In another case, the Commission was urged to hold that Section 5 prohibited price cutting that offended neither the Sherman Act nor the Robinson Patman Act.[10] Again, the agency wisely declined. And the agency ultimately abandoned many of its rulemakings intended to regulate or ban advertising as an unfair practice. With the help of Congress and the courts, the Commission came to recognize that advertising can actually be beneficial to competition and consumers.[11]

Even after the Supreme Court's green light in *S&H*, the Commission found skeptical appellate courts when it tried to exceed settled limits in the antitrust laws. One Court of Appeals tossed out a case seeking to prohibit parallel-pricing that did not arise to an illegal conspiracy under the Sherman Act.[12] Another Court overturned a Commission decision that took issue with a company that had kept resale prices at suggested levels by refusing to deal with retailers who

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6 *Id.* at 244 (citing Unfair or Deceptive Advertising and Liability of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. at 8355).

7 *See,* MacLeod, et al., "Three Rules and a Constitution: Consumer Protection Finds Its Limits in Competition Policy," *Antitrust Law Journal* (No. 3), 2005.

8 Timothy J. Muris & J. Howard Beales, THE LIMITS OF UNFAIRNESS UNDER THE FEDERAL TRADE COMMISSION ACT 14 (Ass'n of Nat'l. Advertisers, Inc. 1991).

9 *See* How History Informs Practice – Understanding the Development of Modern U.S. Competition Policy, Prepared Remarks of Timothy J. Muris, Chairman, Federal Trade Commission, Before American Bar Association Antitrust Section Fall Forum Washington, DC November 19, 2003

10 *General Foods Corp.*, 103 FTC 204 (1984)

11 *See,* MacLeod, *supra*, note 7.

12 *EI du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984)

did not follow the suggestions – a practice the Supreme Court had long allowed.[13] Yet another decision held that the Commission could not regulate the business of a dominant company that had committed no illegal acts to achieve its position.[14]

The Commission's record in court is better today than in the 1970s, but courts sometimes still question the Commission's prosecutions under Section 5. For example, the Commission failed to survive appellate review when it tried to invalidate advertising restrictions enforced by a dental association,[15] and failed again when it tried to prevent companies from charging for patents that it found the company had agreed not to assert in a standard setting organization.[16]

At times, even the Commissioners themselves disagree on the merits of an action. In another standard-setting case involving an alleged attempt to collect royalties for patent rights after failing to disclose them in the standard-setting context, the Commission held that the company had committed both an unfair act and an unfair method of competition.[17] The majority looked to the *S&H* case for its broad statement of the Commission's power:

> The Supreme Court ... found that the standard for "unfairness" under the FTC Act is "by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons." *FTC v. Ind. Fed'n of Dentists,* 476 U.S. 477, 454 (1986); *see also FTC. v. Sperry & Hutchinson Co.,* 405 U.S. 233, 242 (1972) (FTC has authority to constrain, among other things "deception, bad faith, fraud or oppression").

In dissent, Chairman Majoras, and then Commissioner (and now Chairman) Kovacic argued that the evidence did not support the "deception . . .oppression" that the majority was seeking to stop.[18] This case settled, so we will not know whether a federal court would have agreed with the majority or the dissent.

Section 5 is a Broad Mandate

There are many more examples, but this short summary of a cases and controversies involving the Commission's enforcement of Section 5 should be adequate to demonstrate my first point: the scope of the authority described by the Supreme Court in *S&H* is broad enough to handle any threat that might arise to entrepreneurs, small businesses and the freedom they need to compete. The real challenge for the Commission is to channel that force wisely. Of course, most of the cases the Commission has brought are well within the boundaries of its authority.

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13 *Russell Stover Candies v. FTC,* 718 F.2d 256 (8th Cir. 1983).

14 *Official Airline Guides, Inc. v. FTC,* 630 F.2d 920 (2d Cir. 1980).

15 *California Dental Ass'n v. FTC,* 224 F.3d 942 (9th Cir. 2000).

16 *Rambus v. FTC,* No. 07-1086 (D.C. Cir. 2008).

17 *In the Matter of Negotiated Data Solutions LLC.,* FTC File No. 051 0094.

18 Dissenting statement of Chairman Majoras, Dissenting Statement of Commissioner Kovacic, *available at* http://www.FTC.gov/os/caselist/0510094/index.shtm.

And most demands for action call for a straightforward prohibition of harmful practices and unfair methods of competition that everyone would acknowledge.

This illustration of the Commission's authority also provides the corollary to my first point. It is hard to imagine an agency today getting a grant of authority as broad as that which the Commission received almost a century ago. When the Commission gets special powers today, these are typically narrower than the unfairness authority the agency already possesses. And these replacements of the Commission's fundamental mandate can contribute to the atrophy of Section 5.

Whenever an agency is given a specific grant of authority over a certain industry or a certain practice, it is natural for the agency to use that authority. If that agency is the Commission, a new power means that the power and precedent of unfairness cases will be one step removed from the enforcement of the new authority. Unfairness may still inform the exercise of the new authority, but the tradition of Section 5 – the *stare decisis* – will no longer control. Instead of applying nearly a century of understanding of Section 5, a new statute can put Commission cops on a beat with rules they never enforced. An agency learning how to enforce rules it has just acquired may not be as effective as the enforcer wielding a familiar weapon.

Resources Constrain the Commission

The summary of cases also illustrates my second point. The limits of Section 5 do not lie in the imagination of the officers sworn to uphold it. A far more pressing limit is the number of officers available to patrol the market and prosecute those who try to distort it for their own gain. In my day at the Commission, there was no higher calling than to ferret out the great case, to stop the wrong-doer, to protect the consumer and the market. I know many of the people at the Commission today, and that same dedication pervades the institution. They are eager for the next tip that will turn into the next case.

Of course, resources are limited, and the budget of the Federal Trade Commission cannot stand as an exception. However there is one way to enhance the law enforcement resources of the Commission without spending a dollar of additional funds – that is to relieve the Commission of the obligation to write new rules to implement new mandates that it receives. The agency has devoted considerable resources in the last few years writing rules to regulate behavior that was already understood to violate Section 5.

