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Antitrust Review 2007 | Energy Mergers | Sweepstakes

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COVER: "High and Dry," Honorable Mention, 2007 Texas Tech International Cultural Center juried competition, photograph by Larry Gustafson, Dallas.

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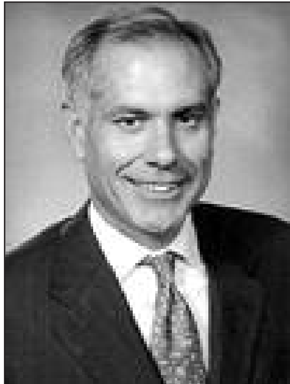
FROM THE SECTION CHAIR



Dear Section Members:

As the calendar year comes to a close, I thought that I would update you on a couple of the more significant activities that the Section Council has undertaken over the past few months. We determined that there was no longer a significant need for a large, stand-alone CLE program each year. We thus launched (in November) the first of a series of regional programs that will be presented in partnership with local bar groups. The first program—which was undertaken with the Dallas Bar Association's Antitrust Section—was by all accounts very successful. Thanks go to Council member and DBA Section Chair Frank Carroll. Additional programs are taking shape for Austin, Houston and San Antonio. The Section has also made a significant commitment to pro bono work by pledging to support clinical work in Texas law schools. Details of this undertaking will follow in the Spring.

This volume of the *Journal* is, as always, full of practical insight and analysis. And—again, as always, thanks go to Mike Ferrill. This edition includes articles by Leslie Hyman on antitrust developments, Bruce McDonald on recent FTC challenges to oil industry mergers, and Tom Van Arsdel on the law of sweepstakes contests. If you have an article in mind for future issues, please contact Mike Ferrill (amferrill@coxsmith.com). We're always on the lookout for interesting articles touching on any aspect of business litigation. Thanks also to Larry Gustafson, whose cover photograph, "High and Dry," received an Honorable Mention at the 2007 Texas Tech International Cultural Center juried competition.

In closing, I would like to thank Justice Jim Moseley and Todd Murray for supervising (and executing) the overhaul of the Section web site. Check it out at www.tablit.org.

Best regards,

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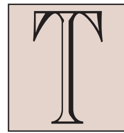
FROM ▪ THE ▪ EDITOR



This issue of the Journal features the annual survey article on antitrust developments by Leslie Hyman, an article by Bruce McDonald on recent FTC challenges to oil industry mergers, and an article by Tom Van Arsdel on the rules governing sweepstakes contests.

As always, we solicit written contributions to the Journal. We currently have commitments for annual survey articles on antitrust, securities, RICO, business torts, class actions, D&O and expert witness developments. If you have an idea for a survey article in another area of business litigation, or an article focusing on a particular aspect of or development in the law (even if it falls within one of the broad survey categories), contact me at 112 E. Pecan, Suite 1800, San Antonio, Texas 78205 (210) 554-5282; (210) 226-8395 (fax), amferril@coxsmith.com.

A. Michael Ferrill
Editor

Antitrust Review 2007

By Leslie Sara Hyman[1]

In the past year, the Supreme Court decided four antitrust cases. Each decision made it more difficult for a plaintiff to succeed in bringing an antitrust claim. The Court addressed the standard of proof for minimum resale price maintenance and predatory bidding and the pleading standard for conspiracy based upon parallel action. The Court also addressed the interaction between the antitrust laws and federal securities laws. The Fifth Circuit gave a plaintiff a second chance by reversing a grant of summary judgment in a concerted refusal to deal case and affirmed a motion to dismiss for lack of antitrust injury. There were no reported antitrust decisions from Texas state courts during the past year.

Resale Price Maintenance and the Per Se Rule

Leegin Creative Leather Products, Inc. v. PSKS, Inc., __ U.S. __, 127 S. Ct. 2705 (2007)

In a 5-4 opinion, the Supreme Court rejected 96 years of precedent to hold that minimum resale price maintenance is to be judged under the rule of reason. The Court overturned the rule announced in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), that it is *per se* illegal under section 1 of the Sherman Act for a manufacturer and its distributor or retailer to agree on the minimum price that the latter will charge for the manufacturer's goods.

Leegin manufactures the Brighton line of women's accessories, which are sold primarily in small, independently-owned boutiques. Leegin sold Brighton products to the plaintiff, a women's clothing and accessories specialty store. In 1997, Leegin instituted its "Brighton Retail Pricing and Promotion Policy," which provided that Leegin would do business only with retailers that followed its suggested retail prices. Leegin also introduced a marketing initiative that rewarded retailers for certain promotional activities. The initiative required retailers to pledge to follow the "Brighton Suggested Pricing Policy at all times."

In contravention of these stated policies, the plaintiff placed its entire line of Brighton products on sale. When the plaintiff refused to stop discounting, Leegin suspended all shipments of Brighton products to the plaintiff, which resulted in a substantial decrease in the plaintiff's sales. The plaintiff sued, alleging that Leegin had violated section 1 of the Sherman Act by entering into illegal agreements with retailers to fix the prices of Brighton products and by terminating the plaintiff as a result of those agreements. Leegin had planned to introduce expert testimony at trial describing the procompetitive effects of its pricing policy. Relying on the *per se* rule against minimum resale price maintenance, the district court excluded the testimony as irrelevant to the jury's inquiry. The jury found that Leegin and its retailers agreed to fix prices, causing the plaintiff to suffer antitrust injury and lost profits of $1.2 million.

The Fifth Circuit affirmed the verdict in an unpublished decision, holding that Supreme Court precedent required application of the *per se* rule without regard to Leegin's claimed lack of competitive harm. The Supreme Court granted certiorari.

The Supreme Court examined the *Dr. Miles* decision, which was based on the common law rule that restraints upon alienation are ordinarily invalid and on the argument that the resale agreements were analogous to an illegal agreement between competing distributors because the resale agreements benefited the distributors, not the manufacturer. The Court explained that these rationales had been rejected by more recent Supreme Court jurisprudence. Since *Dr. Miles*, the Court has rejected attempts to base antitrust law on "formalistic" legal doctrines, such as the common law rule against restraints upon alienation, in favor of demonstrable economic effects. Quoting *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977), the Court "reaffirm[ed] that 'the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today.'" Similarly, since *Dr. Miles*, the Supreme Court has rejected analyzing vertical restraints by comparing them to horizontal restraints.

Because the foundations of the *Dr. Miles* rule have since been rejected, the Supreme Court determined that it should examine afresh whether a *per se* prohibition against minimum resale price maintenance is appropriate. In doing so, the Court relied upon

empirical studies and economics literature written by certain economists skeptical of resale price maintenance, suggesting procompetitive reasons for a manufacturer's imposition of mandatory resale prices. The Court recognized that resale price maintenance can have anticompetitive effects. On the other hand, the elimination of intrabrand price competition "encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers. Resale price maintenance also has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between." The Court concluded that resale price maintenance can increase interbrand competition by "facilitating market entry for new firms and brands" and by encouraging retailer services that would not otherwise be provided. These procompetitive justifications made application of the *per se* rule inappropriate because *per se* prohibition would "proscribe a significant amount of procompetitive conduct." The Court rejected *stare decisis* as a reason to maintain the *per se* rule in large part because the Sherman Act is expected to "evolve to meet the dynamics of present economic conditions" and because it is not uncommon for the Supreme Court to reverse precedent where, as here, subsequent cases have undermined an opinion's doctrinal basis.

The Court provided guidance for the application of its newly-announced rule of reason test, suggesting that lower courts should consider the number of manufacturers that make use of the practice in a given industry to determine the likelihood that the practice is being used to facilitate a manufacturer cartel. Also relevant is the source of the restraint because if retailers were the impetus, the restraint might be facilitating a retailer cartel or supporting a dominant, inefficient retailer. The Court also suggested that the market power of the manufacturer and retailer involved should be considered because a dominant player could abuse resale price maintenance for anticompetitive purposes.

Justice Breyer, joined by three other Justices, dissented. For those justices, the doctrine of *stare decisis* would mandate continued adherence to *Dr. Miles*. Justice Breyer concluded that no changed circumstances justified departure from the nearly century-old *per se* prohibition against minimum resale price maintenance, particularly given that in 1975, Congress repealed the McGuire and Miller-Tydings Acts, which had made certain resale price maintenance *per se* legal. Justice Breyer concluded that in doing so, Congress had consciously extended the *per se* rule. Justice Breyer then examined the list of factors the Court is to consider when overturning its own precedent and determined that the fact that this is a statutory, not constitutional, case, that *Dr. Miles* is 100 years old and has been relied upon by the Supreme Court in the interim, that the *per se* rule has not created an unworkable legal regime, that *Dr. Miles* has not unsettled the law, that the case involves property and contract rights, and that the *Dr. Miles* rule had become "embedded in our national culture" were all reasons not to overrule *Dr. Miles*.

Section 1 Conspiracy: Pleading Standard

Bell Atlantic Corp. v. Twombly, __ U.S. __, 127 S. Ct. 1955 (2007)

The Supreme Court held that a complaint that alleges that competitors engaged in parallel conduct but that lacks a description of facts "suggesting agreement, as distinct from identical, independent action" cannot survive a Rule 12(b)(6) motion to dismiss for failure to state a claim.

The plaintiffs, on behalf of themselves and a putative class of all "subscribers of local telephone and/or high speed internet services" alleged a conspiracy in restraint of trade that resulted in inflated charges for local telephone and high-speed Internet service. The defendants were the "Baby Bells" or Incumbent Local Exchange Carriers ("ILECs") originally created as regional monopolies by the divestiture of AT&T. More than a decade after the divestiture Congress enacted the Telecommunications Act of 1996, which withdrew approval of the ILECs' monopolies and imposed duties upon the ILECs intended to facilitate market entry. These duties included the obligation to share the ILECs' networks with competitive local exchange carriers ("CLECs"). The ILECs successfully litigated the scope of their sharing obligation, which resulted in a narrowing of the range of network elements to be shared with the CLECs.

In their complaint, the plaintiffs alleged that the ILECs engaged in parallel conduct in their respective service areas to inhibit the growth of upstart CLECs, including making unfair agreements for access to the ILEC networks and providing inferior connections to the networks. The plaintiffs alleged that the ILECs had a common motivation to suppress competition from the CLECs, which led the ILEC's to form a conspiracy. The plaintiffs also alleged that the ILECs agreed not to compete with each other, which could be inferred from the fact that the ILECs had failed to pursue business opportunities in one another's markets.

The United States District Court for the Southern District of New York granted the ILECs' motion to dismiss for failure to state a claim. The court held that circumstantial evidence of consciously parallel behavior was insufficient to state a claim under section 1 of the Sherman Act absent allegation of facts tending to show that the defendants' behavior could not be explained as independent, self-interested conduct. The Second Circuit reversed, holding that an antitrust plaintiff making a section 1 claim based upon parallel conduct is not required to plead "plus factors." Instead, such a plaintiff could survive a motion to dismiss by pleading facts demonstrating that a conspiracy is a plausible possibility and that dismissal would be proper only if there was no set of facts that would demonstrate that the parallelism alleged was the product of a conspiracy.

The Supreme Court reversed in a 7-2 decision. The Court first restated the standard for proof of conspiracy in violation of section 1. Parallel behavior, even when done consciously of competitors'

actions, is admissible circumstantial evidence of an agreement but does not itself conclusively establish such an agreement. This is because parallel conduct is consistent both with conspiracy and with unilateral, competitive business strategy. In order to survive summary judgment, a plaintiff must offer evidence that tends to rule out independent action by the defendants. Parallel conduct standing alone also does not entitle a plaintiff to a directed verdict.

In analyzing what is required at the pleading stage, the Supreme Court acknowledged that Federal Rule of Civil Procedure 8(a)(2) requires only a "short and plain statement of the claim showing that the pleader is entitled to relief." A plaintiff need not include detailed factual allegations but must do more than recite the elements of a cause of action, and the allegations in the complaint "must be enough to raise a right to relief above the speculative level." In so holding, the Court expressly rejected literal reliance on the statement from *Conley v. Gibson*, 355 U.S. 41, 47 (1957), that a complaint should not be dismissed for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Although lower courts had relied upon the "no set of facts" language to permit a claim to survive 12(b)(6) unless its factual impossibility was shown from the face of the pleadings, the Court held that "[t]he phrase is best forgotten."

The Court rejected for two reasons the dissent's argument that disposing of implausible claims should be accomplished after the 12(b)(6) stage. First, the Court recognized that discovery is expensive and time consuming. Second, the Court acknowledged that courts have had limited success in checking discovery abuse. The expense of discovery means that defendants are likely to settle even meritless claims before the summary judgment or trial stage.

Applying its general standards to section 1 claims, the court held that "stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made," which "calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." The key word in the standard is "suggest." The Court distinguished between allegations consistent with an agreement, which are insufficient to survive a motion to dismiss, and allegations suggesting an agreement, which will survive such a motion. Similarly, showing the *possibility* of entitlement to relief is not enough and a plaintiff must plead facts showing that entitlement to relief is *plausible*. The Court then concluded that because parallel conduct, standing alone, does not establish a conspiracy, an allegation of parallel conduct with a bare assertion of conspiracy is insufficient to withstand a motion to dismiss.

Turning to the plaintiff's' complaint, the Court found that no actual agreement between the ILECs was alleged, just parallel conduct, and that nothing in the complaint "invests either the action or inaction alleged with a plausible suggestion of conspiracy" given the independent reasons that each ILEC would have to resist competition from the CLECs, the historical genesis of the ILECs as sanctioned monopolies, and the difficulties the CLECs were having competing with the ILECs. "Because the plaintiffs [had] not nudged their claims across the line from conceivable to plausible," the Court held that dismissal was appropriate.

Predatory Bidding: Burden of Proof

Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., __ U.S. __, 127 S. Ct. 1067 (2007)

A unanimous Supreme Court held that a plaintiff alleging predatory bidding must meet the same test applied to claims of predatory pricing and prove both sales of output that exceed the cost of that output and a dangerous probability of recoupment of the resulting losses.

Plaintiff Ross-Simmons had been a hardwood lumber sawmill in the Pacific Northwest since the 1960s. Defendant Weyerhaeuser entered the market in 1980 by acquiring an existing lumber company and now owns six hardwood sawmills. Both companies acquire red alder sawlogs on the open bidding market. Between 1998 and 2001, prices for red alder sawlogs rose while prices for the finished lumber fell. Ross-Simmons suffered heavy losses and eventually shut its mill. Ross-Simmons then sued Weyerhaeuser for monopolization and attempted monopolization, alleging that Weyerhaeuser had overpaid for sawlogs in order to artificially raise prices so high that Ross-Simmons could not make a profit.

Weyerhaeuser moved for summary judgment before trial and for judgment as a matter of law at the close of the trial evidence but the district court denied both motions. The district court instructed the jury that Ross-Simmons could succeed on its predatory bidding case if the jury found that Weyerhaeuser "purchased more logs than it needed, or paid a higher price for logs than necessary in order to prevent [Ross-Simmons] from obtaining the logs they needed at a fair price." The jury found for Ross-Simmons on the monopolization claim and awarded $26 million in damages.

On appeal to the Ninth Circuit, Weyerhaeuser argued that proof of illegal predatory bidding should mirror that required by the Supreme Court in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), for predatory pricing — pricing below cost in order to drive rivals from the market. In *Brooke Group*, the Supreme Court held that recovery on a predatory pricing claim requires proof that the complained-of prices are below an "appropriate measure" of the competitor's costs and that the competitor had a "dangerous probability" of recouping the losses caused by the below-cost pricing. The Ninth Circuit disagreed with Weyerhaeuser and affirmed the jury's verdict.

The Supreme Court granted certiorari to consider the proper test for analyzing a claim of monopolization by predatory bidding. Relying heavily on scholarly articles, the Court described predatory bidding as a scheme in which a buyer acquires monopsony power by

bidding up the market price of a necessary product so high that rival buyers cannot compete. Once the buyer has caused its competitors to leave the market, it will seek to reduce the price for the products by restricting its purchases below the competitive level. The resulting cost savings then offsets any losses incurred during the bidding-up phase. The Court noted that when the predatory firm's competitors are in both the input market and the output market, the firm might also recoup its losses by raising the output prices to monopolistic levels.

The Court held that predatory pricing and predatory bidding are economically similar in that both involve "the deliberate use of unilateral pricing measures for anticompetitive purposes" and both require firms to incur short-terms losses for the change for supracompetitive profits in the future. Because of the requirement of suffering initial certain losses for uncertain gains, the Court determined that both practices are probably rarely attempted and rarely successful. The Court noted that predatory overbuying has an identical economic impact as predatory bidding and that the practices should be treated as legally the same. The Court recognized that firms may have legitimate, even procompetitive, reasons for setting low prices for output or paying high prices for needed input and that failed predatory pricing schemes and failed predatory bidding schemes both may benefit consumers.

These similarities convinced the Court that the two-pronged *Brooke Group* test was appropriately applied to predatory bidding. A plaintiff alleging predatory bidding must thus prove that the alleged predatory bidding led to below-cost pricing of the bidder's outputs because the cost of the outputs exceeded the revenues generated in selling the outputs. The plaintiff must also "prove that the [bidder] has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power." Ross-Simmons conceded that it had not satisfied the *Brooke Group* test. Its predatory bidding theory thus could not support the jury's verdict.

Antitrust and the Securities Laws

Credit Suisse Securities v. Billing, __ U.S. __, 127 S. Ct. 2383 (2007)

A putative class of securities investors sued the underwriting firms that marketed and distributed the securities, alleging that the firms had committed antitrust violations by unlawfully agreeing with each other to refuse to sell buyers shares of a popular new issue unless the buyers agreed to certain terms. The Supreme Court, in a 7-1 decision (Justice Stevens concurred in the judgment, Justice Kennedy took no part in the decision), held that the securities laws implicitly precluded the antitrust claims.