A good example of the paradox of granting new authority to the Commission can be seen in the recent rulemaking on oil price manipulation. In the Energy Independence and Security Act of 2007 (EISA), Congress gave the Commission the authority to promulgate regulations dealing with deception and manipulation in oil markets. There is little doubt that Section 5 gives the Commission all the authority it needs to investigate deception and manipulation in these markets. In fact the agency had conducted intensive investigations of the practices at many levels of energy supply and distribution. Today, FTC officials who could be investigating and bringing cases are proposing rules, reviewing comments, revising proposals and preparing justifications for their interpretation of the new statute. The immediate effect of the EISA has been to take cops off the beat and to turn them into rule writers. The next effect will occur when

the Commission goes back onto the beat and brings the first cases under the new statute. The prosecutions will be cases of first impression, rather than the latest cases drawing upon a century of enforcement. Given the uneven history of the agency working with new authority, we will have to wait years before we know whether the new rules protect competition, businesses and consumers, as well as the familiar standards of Section 5.

Testing the Effectiveness of Enforcement

The final point that I would like to leave with the Committee is to emphasize what I believe to be the best and most valuable use the Commission could make of its authority with Section 5. The Commission must focus its law enforcement on matters that affect the public. The agency does not have the resources to take sides in every private dispute, no matter how appealing the case. Determining which cases merit the Commission's attention – which cases matter most to the economy – is a critical task for the agency to perform. In every case the Commission brings, we should ask whether the case is worthy of the resources committed to the agency.

Every intervention the Commission undertakes should pass a cost-benefit test. The Commission should not bring a challenge unless the costs of the targeted practices exceed the benefits. And the Commission should not impose a remedy unless the benefits of its solution exceed the costs of the order. To be sure, some practices are so unlikely to have any benefits that they are condemned per se, without needing a cost-benefit test. Naked price fixing is a well known example. Such cases are rare at the Commission, however; they are more likely to fall within the province of the Department of Justice. The more complex cases the Commission brings typically require competitive analysis.

Of course, only the Commission has the information to perform a full cost-benefit test. In most cases, Commission observers must employ a proxy. Antitrust law has long recognized that monopolies and cartels cannot survive if they cannot protect themselves from new competitors. Virtually every lasting injury inflicted on a market and on consumers is also an assault against the entrepreneur and the small business that desires to compete for customers of the entrenched sellers. The *sine-qua-non* of unfair competition – whether practiced by a closed circle of colluding providers or an unscrupulous giant that destroys rivals – is the barrier to entry. It is the most direct obstacle to small business. Commission cases should pass the entry-barrier test – is the prosecution likely to lower barriers that stymie small businesses and entrepreneurs from entering a market? If so, the odds are good that the Commission has helped competition and consumers. If not, the Commission has probably wasted its resources, or worse, tilted the market away from efficient practices.

Sometimes, we may not even know enough to tell whether a case passes the barrier-lowering test. The debate among the Commissioners in the *N-Data* case revolved around this very issue. The dissenters argued that the practice condemned by the Commission was unlikely to have a competitive effect – i.e. raise significant costs to competitors. Unfortunately, the majority did not cite facts that rebutted the dissents. Instead, the Commission referred to facts that it declined to reveal, suggested that the practice had the *potential* to deter entry, but rested its decision on the desirability of transparency in standard setting. That may be a worthy goal, and

may be on that satisfies the subjective standards of S&H, but *N-Data will* remain a rare case that does not tell us whether the Commission had the facts to pass the critical cost-benefit or the entry barrier proxy for it.

Most of the time, however, the proxy I propose can typically be applied to a case on the basis of the information that is made public. Many of the Commission's excesses of the 1970s would have put burdens on companies without compensating benefits for consumers or competition. Small companies would have borne more than their share of these burdens. Many of the Commission's efforts today are designed to reduce those burdens and tear down those barriers. For that we should commend the Commission.

In conclusion, the most effective enforcement of Section 5 of the Federal Trade Commission Act is the prosecution that breaks down the barriers that protect the privileged few from the external forces of innovation and energy. The most wasteful enforcement of Section 5 is the intervention that makes it more difficult for the forces of innovation and energy – the small businesses of the United States – to displace the privileged few. Section 5 gives the Commission the authority to do both. We depend on the wisdom of the Commission, and on the oversight of Congress, to see that the Commission keeps Section 5 on the side of competition.

This concludes my testimony. Thank you, again Chairwoman Velázquez, Ranking Member Chabot and Members of the Committee.

Comments to U.S. House of Representatives
Small Business Committee Counsel
Attention: Erik Lieberman

Submitted by Bill Kolter, Corporate Vice-President, Government Affairs, Public Affairs, and Corporate Communication
Biomet Inc.
October 2, 2008

Biomet, Inc. respectfully submits these comments to the U.S. House of Representatives. Biomet, Inc. is a manufacturer of medical devices for total joint replacement, dental reconstruction, trauma/fracture fixation, spinal disorders, cranio-maxillofacial reconstruction, sports medicine, and cell factor and biologics delivery. The company is headquartered in Warsaw, Indiana.

Group purchasing organizations (GPOs) are an oddity in the U.S. healthcare system. The federal government has gone to great lengths to ensure that clinical decisions are not tainted by financial incentives, enacting the Stark laws, the Civil Monetary Penalties, and the Federal Anti-Kickback Statute. Most recently, both the House and Senate have introduced legislation requiring disclosure of payments to healthcare providers by manufacturers of pharmaceuticals and medical devices, in order to provide greater transparency to the relationships between medical companies and healthcare providers.

Thus, it is quite odd, given the multiple statutory safeguards Congress has constructed to protect patients from undue financial influence on healthcare providers, that large device manufacturers are allowed to buy access to large groups of hospitals—and shut out competitors—by contracting with GPOs, which pay hospitals that "comply" by using the manufacturers' devices with pre-determined frequency.

In any other business, this would be considered restraint of trade. In the U.S. healthcare system, it is called a "safe harbor."

The stated purpose of a GPO is to expand the buying power of hospitals by grouping them into a large organization, and using the leverage of larger volume to negotiate discounts with manufacturers. The mechanism by which GPOs accomplish this is to limit the number of manufacturers with which they contract. Fewer manufacturers means higher volume for the chosen few, and potentially translates into deep volume discounts from those manufacturers. So far, so good.

However, GPOs throw in an interesting wrinkle: they charge the manufacturers a percentage of the volume of the contract. This is called an "administration fee." The GPO then pays a portion of the administration fee back to the hospitals based on the volume of contracted product used. The higher the percentage of procedures performed with the contracted products, the greater the payout to the hospital.

In effect, the manufacturer is indirectly paying hospitals to use higher volumes of its products. This would be illegal if done without the "safe harbor" of the GPO. The GPO, of course, retains a portion of the fee in exchange for negotiating discounts that theoretically would not be available to its member organizations.

This process lacks transparency; no portion of this arrangement must be publicly disclosed. As a result, patients have no knowledge whatsoever that hospitals have strong incentives to use products chosen by GPOs (as opposed to their surgeons), which are paid handsomely for limiting patients' and surgeons' choice of implants.

The clinical performance of the products chosen is, at best, a minor consideration. GPOs are not qualified to evaluate the relative clinical merits of products. Morevoer, in our experience, GPOs never inquire about clinical performance or any other attributes of medical devices.

Do these discounts in fact materialize? Not necessarily. GPOs lose money if the chosen manufacturers' dollar volume goes down in a hospital, because they are paid a percentage of that dollar volume. So their incentive is not true cost savings for the hospital, but big volume and high prices for the chosen few manufacturers. In fact, it is questionable that GPOs represent hospitals' best interests at all. It appears that GPOs represent the interests of a small handful of chosen manufacturers. How arrangements like this reduce costs in an overtaxed healthcare system is a mystery. It is even more of a mystery why the government has chosen to bless them with a "safe harbor."

Indeed, if GPOs provided true value to hospitals, logic dictates that hospitals would happily pay for their services. Instead, GPOs charge manufacturers and pay hospitals. This is a counter-intuitive structure that appears to be more of a "pay to play" arrangement that payment for real value.

The government has consistently promoted the concept that manufacturers must pay no more than fair market value to healthcare providers for services rendered. A GPO is not a healthcare provider, as such; it is a conglomeration of providers, which is a tenuous distinction at best. What is the fair market value to manufacturers for buying access and for locking out competitors? If the government is going to retain a safe harbor which allows manufacturers to buy access to hospitals through administration fees, shouldn't it provide some guidance on what the fair market value is for that access, and for denying access to competitors?

The fact is that the concepts of fair market value and "administration fees" are at complete odds with each other. Economic theory and antitrust laws tell us that there is nothing "fair" about paying for access and to lock out competitors. Of all the industries to which the government could have applied a safe harbor of this sort, healthcare would seem to be the least likely candidate, given the stakes involved and the efforts undertaken to eliminate financial inducements and to increase transparency in healthcare.

Do volume-based contracts affect the quality of patient care? Ask Kathleen Davis. She was a victim of a volume-based contract. The hospital, Iowa Health Systems, pressured her doctor to use a device provided by a manufacturer which had a volume-based contract with the hospital. The hospital received significant monetary benefits from this manufacturer if it hit its volume targets for device usage. The doctor felt that the device was not appropriate for the patient, but succumbed to the pressure. Complications and two corrective surgeries resulted, with the surgeon finally using the device he would have preferred in the first place. (Des Moines Register, October 23, 2004).

It is interesting to note that individual companies with multiple hospitals, such as a four-hospital group in Florida, are calling themselves GPOs and attempting to charge manufacturers administration fees, which is perfectly legal under the safe harbor. If the safe harbor persists, will we see as few as two hospitals creating a "GPO" and paying themselves for restricting access to medical devices? At what point does the safe harbor end and the Anti-Kickback statute begin?

Finally, we continually hear that Medicare officials are concerned about incentives for overutilization. It seems inconsistent to leave intact a safe harbor which provides incentives to hospitals and GPOs for higher volume usage of medical devices.

We urge Congress to repeal this counter-productive and anti-competitive safe harbor, which creates a real threat to patient care.

Testimony of David A. Balto,
Senior Fellow, Center for American Progress Action Fund

"A Progressive Vision for Antitrust Enforcement to Protect the Opportunities for Small Businesses and to Protect Consumers"

Before the House Small Business Committee Hearing on "Small Business Competition Policy: Are Markets Open for Entrepreneurs?"

Thursday, September 25, 2008

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Introduction

I am pleased to submit this written testimony on behalf of the Center for American Progress and the Consumer Federation of America[1] about the impact of antitrust enforcement on small businesses and entrepreneurs.

As I suggest in my testimony, over the past several years antitrust enforcement has gone on a misguided detour in failing to fully recognize the concerns of small businesses and entrepreneurs. When dealing with antitrust issues concerning small businesses and entrepreneurs, the antitrust enforcers always bring out the shop-worn bromide from Justice Brennan, that "antitrust laws protect competition, and not competitors."[2] That certainly is true, but in doing so, the antitrust agencies have become increasingly insensitive to the legitimate competitive concerns of small businesses, placing these businesses into a "disfavored class" for antitrust enforcement. This is a serious error, not only for these small businesses, but also for the American economy generally and for consumers.

My testimony today is based on over a quarter century as an antitrust practitioner, the majority of which was spent as an enforcer in the Antitrust Division of the Department of Justice, and in several senior management positions, including Policy Director at the Federal Trade Commission ("FTC"). I regularly practice before both the agencies, and frequently appear on behalf of small businesses and associations of small businesses, including pharmacies, healthcare providers, medical device manufacturers, truck stops, supermarkets, farmers, and others.

I want to make it clear at the outset that I am not criticizing the dedicated staff attorneys of the FTC, or the Antitrust Division of the Department of Justice, or even the individuals who set the enforcement agenda. For periods of time in the past, antitrust enforcement was somewhat misguided, and in some respects, attempted to protect competitors rather than competition. For example, in the 1960s the FTC brought countless Robinson-Patman enforcement actions, which

[1] Consumer Federation of America ("CFA") is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior citizen, low income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

[2] *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977).

may ultimately have led to higher prices for consumers. Perhaps one might have envisioned at that point that small businesses were sort of a "protected class" receiving undue recognition by antitrust enforcers. Those policies were clearly reversed during the 1980s with more sensible antitrust enforcement.

Unfortunately, the pendulum of antitrust enforcement has swung too far, with antitrust enforcers being increasingly unresponsive to the concerns raised by small businesses. In some respects as described in my testimony small business has become a "disfavored class." That is why the Committee's hearing on this issue is so crucial. By failing to recognize the legitimate concerns of small businesses and entrepreneurs, antitrust enforcement fails to live up to its mission to protect competitive markets and to protect consumers.