In the typical initial public offering ("IPO") of shares in a company, a group of underwriters forms a syndicate to help market the shares. The syndicate conducts an investigation into suitable initial share prices and quantities and makes a recommendation to the company. The investigation typically involves meetings between potential investors and the syndicate underwriters and representatives of the company in which the underwriters present information about the company and the stock and attempt to gauge the strength of the investors' interest in the stock. The syndicate and the company then agree upon the number of shares to be sold and the price per share. The syndicate buys all the newly-issued shares from the company at a discount and then resells the shares to the public at the agreed-upon price, netting the difference as commissions.

A group of 60 investors filed two antitrust class actions against ten leading investment banks that allegedly had formed underwriting syndicates to help execute the IPOs of several hundred technology-related companies. The investors alleged that the underwriters had "abused the ... practice of combining into underwriting syndicates" by agreeing to impose conditions upon potential investors. Specifically, the underwriters allegedly required that the investors pay charges in addition to the usual underwriting commission in the form of (1) investor promises to place bids in the aftermarket at higher prices; (2) investor promises to purchase other, less attractive securities; and (3) investor payment of excessive "commissions," including agreements to purchase an issuer's shares in follow-up public offerings. The investors alleged that the underwriters' agreement artificially inflated the price of the securities in question.

The underwriters moved to dismiss the investors' complaints on the ground that federal securities law impliedly precludes application of antitrust law to the underwriters' conduct. The district court granted the motion to dismiss but the Second Circuit reversed and the Supreme Court granted certiorari.

The Supreme Court first canvassed three prior Supreme Court decisions addressing the relationship between securities law and antitrust law: *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963); *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975); and *United States v. National Assn. of Securities Dealers, Inc.*, 422 U.S. 694 (1975). In *Silver*, the Court had held that where possible, courts should reconcile the operation of both the securities and the antitrust statutory schemes and that the securities laws should be implied to have precluded application of the antitrust laws only when necessary, and only to the extent necessary, to make the Securities Exchange Act work. The *Silver* Court found no such necessity and held that the securities laws did not preclude application of antitrust laws to an alleged boycott of a broker by the New York Stock Exchange. In *Gordon*, the Court held that an "implied repeal" of the antitrust laws should be found only when there is a "plain repugnancy" between the two statutory schemes. The *Gordon* Court found that such a repugnancy precluded application of antitrust laws to a complaint regarding the commissions charged by stockbrokers. In doing so, the Court relied in large part on the SEC's direct regulatory power over commissions and the SEC's active role in reviewing commission rates. In *NASD*, the Court applied a "clear repugnancy" test in holding that the securities laws precluded an antitrust claim alleging that securities broker-dealers had conspired to, among other things, fix prices and terms of sale. Again, the *NASD* Court relied upon the SEC's existing regulatory authority over the challenged practices.

This review of prior cases led the Court to conclude that the proper test for considering whether securities law precludes application of the antitrust laws is whether, given the context and the likely consequences, securities law and the antitrust allegations are "clearly incompatible." Relying on *Gordon* and *NASD*, the Court concluded that in making this determination the following factors are critical: (1) the existence of securities-related regulatory authority over the activities in question; (2) evidence of the exercise of that authority; (3) a risk that if both schemes were applicable, conflicting guidance, requirements, duties, privileges, or standards of conduct would arise; and (4) whether the challenged practices "lie squarely within an area of financial market activity that the securities law seeks to regulate."

Applying these principles to the investors' complaints, the Court easily concluded that the first two factors weighed in favor of preclusion of antitrust law. The SEC has authority to supervise all of the IPO-related activities in question and has continuously exercised that authority. The Court also found that the fourth factor clearly supported preclusion because the activities in question were "central to the proper functioning of well-regulated capital markets."

Turning to the third factor – the risk of conflict – the Court read the investors' complaints regarding particular underwriting practices to attack the manner in which the underwriters jointly sought to collect the allegedly excessive commissions. The investors contended that these claims could not be repugnant to the securities laws because the SEC has disapproved of the challenged practices. The Court rejected this argument, holding instead that the securities and antitrust laws were clearly incompatible in this situation. The Court relied on several facts, the first of which was the "fine, complex, detailed line" that currently separates IPO-related underwriter activity "that the SEC permits or encourages ... from activity that the SEC must (and inevitably will) forbid." The Court determined that "evidence tending to show unlawful antitrust activity and evidence tending to show lawful securities marketing activity may overlap, or prove identical." Because of this fine line, the Court expressed concern that nonexpert judges and juries across the country would be unable to separate acceptable behavior on the part of underwriters from unacceptable behavior, given the "nuanced nature" of the required evidentiary evaluations. Given the fact-specific nature of the evaluations, different courts might not evaluate similar fact patterns consistently.

The Court believed that "antitrust courts are likely to make unusually serious mistakes" in attempting to differentiate between lawful and unlawful activities. Such likely mistakes, in the Court's view, means that underwriters would have to forgo permitted activities in order to safely avoid prohibited activities. The Court acknowledged that this may be a problem "to some degree in respect to other antitrust lawsuits" but concluded that mistakes are "unusually likely" in the IPO arena.

The Court concluded that allowing an antitrust lawsuit in these circumstances "would threaten serious harm to the efficient functioning of the securities markets," that there was an unusually small enforcement-related need for an antitrust lawsuit, and that permitting an antitrust lawsuit might enable a plaintiff to circumvent the procedural requirements that securities plaintiffs must satisfy. In the face of these conflicts, the securities laws were clearly incompatible with the application of the antitrust laws to the underwriters' complained-of activities and the Second Circuit's ruling was reversed.

In concurring in the judgment, but not the majority's opinion, Justice Stevens opined that the complained-of activity did not violate the antitrust laws. Justice Stevens wrote, "I would not suggest, as the Court did in *Twombly* and as it does again today, that either the burdens of antitrust litigation or the risk 'that antitrust courts are likely to make unusually serious mistakes,' should play any role in the analysis of the question of law presented in a case such as this."

Justice Thomas dissented. He concluded that the savings clauses of the Securities Act and the Securities Exchange Act would preserve the rights and remedies of the antitrust laws.

Concerted Refusals to Deal

Tunica Web Advertising v. Tunica Casino Operators Ass'n, Inc., 496 F.3d 403 (5th Cir. 2007)

An Internet advertising company sued casino operators, alleging a concerted refusal to deal. The district court granted summary judgment in favor of the casinos but the Fifth Circuit reversed, holding that a fact issue existed on whether there had been concerted action. The Fifth Circuit also instructed the district court to consider whether the plaintiffs had alleged a *per se* illegal horizontal boycott.

Tunica Web Advertising and its owner, Cherry Graziosi, owned the domain names "tunicamiss.com," "tunicamississippi.com," and "tunica.com" and leased the domains to the Gold Strike casino in Tunica County, Mississippi for several years. None of the domains had a web site. Instead, they redirected searchers to the casino's home page.

The Tunica Country Tourism Commission (the "TCTC") sued Graziosi, alleging that she was a cybersquatter who had no right to own "tunicamiss.com" or "tunicamississippi.com." As part of the settlement of that suit, Graziosi transferred all her rights in "tunicamiss.com" and "tunicamississippi.com" to the TCTC and the TCTC released all claims to "tunica.com."

Graziosi then proposed to the TCTC that she lease "tunica.com" collectively to all the casinos in Tunica Country. Under the terms of the proposal, in exchange for a monthly payment from each casino, visitors to "tunica.com" would be redirected to the TCTC web site, which already contained information about the casinos. The proposal was referred to the casinos' trade group, the Tunica Casino Operators Association (the "TCOA"). The TCOA met and discussed the proposal and reached a consensus to not jointly utilize the

"tunica.com" domain name. Graziosi and Tunica Web Advertising contend that at the same meeting, the members of the TCOA agreed to refuse to deal with Tunica Web Advertising on any terms. Shortly after the TCOA meeting, the Gold Strike casino cancelled its lease of "tunica.com." Gold Strike's marketing director allegedly told Graziosi that the casinos had entered into a "gentlemen's agreement" not to do business with Tunica Web Advertising and that her hands were tied by the TCOA. Supposedly, the refusal to deal was intended to lower the value of the "tunica.com" domain name.

Tunica Web Advertising then developed its own web site at "tunica.com" with the intention of generating revenue through advertising from casinos and/or commissions from online hotel booking. Tunica Web Advertising approached the casinos with this new business model but none of the casinos chose to advertise on the site. Graziosi and Tunica Web Advertising alleged that this refusal was pursuant to the earlier agreement to refuse to deal with Tunica Web Advertising and presented an email from Gold Strike's marketing director to Graziosi stating that the TCOA later met and reaffirmed its agreement.

Graziosi and Tunica Web Advertising sued the casinos, the TCTC, and the TCOA. The TCTC was dismissed by the court on immunity grounds and the TCOA and Gold Strike were dismissed by agreement of the parties. The court granted summary judgment for the remaining casinos, holding that (1) the casinos' alleged conduct could not constitute a *per se* violation of Section 1 of the Sherman Act; (2) the alleged original agreement not to deal with Tunica Web Advertising was a legal joint response to a joint proposal; and (3) Tunica Web Advertising did not show that any refusals to deal after the original agreement were the result of concerted action because it did not present detailed evidence of its proposals to the casinos.

On appeal, the Fifth Circuit agreed that the casinos' original agreement to reject Tunica Web Advertising's offer was not actionable because it was a joint response to a joint proposal. But the court disagreed that there was no evidence of any actionable agreement. The court held that the statements from the Gold Coast's marketing director reporting a "gentlemen's agreement" between the casinos that none of them would use "tunica.com" or deal with Tunica Web Advertising, and the later email reporting a subsequent agreement, were sufficient to raise a fact issue about whether the casinos had engaged in concerted action. The court held that such direct evidence of an agreement relieved the plaintiffs of the need to provide circumstantial evidence of agreement such as the details of the rejected proposals to the casinos. The direct evidence also meant that the existence of plausible reasons for independent action did not establish the casinos' right to summary judgment.

The Fifth Circuit also considered Tunica Web Advertising's argument that the refusal to deal was a *per se* illegal horizontal boycott. Although the casinos were clearly direct competitors, they pointed to language from the Supreme Court and Fifth Circuit suggesting that *per se* illegal boycotts are those intended to harm a competitor of the conspirators. Relying on this language, the casinos argued that a *per se* illegal horizontal boycott requires that at least one of the conspirators be a direct competitor of the victim. The Fifth Circuit recognized that "[p]recisely which group boycotts are subject to the per se rule is ... not always clear." The court concluded, however, that the Supreme Court has never held that injury to a competitor of the conspirators is an absolute prerequisite to a finding of *per se* illegality and that the district court had erred in so holding. Relying on *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), the Fifth Circuit held that in determining whether the *per se* rule should apply to the alleged horizontal boycott, a court should consider "(1) whether the casinos hold a dominant position in the relevant market; (2) whether the casinos control access to an element necessary to enable [Tunica Web Advertising] to compete; and (3) whether there exists plausible arguments concerning pro-competitive effects." The Fifth Circuit remanded the case to allow the district court to make the first analysis of these issues.

Antitrust Injury

Norris v. The Hearst Trust, __ F.3d __, No. 05-20710, 2007 WL 2702941 (5th Cir. September 18, 2007)

Former distributors of the *Houston Chronicle* sued the newspaper's owners alleging that they had been wrongfully terminated. The Fifth Circuit held that the former distributors' antitrust claims failed because the distributors lacked antitrust injury and antitrust standing.

The Hearst Trust, the Hearst Corporation, and Hearst Newspapers Partnership, L.P. (collectively, "Hearst") cancelled the plaintiffs' distribution agreements for the *Chronicle*, which is the only daily newspaper of general circulation in the greater Houston area. All but one of the plaintiffs sued in state court, alleging that Hearst had coerced the plaintiffs to produce fraudulent circulation reports and that the cancellation of their distribution contracts was in retaliation for the plaintiffs' complaints. Judgment was entered against the plaintiffs in state court and, joined by an additional distributor, they filed suit in federal court alleging essentially the same claims as had been alleged in state court with the addition of federal and state antitrust claims. The only product described in the distributors' complaint was the *Houston Chronicle* and the only users of that product were its readers and advertisers. The distributors did not allege that they were consumers of the paper or its advertising services or that they were competitors of Hearst or the paper. The distributors did not allege that the cancellation of their distribution agreements had harmed the subscribers or readers. They did allege that their termination had been related to Hearst's plan to inflate circulation figures with the intended result of increasing advertising sales and revenue.

The federal district court granted Hearst's Rule 12(b)(6) motion, holding that the state court plaintiffs' repled claims were barred by res judicata and collateral estoppel due to the prior state

court judgment and that the antitrust claims of all of the plaintiffs were barred for lack of antitrust injury and antitrust standing. The Fifth Circuit affirmed. The distributors alleged that they had sustained antitrust injury because they were terminated as a result of their refusal to participate in Hearst's illegal scheme to raise advertising prices, itself an antitrust violation. The court rejected this argument. The court held that the only persons that would be directly injured by Hearst's scheme to inflate circulation numbers would be those desiring to advertise in the *Chronicle* and other media that sell advertising. The court concluded that such persons were the appropriate parties to sue for any violation arising from Hearst's alleged scheme.

The court further held that the plaintiffs' bare allegations that Hearst had vertically integrated into newspaper distribution and was thus the distributors' competitor did not confer antitrust standing in the absence of any allegation that the vertical integration had anything to do with the plaintiffs' termination. There was no allegation that the plaintiffs' termination increased the *Chronicle's* price or decreased its availability. In these circumstances, even had Hearst terminated the distributors to take over the *Chronicle* distribution previously performed by the terminated distributors, Hearst would not have committed an antitrust violation giving rise to antitrust injury in the distributors.

The FTC's 2007 Oil Industry Merger Challenges: Another Year of "Special Vigilance"

By: J. Bruce McDonald[1]

Petroleum markets in the U.S. are intensely competitive. You would think otherwise, reviewing the antitrust enforcement activities of the Federal Trade Commission ("FTC"). The FTC's oil industry merger challenges historically have been aggressive, holding these industries to a higher standard than in other markets. An effort to avoid underenforcement in a "critical" industry, or to dodge the threat of expansive legislation, may help explain this pattern. In 2007, the FTC has kept up its enthusiastic efforts against petroleum market mergers, so far with one loss, one loss with a good chance for appellate reversal, and one consent order.

Western Refining / Giant Industries

The leading recent example of the FTC's intensive enforcement against energy mergers is the agency's unsuccessful challenge to the combination of Western Refining and Giant Industries, two independent oil refiners.[2] In August 2006, Western agreed to acquire Giant in a $1.4 billion transaction that would make Western the country's fourth largest, independent, publicly-traded refiner and marketer. The FTC staff commenced an investigation and identified as the critical overlap both refiners' supplying gasoline to northern New Mexico, the area around Albuquerque.

Headquartered in El Paso, Texas, Western refines crude oil and markets refined products in the Southwest. Western owns a refinery in El Paso, which supplies refined products to northern New Mexico and West Texas and parts of Arizona and northern Mexico. The supply to northern New Mexico travels through The Plains Pipeline from El Paso to Albuquerque.

Headquartered in Scottsdale, Arizona, Giant had operations in the Southwest and mid-Atlantic. Giant owned two New Mexico refineries, from which it trucked gasoline to points in Arizona, southwest Colorado, and New Mexico, including Albuquerque. Giant also owned wholesale and retail outlets in New Mexico and elsewhere in the Southwest. Giant's refineries had been running below capacity, because it had been unable to acquire enough of the local sweet crude that was its primary feedstock. However, Giant recently had purchased a pipeline through which it would be able to obtain more feedstock, and Giant predicted increasing its refineries' output in 2007.

In addition to Western and Giant, a number of other refiners supply gasoline to Northern New Mexico. Holly Corporation ships gasoline through several pipelines from its refinery in southeast New Mexico. ConocoPhillips and Valero Energy both send gasoline to Albuquerque from their refineries in the Texas Panhandle. Alon ships gasoline to Albuquerque from its Big Spring, Texas, refinery. Product from Gulf Coast refiners is delivered to Albuquerque by truck.

In April 2007, the FTC filed an action in the District of New Mexico,[3] seeking a preliminary injunction of the merger under FTC Act § 13(b).[4] The FTC alleged that the merger would lessen competition in the bulk supply of gasoline to northern new Mexico. The FTC Complaint recognized that northern New Mexico had seven "significant" bulk suppliers. And the FTC alleged that six ("only six") of the refiners "are currently capable of responding" to a decrease in supply to northern New Mexico.[5] The FTC even acknowledged that Holly, ConocoPhillips, and Valero had large, nearby refineries connected to pipelines with significant unused capacity running to Albuquerque.[6]

In most markets, a "6 to 5" merger would hardly get a second glance.[7] But here the FTC identified peculiar local market facts that led it instead to challenge the merger. (1) Giant was a maverick and, with expanded refinery output, Giant would increase the supply of gasoline to Albuquerque, bringing lower prices. (2) To avoid losses caused by lower prices, Western would divert Giant's new supply away to other markets. (3) These changes in output by Giant and Western would not be countered by other suppliers; the historical "limited supply responsiveness" of the other suppliers indicated they would not respond to Giant's increasing supply by backing out their own supply, nor would they replace supply if Western diverted gasoline away from northern New Mexico, the FTC alleged.

The parties battled over the FTC's assertions in a five-day preliminary injunction hearing in Albuquerque in May 2007. The parties presented six fact witnesses and three experts.[8] Three weeks later, the court announced its decision, finding in favor of the defendants on the key issues and rejecting the FTC challenge.