The problem identified in today's hearing was illuminated in an extremely thoughtful article by Professor Warren Grimes "The Sherman Act's Unintended Bias Against Lilliputians: Small Players' Collective Action as a Counter To Relational Market Power."[3] Professor Grimes observes that:

> There is a systemic bias against small players in modern markets. Large power players are ubiquitous. Because power checks power, big firms are relatively comfortable in dealing with fellow giants. Small players, in contrast, usually lack countervailing leverage and are likely targets of strategic behavior by power players. Antitrust law and policy has contributed to this bias. [A]ntitrust is relatively intolerant of collective action that would allow small players to achieve countervailing power. Doctrinal developments over the past three decades have exacerbated the problem by limiting small players access to antitrust remedies for power abuses. Well-intentioned but overreaching screening rules now limit the small player's ability to establish claims such as predatory pricing or an unlawful tie-in, even when the conduct produces unambiguously anticompetitive effects.
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> .....
>
> So who falls into this class of Lilliputians that are victimized by this Sherman Act bias? Among the disfavored are professionals (such as doctors or lawyers) who practice individually or in small groups and must do business with power buyers of their services; small businesses (such as independent pharmacies or bookstore owners) that confront power buyers or sellers; small franchisees that have ongoing dealings with a powerful franchisor; small farmers or ranchers that sell their output to power buyers; and any independent contractor that sells services to a power buyer (such as a taxicab or truck owner that sells his services to a large taxicab or trucking firm).

The purpose of my testimony today is to begin to outline a progressive vision of how to reverse this unintended bias against small business in the interpretation and enforcement of the antitrust laws.

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[3] Warren Grimes, *The Sherman Act's Unintended Bias Against Lilliputians: Small Players' Collective Action As A Counter To Relational Market Power*, 69 Antitrust L.J. 195 (2001).

The Crucial Role of Small Business in the U.S. Economy

The American economy is based on the idea of the American Dream – anyone can make it. That is why small businesses and entrepreneurship are such a dominating factor in the American economy. Small businesses are critical to the American economy, employing millions and serving as the linchpin to competition in almost every market. Over 99% of independent enterprises employ less than 500 people with the workers for these enterprises totaling 50.8 million workers, 52% of privately employed workers in the United States. In addition, employment among Fortune 500 companies has fallen to its lowest level of less than 9% of the private workforce today compared with 20% in 1980.

Small businesses are also the prime place for growth in the American economy. Over the last few decades, three quarters of the new jobs in the economy were within small business enterprise. Since 1998, between 60-80% of net new jobs have annually been provided by small businesses. Economic history demonstrates that it is small business that is the entrepreneur, the risk taker, the aggressive price cutter, the innovator. For example, "small businesses' patents are twice as likely as those from the larger firms to be among the 1 percent most cited; small businesses employ 39 percent of high-tech workers such as scientists, engineers, and information technology workers, generating the majority of innovations that come from U.S. companies; and these businesses are able to pioneer new alliances and partnerships, in contrast to large businesses with demarcated competitive interests, as shown by biotechnology companies vis-à-vis the U.S. pharmaceutical giants."[4]

Small businesses are more flexible than large corporations, especially in their ability to respond quickly to changing economic and technological conditions. They often know their customers personally and are especially suited to meet local needs. Small businesses respond more easily and rapidly to the ever-changing needs of consumers and the economy as a whole. They are also more innovative than larger businesses, producing 13 to 14 times more patents than larger firms.

The rapid technological advancements brought forth by start-up firms and other small businesses in recent years have taught us that when small businesses are allowed to compete on a level playing field, they bring new products and services to the market, often at a greater rate of innovation and lower prices than those of their competitors. When antitrust enforcement fails to adequately address the concerns of small businesses, however, consumers are deprived of the benefits of these smaller, more nimble competitors. In failing to fully recognize the concerns of small businesses, the antitrust enforcers dampen these voices of innovation and competition, ultimately failing to protect competition and consumers. This failure in antitrust enforcement needs to be reversed.

Today I will outline three substantive areas and two procedural areas in which current antitrust enforcement needs to be adjusted. I will close my testimony with several practical suggestions about how the agencies can address these issues.

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[4] Derek Leebaert, *How Small Businesses Contribute to U.S. Economic Expansion*, available at http://usinfo.state.gov/journals/ites/0106/ijee/leebaert.htm.

Substantive Issues

The Department of Justice Approach to Dominant Firm Cases is Misguided

Perhaps in no area is antitrust enforcement as important for small businesses as enforcement against exclusionary conduct by dominant firms. Dominant firms can engage in a wide variety of practices that limit the ability of entrepreneurs to either enter or expand. Some of these practices may, in essence, be procompetitive, resulting in lower prices to consumers. However, a wide variety of these practices may limit the opportunities for small businesses to effectively compete.

The Committee has heard testimony both from automobile repair part manufacturers and medical device manufacturers about how a wide variety of practices by dominant firms limit their ability to compete. The Committee should recognize that these small businesses play a critical role in making these markets competitive. Their efforts to develop new products offer lower prices or better services are crucial to consumers. This is true in not only these markets, but also numerous other markets.

Earlier this month, the DOJ issued a report on dominant firm conduct,[5] which attempted to provide de facto rules of *per se* legality for dominant firms. These rules will basically permit exclusionary conduct by monopolists unless the small firm can demonstrate that the anticompetitive effects are "disproportionately" greater than the procompetitive potential of the exclusionary conduct. Not only are the standards articulated by the DOJ inconsistent with the law and sound antitrust and economic policy, but also these rules would give monopolists free reign to crush new or existing rivals.

I must admit as an antitrust practitioner who was invited to testify before the hearings, I found the report a bit stunning. Certainly there are areas of antitrust enforcement that need reform, and markets that are not behaving entirely competitively. But the area of dominant firm conduct is not one of them. There is barely any evidence that uncertainty in antitrust law has dampened the ability of dominant firms to compete aggressively. Moreover, in the seven years of the Bush Administration, the DOJ has brought no monopolization cases of any consequence. In contrast, the previous Administration brought dominant firm cases challenging a wide variety of anticompetitive conduct by dominant firms such as Microsoft, American Airlines, Visa and MasterCard.

It is difficult to interpret and understand the DOJ's absolute reversal of enforcement policy towards dominant firms. It was not as if there was any evidence that suggested that dominant firms were being inhibited from competing effectively, or that consumers were ultimately being harmed because dominant firms had to refrain from competition. Simply put, the DOJ report attempts to solve a problem that did not exist. In doing so, it created more harm than good.

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[5] US Dept. of Justice, *Competition and Monopoly: Single-Firm Competition Under Section 2 of the Sherman Act* (September 2008), available at http://www.usdoj.gov/atr/public/reports/236681.pdf.

The DOJ has perpetuated its misguided enforcement policy by engaging in lopsided advocacy as *amicus curiae* before our courts. During the Bush Administration the DOJ has authored numerous amicus briefs before the courts in antitrust cases. In all but one case, the DOJ favored the defendants, arguing for a minimalist interpretation of antitrust law. The DOJ monopolization report is an attempt to author an amicus brief for the ages, perpetuating their one-sided philosophy of a minimalist antitrust law far beyond the tenure of the Bush Administration.

Fortunately, a majority of the FTC Commissioners issued an 11-page statement setting out the serious flaws of the DOJ monopolization report.[6] The Commissioners presented two key concerns. First, "the U.S. Supreme Court has declared that the welfare of *consumers* is the primary goal of the antitrust laws. However, the Department's Report is chiefly concerned with firms that enjoy monopoly or near monopoly power, and prescribes a legal regime that places these firms' interests ahead of the interests of consumers. At almost every turn, the Department would place a thumb on the scales in favor of firms with monopoly or near-monopoly power and against other equally significant stakeholders." Second the Commissioners observe that the report "seriously overstates the level of legal, economic, and academic consensus regarding Section 2." Thus, the Commissioners caution that the DOJ's approach if "adopted by the courts, would be a blueprint for radically weakened enforcement of Section 2 of the Sherman Act."

As I recommend below, this Committee and Congress should not stand by as DOJ attempts to vanquish Section 2 as a vital tool of antitrust enforcement. This Committee should recommend to Congress that they affirmatively reject the DOJ Report.

Fortunately, the FTC has continued to bring monopolization cases in a sensible manner during the current Administration. However, the Committee should recognize that the FTC does not have jurisdiction over all industries, and some industries are solely within the jurisdiction of the Antitrust Division of the DOJ. The imbalance in dominant firm enforcement between the FTC and DOJ should be addressed and resolved in the next Administration.

One place for the new Administration to start is the area of medical devices. This Committee heard the testimony of the Medical Device Manufacturers Association on the contracting practices by Group Purchasing Organizations and other conduct by dominant firms to foreclose smaller innovative rivals from the market. Examples of alleged exclusionary practices include sole-source contracts, market share discounts, and bundling of products so hospitals must purchase the bulk of their supplies from a single vendor to qualify for a discount on any one product. The FTC and DOJ received significant testimony at their 2003 healthcare hearings about how these practices deterred innovation and price competition in various medical device markets. Over a dozen private suits have been brought, some successfully, by small innovative medical device manufacturers against exclusionary practices by GPOs and device manufacturers. Yet in spite of that hearing testimony and these numerous private actions, the FTC has not challenged this type of conduct.

[6] Statement available at http://www.ftc.gov/opa/2008/09/Section2.shtm.

The Failure of the Agencies to Recognize the Harm of Buyer Power

In numerous markets, especially healthcare and agriculture markets, providers of services and goods face dominant buyers. Often the role of dominant buyers can be procompetitive in forcing suppliers to reduce costs and become more efficient. Moreover, powerful buyers sometimes can prevent sellers from being able to collude, either explicitly or tacitly. But buyer power poses issues that are different from the existence of seller power and can harm consumers.

However, the antitrust agencies have failed to adequately grapple with buyer power issues. Let me provide several examples:

- There has been no Robinson-Patman price discrimination enforcement actions during the current Administration.[7]
- The antitrust agencies have brought no challenges to any agricultural processing merger even though all agricultural processing markets have become much more concentrated.
- In the past 10 years, there have been over 400 health insurance mergers; however the DOJ has only challenged three of those mergers, requiring relatively modest divestitures.
- In a recent Congressionally-mandated report, the FTC blessed the exclusionary practices of the PBM industry, which have squeezed independent pharmacists, without bringing any benefit to consumers.

Some people may suggest that price discrimination enforcement is wholly unnecessary. Indeed, the Antitrust Modernization Commission recommended that the Robinson-Patman Act be abolished. In a thoughtful forthcoming report, the American Antitrust Institute has explained why separate Robinson-Patman enforcement is necessary.[8] The Report highlights the anticompetitive harm that can come about from price discrimination and cannot be addressed in the other antitrust statutes. The report also goes on to suggest reform of the Robinson-Patman statutes to assure that it does not prevent procompetitive conduct.

Let me provide two examples of the lack of price discrimination enforcement:

- Booksellers. Perhaps the most important area in which antitrust enforcement has failed to address competitive problems involves booksellers. Probably every member of this Committee enjoys the pleasure of shopping at an independent bookseller, but that opportunity unfortunately is becoming increasingly rare.

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[7] It is notable that the examples of enforcement that FTC Chairman Kovacic points to in his testimony (the McCormick Spice case and the study of slotting allowances) were initiatives of the Clinton Administration FTC.

[8] The American Antitrust Institute, *Transition Report on Competition Policy to the 44th President of the United States*; *see also* American Antitrust Institute, *The Robinson-Patman Act Should be Reformed, Not Repealed* (July 1, 2005), available at http://www.antitrustinstitute.org/archives/files/425.pdf.

Independent booksellers provide an important source of competition, not only in terms of prices but variety, quality and additional services. Unfortunately because of the power of the bookstore chains, the market share of independent booksellers has dwindled from about a third, to approximately 9 percent today. Independent booksellers provide a crucial role in offering a diversity of selection, promotion and a wide variety of services, including serving smaller communities.

As the American Bookseller Association ("ABA") noted in testimony before the Antitrust Modernization Commission,

> The playing field is more level than it used to be, due in no small measure to Robinson-Patman enforcement by the American Booksellers Association against publishers and powerful buyers. Larger retailers still enjoy a significant unfair advantage in purchasing terms. Flaws in the Robinson-Patman Act can contribute to the inability of independent booksellers to obtain a completely level playing field, but despite its flaws the existing act has at least limited the unfair price advantages enjoyed by large retailers. [9]

The ABA noted that if the Act was abolished or narrowed, inevitably the larger retailers would dictate prices to publishers, and the gap in purchasing terms between small and large retailers would widen so much that a huge number of the remaining independent booksellers would go out of business.