First, the court questioned the FTC premise that premerger Giant would have increased total supply to bring lower prices. The

FTC alleged that Giant, consistent with being a maverick, would use its increased refinery output to increase its gasoline supply to northern New Mexico, even though this would cause prices to drop. Specifically, the FTC alleged that, with higher refinery output, and if Giant allocated that new production as it did its existing production, Giant would allocate "substantially more" gasoline to Albuquerque, causing gasoline prices "to fall significantly below where they would have been otherwise."[9]

The FTC's "maverick" story was based in large part on a single, draft Giant document, which Giant's expert concluded reflected a Giant plan to use the new refinery output to bring 900 incremental barrels to Albuquerque. The court seemed skeptical that it could rely on this document's analysis.[10] Furthermore, the court reasoned that, if it profit-maximized, Giant would not increase its own output and still continue to purchase gasoline from third parties (like Western) to meet its obligations to customers.[11] Instead, the court recognized, Giant would cut back its purchases from other refiners with which it was supplying Albuquerque, rather than lose money as prices fell:

> Chasing customers in Albuquerque at a deep discount – as the FTC asserts Giant will do – is inconsistent with Giant's business practices. Giant seeks to sell its refinery production, not to resell products that others refine … Giant has no economic incentive to purchase product from Western at market prices and then resell the same barrels at a discounted price.[12]

Second, the court did not believe the merger would motivate Western to divert away Giant's new supply. The FTC alleged that, with a high share of northern New Mexico gasoline sales, Western was more exposed to Albuquerque gasoline prices than Giant, giving it the incentive to limit output increases that could lower prices. Therefore, the FTC predicted, the postmerger Western could find it profitable to reduce the combined firm's supply to northern New Mexico, causing increased prices. The FTC alleged the postmerger Western might "divert" Giant's supply to other markets or cut the amount of gasoline Western supplied from El Paso to Albuquerque.[13]

The court determined that the merger would not change the incentives of the combined Western/Giant to bring Giant's new supply to northern New Mexico.[14] The court reasoned that the merged firm actually would have a relatively small market share, that customer demand was the key factor in Western's supply decisions, and that Western's large customers had alternatives if Western raised prices.[15]

Third, the court rejected as "not reasonable" the FTC assertion that other suppliers would not respond. The FTC alleged that other suppliers' historical "limited supply responsiveness suggests they are unlikely to competitively constrain any small output reduction or price increase."[16] Therefore, the FTC predicted that the "other bulk suppliers … are unlikely to respond in a way to make Western's output reduction unprofitable."[17]

The court found it could not accept the FTC's view of which firms competed for northern New Mexico gasoline sales, much less that these competitors would not respond to significant output changes by Giant and Western. At the preliminary injunction hearing, the FTC's expert identified seven bulk suppliers as competitors in the relevant market: Western, Giant, ConocoPhillips, Valero, Holly, Chevron, and Shell. The combined Western/Giant would have a 19% market share or, under an "alternative market shares" calculation, just over 35%. (Calculating a market share above 35% allowed the FTC to argue that the merger would fall outside the Merger Guidelines' "triggering thresholds.")[18]

Adding to the FTC's competitor list, the court found that the FTC should not have excluded Alon, a west Texas refiner that supplies Albuquerque through exchange agreements and gasoline purchased in El Paso.[19] The court also recognized that supply by truck from Texas is playing an increasingly significant role in northern New Mexico.[20] And even the possibility of supply from the Gulf Coast has an effect on price in northern New Mexico.[21] Finally, the court noted that even though The Plains Pipeline, which runs from El Paso to Albuquerque, was capacity constrained, it was possible for new shippers to obtain some capacity, and a significant expansion of the pipeline is being planned.[22]

Ultimately the court found that the merged firm would have a market share of about 6% and that the merger would increase the HHI by 15. This gave the FTC a "weak" prima facie case, but that was as far as the agency got.[23] The court otherwise could not find substantial proof of anticompetitive effect.[24]

The linchpin of the FTC case was its theory that these rivals would not respond to Giant output increases (rivals would not respond to lower prices by shifting their own supply to other markets) or Western supply diversions (rivals would not respond to higher prices by adding more supply to Albuquerque).

The defendants argued that, if Giant were to increase its supply to Albuquerque, leading to a price increase, other suppliers would be motivated to divert their supplies away from Albuquerque and to higher netback markets.[25] Likewise, if Western were to reduce supply to northern New Mexico, rivals would take the opportunity to supply more, as evidenced by "natural experiments" observed in northern New Mexico: historically suppliers actually had increased supply in response to short term shortages, and the long term decline in Giant's production had not resulted in higher prices.[26] The court agreed, concluding that

> [t]he FTC's "price down" and "price up" theories are flawed because they assume that firms do not maximize profits. The FTC's theory "implies a kind of blinders to profits, profit-making opportunities." According to [defendants' expert] Professor Kalt, "oil companies ... have been profit-maximizing, profit-seeking" firms. The FTC's assertions are not reasonable, because in the FTC's framework, oil companies "do not respond when they lose money, and they can't respond when they make money."[27]

While it is not inconceivable that some participants in some markets would be unable to shift supply in response to price changes, the *Western* court seemed skeptical of the theory as applied to this market and eventually was unconvinced it was supported by the facts.

Although it does not appear to have had a major effect on the analysis, the court also noted that the FTC's 2006 report to Congress on post-Katrina price increases had found that bulk gasoline supply markets in Albuquerque and other areas were operating competitively and that the FTC had found in those areas no evidence of price manipulation.[28]

To obtain preliminary injunction of a merger, the FTC must show it is likely to succeed on the merits in its Clayton Act § 7 challenge to the merger and that the equities favor granting the injunction.[29] The *Western* court accepted that the FTC had made a "weak" prima facie case, but held that the defendants had rebutted any presumption of anticompetitive effect, by showing that competitors would constrain the defendants postmerger.[30] The court also held that the public and private equities did not justify requiring the parties to delay their merger by the 13-16 months it would take for the FTC to complete its administrative proceeding.[31]

The Commission sought to appeal the district court ruling, but the Tenth Circuit Court of Appeals denied the FTC request for an injunction pending appeal,[32] which the FTC subsequently dismissed. The Commission also dismissed the administrative complaint, terminating its administrative proceeding.[33]

Western is the most recent example of the FTC's strenuous efforts to limit petroleum industry mergers, even where the theory is difficult and evidence is slim, where it is convinced the transaction will have an anticompetitive effect. Despite this loss, the FTC should be expected to continue to be especially demanding in its review of energy company mergers.

Equitable Resources / Dominion Resources

Later in 2007, the FTC brought an action to block the merger of two natural gas utilities. Although the merits of the challenge have not been decided, the district court's ruling that the FTC action was precluded by "state action" in the form of the Pennsylvania PUC's authorizing the merger creates a potential obstacle to federal merger enforcement in regulated industries.

Equitable Resources produces natural gas and distributes gas to residential and commercial customers in Pennsylvania and West Virginia. In 2006, Equitable agreed to purchase a subsidiary of Dominion Resources, The Peoples Natural Gas Company, which owns local gas distribution systems that serve customers in southwestern Pennsylvania ("Dominion"). These distribution systems have since the early 1900s overlapped in Pittsburgh and nearby counties in western Pennsylvania, although such overlapping retail service now is rare and generally disapproved by the Pennsylvania PUC. About 500 industrial and commercial customers enjoyed the benefits of this "gas on gas" distribution competition.

The PUC, under its statutory authority to review and approve mergers, examined the proposed merger and approved it in April 2007. The PUC determined that the gas-on-gas distribution competition between Equitable and Dominion was inefficient and that elimination of the overlap would produce overall efficiencies, benefiting about 650,000 retail customers.

The FTC, disagreeing on the merits with the PUC decision, filed a challenge seeking a preliminary injunction.[34] The FTC alleged that Equitable and Dominion had competed vigorously in providing gas distribution services to the overlap business customers, by offering rates below their PUC-approved maximum rates and by offering better service and other incentives.[35] The FTC alleged that the merger would lessen competition and increase prices for those 500 overlap customers.[36]

Of most interest to practitioners is the ruling by the district court on the defendants' motion to dismiss the FTC complaint on state action grounds. The PUC has the authority to review and approve a merger of gas distribution companies, to determine if it is likely to result in "anticompetitive or discriminatory" conduct or harm a variety of other "consumer protection" interests.[37] The PUC also has the authority to determine whether a distribution company's proposed maximum rates are just and reasonable.[38] The defendants asserted that the grant of this authority to the PUC satisfied the "state action" defense, which recognizes that federal antitrust legislation should give way to decisions by state governments to allow anticompetitive activities, subject to state oversight.

For the state action defense to apply, an antitrust defendant must satisfy two requirements. First, the defendant's conduct must have been the "foreseeable result" of a "clearly articulated and affirmatively expressed … state policy" to replace competition with regulation.[39] Second, the defendant must show that the state "actively supervised" its program and that state officials had the power to review the defendant's activities and disapprove any that were inconsistent with state policy.[40]

The district court agreed with the defendants, holding that the PUC's merger approval authority and ongoing regulatory authority constituted a "clearly articulated policy to displace competition" along with active supervision going forward.[41] The court dismissed the FTC's action; however, the Court of Appeals for the Third Circuit has enjoined the parties from closing the merger pending appeal.[42]

In the Third Circuit, the FTC has argued that the existence of pervasive industry regulation is not enough to conclude that the legislature has authorized particular activities that are inconsistent with competition or empowered the PUC to regulate the postmerger conduct that allegedly would cause antitrust injury.[43] The FTC's appeal has been fully briefed and argued and is ready for decision.

Obviously the FTC reached different conclusions than did the Pennsylvania PUC on the likely anticompetitive effects of the combination, possible efficiencies, and the significance of the fact (found by the PUC) that a large category of customers would benefit even if a small group might suffer. The district court too implied its disagreement with the FTC on the merits:

> The FTC continually and inaccurately labels the merger as "anti-competitive," which it is not. Further, the FTC stated that this Court "suggest[ed]" that "the PUC may permit an anti-competitive merger," which it did not. The merger benefits 600,000 plus customers and may disadvantage approximately 500 customers – that is not an anti-competitive merger.[44]

There appear to be legitimate merits arguments on both sides. The FTC has not made public the full reasoning behind its challenge to this merger, although it has asserted it has evidence that Equitable projected a significant price increase and that the merging parties had begun to refrain from competing with each other premerger.[45] Furthermore, the FTC may have considered whether the competitive benefits obtained by the business customers might redound to the benefit of many ultimate consumers. On the other hand, the PUC had determined that, given the Pennsylvania rate regulation scheme, the residential customers were essentially subsidizing the below cost-of-service rates that the overlap business customers had obtained from these competing suppliers.[46]

The district court's view on the merits of the FTC's merger challenge may have influenced its decision on the state action question. The court cited the supposed benefits of the merger in its decision granting the defendants' motion to dismiss:

> While this statement [the that PUC's public interest review does not conflict with federal antitrust policy] may be true on some theoretical level, the real world implications are that the FTC is attempting to stop a transaction which the PUC has found to be in the overall public interest of the citizens of the Commonwealth of Pennsylvania.[47]

Certainly it is not unusual for a federal antitrust agency to disagree with the conclusions of a regulatory agency on whether a particular transaction should be allowed, especially where the regulatory agency applies a "public interest" or similar standard of which the competition analysis is only one part.[48] Nevertheless, this is a novel defense as applied here, and in the past there have been numerous federal challenges to mergers in regulated industries to which this argument might have applied.[49] Therefore, whatever the merits of the FTC's merger challenge, the resolution of this state action question will be of exceptional significance to the federal antitrust enforcers.

Kinder Morgan / Magellan Midstream Partners

In a third matter, the FTC challenged the acquisition of a part interest in a firm that owns petroleum terminaling operations by investors that already had interests in a competing terminaling company. This is another example of the agencies' treating overlaps created by partial ownership interests as lessening competition in the way a full merger could.

The transaction that initiated the FTC action involved the management buyout of Kinder Morgan, Inc. ("KMI"), a midstream energy firm that owns terminaling operations for gasoline and other petroleum products, among its other diversified energy assets. KMI had agreed to sell its shares to KMI management and a set of private equity investors, including equity funds controlled by Riverstone Holdings LLC and Carlyle Partners IV, L.P., part of The Carlyle Group. The transaction would result in a fund controlled by Carlyle owing 11% of KMI and a fund controlled by Riverstone and Carlyle owning another 11%. Each fund would have the right to appoint one KMI board member.[50]

Before the KMI transaction, through another jointly-controlled fund, Carlyle and Riverstone already owned 50% of the general partner that controls Magellan Midstream Partners, L.P. ("Magellan"), a midstream terminal and pipeline company. The fund had the right to appoint two of the Magellan general partner's four board members and also exercise certain management and veto rights.[51] Both KMI and Magellan have terminaling operations in the southeastern U.S.[52]

The FTC complaint challenged the funds' acquisitions of interests in KMI and Magellan as "combining KMI and Magellan under Carlyle and Riverstone." As the FTC analysis for public comment put it,

> Although the proposed transaction will not directly merge KMI and Magellan, it will have the effect of combining the two companies through partial common ownership. Carlyle and Riverstone, through their funds, will acquire a combined 22.6% interest in KMI, in addition to their existing 50% interest in the general partner controlling Magellan.[53]

The FTC claimed that this "combination" would lessen competition in petroleum terminaling in eleven metropolitan markets in the southeastern U.S. The FTC alleged that Carlyle and Riverstone likely would reduce competition between KMI and Magellan through their dual board representations, by exchanging competitive information between KMI and Magellan, and by using information learned from one firm in connection with their activities at the other.[54]

The FTC and the parties agreed to a consent order that would make Carlyle's and Riverstone's interests in Magellan "passive" investments. The FTC order prohibits Carlyle and Riverstone from serving on any of the Magellan boards and from exerting any control or influence over Magellan. The order also requires that they establish firewalls to prevent the exchange of competitively-sensitive, non-public information.[55] The FTC's resolution of its challenge may reflect lesser concern for partial ownership interests than for full

combinations, for which divestiture or some other structural remedy would be the standard.[56]

There have been other federal antitrust challenges to transactions that create partial ownership overlaps. In a recent example, the Justice Department brought an action against Dairy Farmers of America ("DFA"), which had purchased 50% of a dairy processor, when DFA already owned 50% of a nearby, competing dairy.[57] Although DFA objected that a "partial, non-controlling interest" could not support a Clayton Act § 7 challenge, the Court of Appeals for the Sixth Circuit held that the common ownership by DFA, even of only a 50% interest, could motivate the two dairies to lessen their competition against each other.[58] The court cited other factors, including historical business relationships among management of the parties, but rejected the argument that a particular "control mechanism" must be proved for partial ownership to be actionable.[59]

Neither the federal antitrust agencies nor the federal courts have provided definitive guidance on what partial common ownership interests should trigger a § 7 question.[60] The inquiry will rely heavily on all the facts to determine the transaction's effect on competition.

The FTC's Busy Oil Agenda

These enforcement actions are part of a busy oil industry agenda at the FTC. In addition to reviewing mergers and other business activities, the Commission provides its views to Congress and other government bodies,[61] prepares reports on oil industry market conditions upon request of the President or Congress,[62] and has an ongoing project to monitor gasoline prices.[63] This has been an FTC priority, and there is every reason to expect the agency to remain aggressive in bringing oil industry enforcement actions.

The Commission's public message emphasizes that it gives more attention to this "critical" industry than to others. As FTC Chairman Debbie Majoras recently repeated, the FTC has for a quarter century maintained a "special vigilance" in petroleum and other energy sectors.[64] This is needed, the Commission has told Congress, because without its "intensive" efforts, further consolidation would bring consumer harm:

> Intensive, thorough FTC merger investigations and enforcement have helped prevent further increases in petroleum industry concentration and avoid potentially anticompetitive problems and higher prices for consumers.[65]

Of course, second to being viewed as too soft on the oil companies – and there still are critics that assert it is[66] – the FTC would not want to be perceived as unjustifiably aggressive. Highlighting some of the political tensions that may motivate the FTC agenda, Chairman Majoras has observed that

> [t]he major challenge for the FTC is to continue to work to protect competition in these critical [energy] markets without folding to pressure to simply "do something," unduly interfering in a way that will only make matters worse for consumers … This means endeavoring to get past the myth that it is the large oil mergers, approved by the FTC in the late 1990s, that have caused prices to rise in the last few years.[67]

This balanced message seems reassuring, but the facts show that the Commission holds oil industry mergers to a higher standard than in other markets. Although many oil sector mergers have gone untouched, recent challenges like *Western* provide anecdotal evidence of overreaching. And statistics comparing challenges in petroleum markets and other markets provide objective evidence that the Commission has raised the bar for energy company mergers.

Looking to one the few objective benchmarks available, even the FTC itself has pointed to the fact that its petroleum industry challenges have involved markets where concentration levels were on average lower than its challenges in any other industries:

> A review … of horizontal merger investigations and enforcement actions from fiscal year 1996 to fiscal year 2005 shows that the Commission has brought more merger cases at lower levels of concentration in the petroleum industry than in any other industry. Unlike in other industries, the Commission has brought enforcement actions (and in many cases, obtained merger relief) in petroleum markets that are only moderately concentrated.