- Truck Stop Payment Systems. In 2003, the House Appropriations Committee asked the FTC to investigate the existence of price discrimination in the truck stop payment systems market. That market is dominated by a single firm, Comdata. As condition of the approval of Comdata's acquisition of a rival network, the FTC required Comdata to provide licenses to various firms to provide alternative network products. The FTC issued its study in August 2004 and suggested there were not competitive problems in this market. [10] However, the FTC study was seriously deficient in many respects. For example, it failed to recognize that the merger divestiture requirement had failed to restore competition in the market. [11]

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[9] Testimony of Bruce V. Spiva, Comments at the American Booksellers Association to the Antitrust Modernization Commission/Robinson-Patman Act Panel (July 25, 2005).

[10] Letter to Hon. Ted Stevens and Hon. C.W Bill Young, U.S. Congress, re Fed. Trade Comm'n Staff Report on Certain Aspects of Competition in Commercial Trucking Fleet Cards and Truck Stop Operations (August 13, 2004).

[11] *See* Complaint at 81-85, *Flying J v. TA Operating Corp.*, Case No. 1:06cv00030 (D. Utah 2006)(identifying deficiencies of FTC study at ¶ 154-161). *See also* Testimony of J.H. Campbell on behalf of the National Grocers Association before the Antitrust Modernization Commission on the Robinson-Patman Act (July 25, 2005)(discussing why price discrimination in credit card fees is anticompetitive).

Over-Aggressive Enforcement against Collective Activities in Health Care

Although small businesses are frequently run by independent-minded business persons, they often need to work with other businesses in order to achieve economies of scale and scope to compete with larger rivals. The antitrust laws have generally been fairly flexible in permitting small businesses to engage in a wide variety of joint ventures, strategic alliances and other arrangements. These entities are especially important where small businesses attempt to compete with much larger rivals, which have some of those competitive advantages.

Yet, in one area, antitrust enforcement has taken a particularly misguided approach to collective conduct — that involving healthcare. The testimony that this Committee received from the American Medical Association documented how the approach taken by the DOJ and FTC has denied healthcare providers the ability to enter into a wide variety of potentially procompetitive arrangements.

Central to sound health care antitrust enforcement is establishing a balance among these important principles: (1) enforcement should focus on the sectors of the healthcare system with the greatest impact on consumers: (2) enforcement should focus on all segments of the healthcare distribution system; and (3) enforcement must be balanced with clear guidelines and advice to permit procompetitive conduct.

For example, in the 1990s federal antitrust enforcers tried to balance enforcement against healthcare providers with new enforcement efforts against exclusionary conduct by health insurers and other intermediaries such as PBMs. They recognized that health insurers had the power to harm competition and consumers through a wide variety of anticompetitive and exclusionary conduct. If health insurers are too powerful they can charge consumers excessive premiums or engage in other anticonsumer conduct. Consumers are very familiar with the types of egregious practices by insurers including rejection of preexisting conditions, preapproval provisions and discontinuation of coverage. In addition, health insurers with market power can reduce reimbursements substantially to healthcare providers, leading to a significant reduction in healthcare quality.

Similarly, the antitrust agencies in the 1990s attempted to facilitate collective activity by healthcare providers by issuing clearer guidance to permit collaboration by healthcare providers that was not anticompetitive. Three times during the 1990s the agencies revised their Healthcare Guidelines, in part based on the recognition that these markets were evolving and they needed to be flexible about the ability of providers to innovate and participate in the market. The agencies issued over 30 staff opinion letters, authorizing conduct by individual groups of providers.

Yet that balance in enforcement has been lost in the current Administration.

- All of the nonmerger enforcement actions have been brought against healthcare providers without a single action against a health insurer or PBM.

- Merger enforcement has been particularly lax. The agencies have permitted several hundred health insurance mergers and required modest divestitures in only two of those mergers. In one of those mergers, the United/Sierra merger, the

Chairman of this Committee raised concerns with the DOJ that their settlement was insufficient to protect consumers and healthcare providers. A similar trend of consolidation has occurred in the Pharmacy Benefit Manager market which is now dominated by three firms.

- The agencies have not revised their Healthcare Guidelines in the past 12 years even though they are clearly out of date in some respects. The Guidelines are premised upon a managed care model in which providers can collectively negotiate if they accept financial risk – a model that consumers and insurers no longer want. So providers that engaged in financial risk taking are in a now in a legal "no-mans land" where to secure legal status they have to ask for arrangements the market does not desire.

- The agencies have issued only three staff advisory opinion letters authorizing joint provider conduct. The significant downturn in favorable advice is not surprising. Securing the agencies' approval is becoming increasingly more elaborate, complex and expensive and the agencies' letters are increasingly detailed and complex. My understanding is that the cost of securing one of these business approval letters now clearly exceeds $100,000 in attorneys' fees, beyond the financial ability of most provider groups. More important, the types of arrangements that are permissible are so complex and expensive they can only be achieved by very large groups involving several hundred providers. Ironically, the agencies' approach effectively forces providers to create groups so large they may have market power.

Particularly egregious is the lack of health insurance merger enforcement. As several consumer groups stated in testimony before this Committee last year:

> As a result of lack of antitrust enforcement against health insurers an unabated flood of health insurance mergers has led to highly concentrated markets, higher premiums, and lower reimbursement. Skyrocketing premiums have put insurance out of reach for millions of consumers and thousands of small businesses and the number of uninsured Americans has increased to critical levels: over 47 million, or one out of seven Americans under age 65. As consumers have suffered from egregious deceptive and anticompetitive conduct by insurance companies, those companies have recorded record profits. The problems presented could not be starker or have a more severe impact on consumers.[12]

Although the number of actions brought by the agencies against healthcare providers are numerous, one can question the economic impact of the challenged conduct. Outside of healthcare, most government antitrust enforcement actions lead to private treble damage actions seeking to recover damages. Yet none of the healthcare provider cases brought in the current Administration have led to this type of follow on damage litigation. One can question if insurers were really harmed by this conduct, why did they not seek damages. Moreover, the impact on

[12] Statement on behalf of Consumer Federation of America, Consumers Union, and US PIRG to the House Small Business Committee (Oct 25, 2007). (Attachment A).

the ultimate consumer is even more uncertain. The FTC has not done any studies to determine what the consumer impact has been of these numerous enforcement actions against providers. There is no evidence on whether these provider groups continued to exist or were disbanded. Nor is there any evidence of whether the actions enabled health insurers to secure lower rates from providers, or if these lower rates resulted in lower premiums for consumers.[13] Nor is there any evidence if the enforcement actions perhaps weakened the quality of healthcare by decreasing compensation to healthcare providers. Simply there is no evidence that consumers have benefitted from these enforcement actions. Even more disturbing is the fact that many of the agencies' enforcement decisions have been directed at providers in rural areas. Given the shortage of health care services in many rural areas, we should be skeptical of any antitrust enforcement policy that further weakens the incentive and ability of providers to practice in rural areas.