Indeed, one comparison of postmerger concentration levels indicates that the average in challenged cases was significantly higher in the oil industry than in any other. Only in the oil industry has the FTC persistently undertaken enforcement actions at or below the 2400 postmerger HHI level. Almost all enforcement actions taken in postmerger markets with an HHI level of 1800 were in the petroleum industry. And more than 60% of the petroleum industry mergers that have been challenged were in markets with five or more significant competitors.[68] The FTC alleged that Western/Giant was a "6 to 5" merger: only in oil markets has it been more likely than not that the FTC would challenge the merger of two of six competitors, according to data reported by the FTC.[69]

The interesting policy question asks why the FTC is more aggressive in oil industry enforcement. There is nothing in the nature of how petroleum markets work that suggests a more demanding standard is required. Oil and refined products are commodities, traded in markets where buyers and sellers have the benefit of robust information, and these markets are relatively unconcentrated, as the FTC acknowledges.[70] There is nothing in the nature of how petroleum market participants behave that justifies more aggressive enforcement. Repeatedly, after careful review, the FTC and the DOJ have been unable to uncover evidence to

substantiate the suspicions of the politicians and the media that petroleum industry companies are engaged in widespread price gouging, withholding, or other market manipulation that might (without reference to supply and demand) explain price increases at the pump.[71]

Two other considerations may motivate the Commission's ambitious approach: avoiding underenforcement and precluding overlegislation.

Underenforcement. The goal of government antitrust enforcement should be to protect competitive markets by stopping anticompetitive mergers or conduct but without overenforcing, without "unduly interfering in a way that will only make matters worse for consumers." Underenforcement clears the way for creation or exercise of market power, but overenforcement prevents efficient transactions and may chill future, procompetitive business activities.[72]

Getting it just right is not easy, even in a case-by-case enforcement scheme,[73] not to mention a pervasive regulatory regime. And according to the courts, the FTC and DOJ have gotten it wrong more often than right in recent merger challenges.[74] U.S. antitrust policy generally acknowledges that systematic overenforcement can be as anticompetitive as underenforcement.[75] Another policy view might, given the likelihood of error in merger analysis, accept more false positives (mistaken challenges to procompetitive mergers) than false negatives (failures to challenge anticompetitive mergers). The Commission may have decided that the harms of underenforcement in "critical" markets[76] will outweigh the benefits of the marginal, efficient mergers that get blocked.

Overlegislation. The jaded Washington observer may suspect – and wonder if he also should be grateful – that the FTC would rather be seen as over-aggressive than watch what Congress would do if the FTC were not busy.

The energy bills currently being debated in Congress includes several provisions expanding antitrust intervention in oil markets that are fundamentally misguided.[77] For example, one bill includes a provision prohibiting price gouging during states of emergency, using less precise language than some state statutes use – no "unconscionably excessive price."[78] The bill sets a maximum civil fine of $5 million and maximum criminal penalties of $5 million and 5 years in jail, extraordinary punishment for a vaguely-worded prohibition involving ordinary business conduct.[79] Such price regulation, especially using an ambiguous standard, can undercut markets' responding to shortages when additional supply is needed most.[80] Other pending bills would shift the burden of proof to merging competitors in Clayton Act § 7 challenges in oil and gas markets, require they prove a likely net benefit to consumers, and impose a one-year moratorium on mergers of petroleum companies valued over $10 million,[81] despite the fact that most petroleum markets are unconcentrated and do not for inherent reasons require such unique treatment.[82]

If Congress believes it might be perceived as failing to motivate the federal antitrust agencies to take action in energy markets, then one could predict Congress will seek to impose legislative reforms that target those markets.[83] The pending bills are examples of legislative changes that could do more competitive harm than good. Congress' own eagerness to regulate petroleum industry antitrust enforcement and the threat of unsound legislation may motivate the FTC to maintain a vigorous agenda and keep a tight hold on the industry.

Whatever the policy motivation, FTC enforcement efforts in petroleum markets remain aggressive. The agency's 2007 track record fits the historical pattern. Despite the FTC loss in *Western*, energy companies should expect that the FTC will continue to hold oil company mergers to a tough standard.

ENDNOTES

1 Bruce McDonald is a partner in Antitrust & Competition Law practice of Jones Day in its Houston and Washington, DC, offices. From 2003 to 2007 he was Deputy Assistant Attorney General in the U.S. Justice Department's Antitrust Division, with responsibility for antitrust enforcement in energy and other industries. This article reflects his personal views and not necessarily those of Jones Day or its clients.

2 Jones Day lawyers in Washington and Houston, including the author, represented Giant in this litigation. This summary is based on public information.

3 *FTC v. Foster, W. Ref'g, Inc., & Giant Indus., Inc.*, No. 1:07-cv-00352-JB-ACT, (D.N.M., filed April 12, 2007) ("*Western*"). Paul L. Foster was CEO and ultimate parent entity of Western Refining.

4 The FTC Act § 13(b), 15 U.S.C. § 53(b) (1994), authorizes the Commission to bring a district court action seeking preliminary injunction of a merger that would violate the FTC Act or Clayton Act, if in the public interest, pending initiation and completion of an FTC administrative proceeding, at the conclusion of which the Commission may itself issue a cease and desist order, which may be reviewed by a U.S. Court of Appeals. The injunction would have allowed the FTC to maintain the status quo so that it could proceed with an FTC administrative proceeding to determine whether the merger violated FTC Act § 5 or Clayton Act § 7. The Commission filed its administrative complaint in May 2006. *FTC v. Foster*, FTC Docket No. 9323 (filed May 3, 2006).

5 Am. Compl. ¶¶ 34, 17-23. The FTC's administrative complaint alleged "only five" could respond to a gasoline output decrease, while one might be able to shift capacity from diesel to gasoline. Admin. Compl. ¶¶ 27-28.

6 Am. Compl. ¶ 24.

7 Federal Trade Com'n, *Horizontal Merger Investigations Data, Fiscal Years 1996-2005*, Table 4.3 (Jan. 25, 2007) (showing oil market enforcement actions with numbers of significant competitors), *available at* http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf.

8 The FTC's expert economist was Halbert L. White of the Bates White economic consulting firm. The defendants' economist was Joseph P. Kalt of Harvard University's Kennedy School of Government.

9 Am. Compl. ¶ 29. The "maverick" concept is used in the Merger Guidelines to analyze likelihood of coordinated interaction. The Guidelines recognizes the circumstances in which a firm with excess capacity may be motivated to expand output and thereby undercut coordinated interaction in a market. U.S. Dep't of Justice & Federal Trade Com'n, *Horizontal Merger Guidelines*

§ 2.12 (1992). The FTC's complaint alleged both unilateral and coordinated effects would result from the merger. Am. Compl. ¶ 34. The FTC's complaint asserted Giant was a "maverick" with "incentives to expand its supply of gasoline into northern New Mexico." *Id*. These allegations were used to support both the unilateral and coordinated effects cases, but the court found no evidence of coordinated effects or that Giant had in the past acted as a "maverick." *Federal Trade Com'n v. Foster*, 2007 WL 1793441, ¶¶ 455, 458 (D. N.M., May 29, 2007) ("Op.").

10 Op. ¶¶ 416-17. Nine hundred barrels is about five truckloads of gasoline. *Id*. ¶ 417.

11 *Id*. ¶ 429.

12 *Id*. ¶ 438.

13 Am. Compl. ¶¶ 30-32.

14 Op. ¶ 250.

15 *Id*. ¶¶ 378-383.

16 Am. Compl. ¶ 24.

17 *Id*. ¶ 34.

18 Op. ¶¶ 279-81. The Guidelines § 2.2.2 observes that unilateral effects are likely when merging firms market share exceeds 35% and other circumstances are present. This "alternative" calculation produced a premerger HHI of 2,339 with the merger increasing it by 500. The court found that the alternative calculation "inappropriately" attributed Chevron shares to Western. *Id*. ¶ 280

19 *Id*. ¶¶ 201, 204.

20 *Id*. ¶ 215.

21 *Id*. ¶ 221.

22 *Id*. ¶¶ 190, 213-214, 341 (noting the expansion was to much larger than the predicted Giant supply increase to Albuquerque).

23 *Id*. ¶¶ 263-264.

24 *Id*. ¶ 268.

25 *Id*. ¶¶ 451, 453.

26 *Id*. ¶¶ 320 (refinery fire), 377 (refinery outage), 376 (Giant declining supply).

27 *Id*. ¶ 396 (internal citations omitted).

28 Federal Trade Com'n, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," at vi, (May 2006) *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf.

29 Op. at 50.

30 *Id*. at 56.

31 *Id*. at 49.

32 *FTC v. Foster*, 2007 WL 3023158 (10th Cir., May 31, 2007).

33 In re *Foster, Western Ref'g, Inc., & Giant Indus., Inc.*, No. 9323, Order Returning Matter to Adjudication and Dismissing Complaint, at 1 (FTC, Oct. 2, 2007) (3-2 vote), *available at* http://www.ftc.gov/os/adjpro/d9323/071003order.pdf.

34 *FTC v. Equitable Res. Inc.*, No. 07CV0490, (W.D. Pa. filed Apr. 13, 2007).

35 Compl. ¶¶ 19-20.

36 *FTC v. Equitable Res. Inc.*, No. 07CV0490, 2007 WL 1437447, at *1 (W.D. Pa. May 14, 2007).

37 *Id*. at 6-7.

38 *Id*. at 2.

39 *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 373 (1991); *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980).

40 *Midcal*, 445 U.S. at 105.

41 2007 WL 1437447, at *6, *8.

42 *FTC v. Equitable Res. Inc.*, No. 07-2499, Order at 1 (3d Cir., May 21, 2007).