This is not to suggest that healthcare providers should be given a free pass in price fixing or should be permitted to form otherwise illegal cartels. The enforcement agencies should continue to challenge clearly illegal conduct which has a significant adverse impact on consumers. But those efforts should focus on those segments of the market with the greatest threat of competitive harm: health insurance and other health care intermediaries.

We do not know about the reasons for the agencies nonenforcement decisions or the reasons for the change in enforcement priorities. But one reason for this imbalance may be an assumption that the interests of health insurers are coincident with that of consumers. Such a view would be misguided especially when dealing with for-profit insurers that are responsible to their shareholders. Lower rates from providers may simply be pocketed as higher profits, especially where health insurers have market power. And the evidence is indisputable that almost all metropolitan health insurance markets are highly concentrated.

Moreover, health insurers are not true fiduciaries for insurance subscribers. Plan sponsors may have a limited concern over the product based on the cost of the insurance, and not the quality of care. Consequently, health insurers can increase profits by reducing the level of service and denying medical procedures that physicians would normally perform based on professional judgment. Health insurers also prohibit providers from advising patients about medically necessary procedures that may be covered under other plans through physician "gag" clauses. That is why there have been countless consumer protection actions taken against health insurers. If competition among insurers diminishes, patients are more likely to pay for these procedures out-of-pocket or forego them entirely. Ultimately, the creation of monopsony power from the hundreds of health insurance mergers can adversely impact both the quantity and quality of health care.

Another part of the problem is that two separate agencies share healthcare jurisdiction: the FTC is responsible for issues on healthcare providers and hospitals; the DOJ is responsible for health insurance. Having a single agency responsible for both would better facilitate coordinated enforcement and a sound approach to both health insurance and provider issues.

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[13] Indeed, if the insurance market was concentrated, consumers might not receive any benefits from the lower rates secured by the health insurers.

Because of its bipartisan composition and its concurrent consumer protection jurisdiction, the FTC is best suited to take over the role of exclusive health care enforcer.

The agencies may respond that permitting provider collaboration to respond to potential monopsony power will not solve the problem. Rather they will suggest that such "countervailing power" will only lead to higher prices. They are wrong on two counts. First, countervailing power may permit providers to become better patient advocates, by enabling providers to bargain for the elimination of gag clauses and other provisions that limit the doctors ability to advocate for the patient. Second, as an economic matter permitting health care providers to secure countervailing bargaining power may be procompetitive. The effect of high physician market shares on consumer welfare depends on the pre-existing concentration of health plan purchasing power. [14]

Let me provide you with an example of where potential antitrust enforcement against a provider endeavor clearly harms consumers. We are all familiar with the role of pharmacy benefit managers in controlling healthcare costs. Several years ago, a group of pharmacies, under the direction of the National Association of Chain Drug Stores, attempted to form a rival pharmacy benefit manager to compete against the dominant PBMs in the market. The FTC conducted a long and expensive investigation, even though it was clear that the pharmacy-run PBM would not be capable of exercising any type of market power, or raising prices in any respect. The cost and time of the FTC investigation deterred the ability for that alternative to come to the marketplace.[15]

Process Issues

I wanted to raise several process-related issues, based on my experience of representing small businesses and entrepreneurs before the agencies.

I begin by recognizing that the staff of the agencies includes dedicated public servants, who take the enforcement of the antitrust laws seriously. However, on occasion, it is difficult for the concerns of small businesses to be fully recognized by the enforcement agencies. The agencies are used to dealing with large, sophisticated companies, which can hire expensive attorneys and economists to represent their interests. Small businesses, obviously, cannot afford that type of expensive endeavor. Moreover, small businesses are often unfamiliar with the workings of the agencies or the types of concerns that the agencies focus on.

I focus on two process issues: (i) complaints of small businesses in merger investigations and (ii) merger divestitures.

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[14] *See* Roger Blair & Jill Herndon, *Physician Cooperative Bargaining Ventures: An Economic Analysis,* 71 Antitrust L.J. 989 (2004); Tom Campbell, *Bilateral Monopoly in Mergers,* 74 Antitrust L.J. 521 (2007).

[15] In some situations, it might be appropriate to provide an antitrust exemption to permit healthcare providers to collectively negotiate with insurers. *See* Testimony of David Balto, The Impact of Our Antitrust Laws on Community Pharmacies and their Patients before the House Judiciary Committee Antitrust Task Force (Oct. 18, 2007)(advocating for antitrust exemption for community pharmacies).(Attachment B).

I. Complaints of Small Businesses in Merger Investigations

Merger investigations under the Hart-Scott-Rodino Act are an intense and complicated process. Because the agencies have a limited amount of time to investigate a proposed merger, there is a limited opportunity to contact customers and competitors. Although it is difficult for any individual practitioner to generalize, based on my experience in representing small businesses that were affected customers by proposed mergers, I have a concern that the agencies do not adequately survey the concerns of small businesses in evaluating the competitive effects of these mergers.

In part, this is understandable. Because of the time demands of the Hart-Scott-Rodino process, only a limited number of customers can be interviewed. Thus, the agencies almost always focus on the largest customers to determine the competitive impact of the merger. However, in many instances it may be the smallest customers who may be most vulnerable to the anticompetitive effects of the merger. Larger customers may have greater options and maybe less susceptible to anticompetitive harm from the merger.

It is also important for the agencies to credit the concerns of small businesses that are competitors of the merged firm. Too often those concerns are discredited because these small businesses are competitors of the merging parties and the agencies assume that they are complaining because they fear greater competition from the merged parties. While this concern contains a grain of truth, the assumption that smaller firms are necessarily less efficient than larger competitors is not always correct and, in any case, even competition from those firms that are operating at smaller-than-efficient benefits consumers by bringing new products and services to the market at competitive prices.

Often the interests of small businesses are aligned with consumers and should be fully recognized. Probably no example of this error of ignoring the complaints of small businesses is more significant than the complaints raised by local radio broadcasters against the XM-Sirius merger. The concerns raised by the local radio stations were particularly important because one cannot expect that the millions of consumers affected could readily complain to the antitrust enforcers. The DOJ and FCC were quick to dismiss the comments of local radio stations, arguing that these rivals would complain only if they expected heightened competitive pressure from the combined satellite radio provider. But this traditional, pubic choice assessment of merger opposition was shortsighted because it failed to recognize the complex, *two-sided* nature of radio markets. Radio stations bring together two audiences on their platform: listeners and advertisers. Local radio stations were concerned about the merged satellite firm selling additional local advertisements; they were not concerned about the prospect of the merged satellite firm lowering its subscription prices to end users. Stated differently, local radio stations were concerned about the merger effects on one side of the market only. Because satellite radio listeners perceive additional commercial time as a bad thing, the interests of the (complaining) local radio stations and end users were perfectly aligned. Unfortunately, the antitrust agencies failed to detect these aligned interests, and instead dismissed the complaints of local radio stations.

II. Merger Divestitures

In many cases, the antitrust agencies will attempt to resolve the competitive concerns of the merger by requiring the parties to restructure the acquisition and divest the assets of one of the two merging companies. Sometimes the parties are given a period of time after the merger is consummated to divest those assets. In other cases, the agencies will require the divestiture to be conducted almost simultaneously with the approval of the merger.

Again, because time is of the essence in securing these divestitures, merging parties may prefer to divest the assets to a large company, which can acquire all or most of the divested assets. For example, in a merger of supermarkets, in which the divestitures are necessary in several geographic markets, the merging parties may prefer to divest all those assets to a single buyer rather than going to the more lengthy process of finding individual buyers in each of the different metropolitan markets. In effect, the divestiture process, in some instances, provides an implicit preference for divestiture to a large, sophisticated buyer, rather than a small business.

Anything that leads the merging parties to prefer large over small business buyers may be an unfortunate result for consumers. A precedential FTC study of merger divestures in the mid-1990s found that small businesses were more likely to be successful acquirers of divested assets than larger businesses. The reasons are intuitively obvious. For a small business, the acquisition of a divested business will be a more significant investment, one in which it will be more committed than some larger entity. Placing small businesses at an implicit disadvantage in the divestiture process, which may ultimately lead to more divestitures to larger businesses, may not ultimately be beneficial to consumers.

Recommendations

Again, I want to emphasize the commitment of individuals in the antitrust enforcement agencies to the proper enforcement of the antitrust laws. Yet, I believe, and based on my experience in representing parties before the agencies, that they need to be increasingly sensitive to the concerns raised by small businesses. As I have suggested above, substantively the agencies should give greater attention to the conduct of dominant firms and anticompetitive uses of buyer power. In addition, the priorities in the healthcare arena need to be realigned.

Here are four recommendations to improve the process of antitrust enforcement at the agencies for small businesses:

(1) Appoint a small business ombudsman at the FTC.

Some of the problems facing small business entities are one of information and communication. Small business entities may be unaware of the best fashion to articulate their competitive concerns to the agencies. In addition, it would be useful for the agencies to have an individual responsible for evaluating the agencies approach to the concerns raised by small businesses. Thus, the FTC should consider appointing a small business ombudsman to deal directly with small businesses that raise competitive concerns, both in merger and non-merger investigations. In addition, the small business ombudsman can prepare a regular report for the Commission on how issues concerning small businesses are addressed.

(2) The Committee should recommend to the House that it issue a statement regarding the DOJ's monopolization report.

As suggested by three FTC commissioners, the DOJ monopolization report does not reflect current antitrust law, and provides a road map for dominant firms to engage in exclusionary conduct.

Congress should not stand by idly as the DOJ attempts to rewrite the antitrust laws and to severely weaken the scope of Section 2 enforcement. This Committee should recommend to the House of Representatives that it issue a statement criticizing the approach taken in the DOJ report. This would be similar to the approach taken in December 1985, where Congress added language to a proposed public law criticizing the 1985 DOJ vertical restraint guidelines.[16] Such a statement would be instructive, both to the courts and future antitrust administrations about the proper enforcement of Section II.

(3) The FTC should conduct a study of the merger divestiture process and its impact on small businesses.

The FTC's 1998 divestiture report provided tremendous insight into the divestiture process. My own intuitive sense, based on my representation of parties in the divestiture process is that divestitures to small businesses have continued to be more successful than to divestitures to larger business entities. But anecdotal information cannot substitute for true empirical analysis. The FTC should conduct an update of their 1998 divestiture report, with a particular focus of the impact of divestitures and other merger remedies on small businesses.

(4) Merger Process

The FTC and DOJ should make a significant effort to solicit and incorporate the views of small businesses in their analysis of the competitive impact of proposed mergers. In some cases, the FTC and DOJ should try new investigatory methods, such as holding ad hoc meetings with groups of small businesses in order to secure information about the impact of the merger. The DOJ and FTC should also intensify their recent efforts to increase transparency in the merger-review process. Too often, advocacy before the agencies is a game of "inside baseball," dominated by those companies with the resources to hire high-priced lawyers with connections to agency staff. Increasing transparency by making guidelines and enforcement decisions public *and* easily accessible, would benefit smaller businesses with more modest legal budgets. The agencies should also consider publishing helpful tips for businesses and their lawyers who are not as familiar with agency practice.

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[16] Congress stated that the 1985 DOJ Vertical Restraints Guidelines "(1) are not an accurate expression of the Federal antitrust laws or of congressional intent with regard to the application of such laws to resale price maintenance and other vertical restraints of trade; (2) shall not be accorded any force of law or be treated by the courts of the United States as binding or persuasive; and (3) should be recalled by the Attorney General." PL 99-180, *1985 HR 2965*.

Conclusion

The unintended bias against small business in antitrust enforcement costs both competition and consumers. Too often the antitrust laws and enforcement agencies fail to recognize the critical role of small businesses in providing competition and increased choices for consumers. Our parents could dream that we would have every opportunity to create our own businesses and bring new competition to the market. If we are going to be able to pass these dreams on to our children and grandchildren, it is absolutely imperative that small businesses and their concerns receive fair treatment in the antitrust agencies and the courts. The antitrust bias against small business must be reversed.

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