43 *FTC v. Equitable Res. Inc.*, No. 07-2499, Emergency Motion of the FTC at 11, 15-16 (3d Cir., filed May 18, 2007).

44 *FTC v. Equitable Res. Inc.*, No. 07CV0490, 2007 WL 1500046, at *8 (W.D. Pa. May 21, 2007).

45 *Id*. at 4.

46 Opinion and Order, Joint Application of Equitable Resources, Inc., No. A-122250F5000, Before the Pennsylvania Public Utility Com'n, at 63-65 (Apr. 13, 2007).

47 2007 WL 1437447, at *7.

48 *Compare* Press Release, DOJ, Statement by Assistant Attorney General Thomas O. Barnett Regarding the Closing of the Investigation of AT&T's Acquisition of BellSouth (Oct. 11, 2006) (announcing closing of Antitrust Division investigation without challenge), *available at* http://www.usdoj.gov/atr/public/press_releases/2006/218904.pdf *with* In re AT&T Inc. & BellSouth Corp. Application for Transfer of Control, Memorandum Op. & Order, at 150, 10-11 (imposing special access requirements as condition for merger and contrasting FCC "public interest" review and DOJ review "limited solely to an examination of the potential competitive effects of the acquisition, without reference to national security, law enforcement, or other public interest considerations"), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-06-189A1.pdf.

49 Both federal agencies have challenged mergers that also required approval of a state or local authority that postmerger would have some ongoing regulatory authority over the merged entity. For example, the FTC and DOJ have challenged cable mergers, which may be subject to review by county and municipal authorities with responsibility for granting and overseeing cable franchise agreements. *E.g., In re Am. Online, Inc. & Time Warner, Inc.*, No. C-3989 (FTC, filed Dec. 14, 2000), *available at* http://www.ftc.gov/os/2000/12/aolcomplaint.pdf. The Antitrust Division has challenged mergers of electricity generators and telecommunications companies that were subject to approval of state utility commissions with ongoing regulatory authority. *E.g., United States v. Exelon Corp.*, No. 1:06CV01138 (D.D.C., filed June 22, 2006), *available at* http://www.usdoj.gov/atr/cases/f216700/216785.pdf; *United States v. Verizon Commc'ns Inc.*, No. 1:05CV02103, (D.D.C., filed Oct. 27, 2005), *available at* http://www.usdoj.gov/atr/cases/f212400/212428.pdf.

50 *In re TC Group, L.L.C.*, No. C-4183 Compl. ¶¶ 19-25, (FTC, issued Jan. 24, 2007).

51 *Id*. ¶¶ 9-12.

52 *Id*. ¶ 28.

53 *In re TC Group, L.L.C.*, File No. 061-0197, Analysis of Proposed Agreement Containing Consent Orders to Aid Public Comment at 4 (FTC, dated Jan. 25, 2007).

54 Compl. ¶ 34.

55 Decision & Order ¶ II.A-C (Jan. 25, 2007).

56 U.S. Dep't of Justice, Antitrust Division, Policy Guide to Merger Remedies, at 7 (Oct. 2004) ("Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market."), *available at* http://www.usdoj.gov/atr/public/guidelines/205108.pdf.

57 *United States v. Dairy Farmers of Am.*, No. 03-206-KSF, Compl. ¶¶ 7, 11 (E.D. Ky., filed Apr. 24, 2003).

58 *United States v. Dairy Farmers of Am.*, 426 F.3d 850, 862 (6th Cir. 2005).

59 *Id*. at 859. The appeals court reversed the district court's grant of the defendants' summary judgment motion, and the case thereafter settled.

60 *See United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 331-32 (1961) (holding that even retention of nonvoting shares in du Pont by voting shareholders of General Motors could deter du Pont from doing business with GM competitors).

61 *E.g., Prepared Statement of the FTC, Petroleum Industry Consolidation* (May 23, 2007), Before the Joint Economic Committee of the United States Congress, *available at* http://www.ftc.gov/os/testimony/070523PetroleumIndustryConsolidation.pdf ("Salinger Statement"); *Prepared Statement of the FTC before the S. Comm. on the Judiciary, On Petroleum Industry Consolidation* (Feb. 1, 2006), *available at* www.ftc.gov/speeches/kovacic/testimonypetroleumindustryconsolidation.pdf ("Kovacic Statement").

62 *E.g.*, Federal Trade Com'n and U.S. Dep't of Justice, "Report on Spring/Summer 2006 Nationwide Gasoline Price Increases," at 2-3 (Aug. 30, 2007) (concluding that price increases were related to six market factors, not antitrust violations), *available at* http://www.ftc.gov/reports/gasprices06/P040101Gas06increase.pdf; Federal Trade Com'n, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases," at 153-54 (May 2006) (finding no evidence of price manipulation by, e.g., running refineries below capacity or diverting to other markets; price gouging – defined as average prices higher than the previous month – found in 15 cases, but mostly explained by local market trends), *available at* http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf.

63 The Monitoring Project provides FTC staff with information on gasoline and diesel prices so that it can investigate unusual price changes.

64 "Maintaining Our Focus at the FTC: Recent Developments and Future Challenges," Speech by FTC Chairman Deborah Platt Majoras, at 8, before the ABA Section of Antitrust Law 7th Annual Fall Forum (Nov. 15, 2007), *available at* http://www.ftc.gov/speeches/majoras/071115fall.pdf ("Majoras Speech")

65 Salinger Statement at 7. *See also* "The Cost of Filling Up: Did the FTC Approve Too Many Energy Mergers," at 6, 11, Remarks of Luke Froeb, Director, Bureau of Economics, and John H. Seesel, Associate General Counsel for Energy, FTC, before the ABA Section of Antitrust Law, Fuel & Energy Committee (Mar. 31, 2005) ("We remain confident that the Commission has not 'approved' to many energy transactions."), *available at* http://www.ftc.gov/speeches/froeb/050331abareport.pdf.

66 *E.g.*, Tyson Slocum, "Standard Oil Rises Again: How Eroding Legal Protections and Lax Regulatory Oversight Harm Consumers?, 2007 Loyola Consumer L. Rev. 1 (citing weak FTC antitrust enforcement and market manipulation as causes of higher petroleum prices); Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry, at 84 (GAO-04-96) (concluding that mergers approved by the FTC led to price increases), *available at* http://www.gao.gov/new.items/d0496.pdf.

67 "Majoras Speech at 9.

68 Timothy J. Muris and Richard G. Parker, "A Dozen Facts You Should Know About Antitrust and the Oil Industry," at 65-68 (U.S. Chamber of Commerce, 2007) *available at* http://www.uschamber.com/publications/reports/0706oil_antitrust.htm.

69 Federal Trade Com'n, *Horizontal Merger Investigations Data, Fiscal Years 1996-2005*, Table 4.3 (Jan. 25, 2007), *available at* http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf.

70 Feb. 1, 2006 Kovacic Statement ("most sectors of the petroleum industry generally remain unconcentrated or moderately concentrated").

71 *See* supra n. 62.

72 *See* Frank H. Easterbrook, "The Limits of Antitrust," 63:1 Tex. L. Rev. 1, 2 (1984) (contrasting long run costs of overenforcement and underenforcement).

73 "[I]t is very difficult to correctly estimate the competitive effects of mergers" Froeb & Seesel, supra n. 65, at 8.

74 Besides *Western* and *Equitable*, there have been *FTC v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1 (D.D.C. 2007) (denying preliminary injunction in grocery merger); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004) (denying preliminary injunction in merger of coal companies); *United States v. Oracle Corp.*, 331 F.Supp.2d 1098 (N.D. Cal. 2004) (denying preliminary injunction in merger of software companies).

75 See Opening Remarks of Chairman Deborah Platt Majoras, "Estimating the Price Effects of Mergers and Concentration in the Petroleum Industry: An Evaluation of Recent Learning", at 4 (Jan. 14, 2005) ("The wrong enforcement decision, in either direction, can lead to increased prices, decreased output, or inferior service."), available at http://www.ftc.gov/speeches/majoras/050114oilmergerconferenceremarks.pdf.

76 "[W]e are all energy consumers." Majoras Speech at 8. See In re Foster, Western Ref'g, Inc., & Giant Indus., Inc., No. 9323, Statement of the Commission Concerning Dismissal of the Administrative Complaint, at 1(FTC) ("As the Commission has stated repeatedly, no other industry's performance is more deeply felt than that of the petroleum sector.").

77 H.R. 6, "Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007."

78 *Id*. § 603.

79 *Id*. § 609. Civil enforcement authority is given to the FTC, which is instructed to give priority to enforcement actions against Big Oil, companies with U.S. sales exceeding $500,000,000. Id. § 607(a). The "NOPEC" provision of this bill also attempts to authorize the DOJ to bring a Sherman Act challenge against OPEC, by removing the protection of foreign sovereign immunity and act of state doctrines. *Id*. § 710.

80 *Prepared Statement of the FTC, On Market Forces, Competitive Dynamics, and Gasoline Prices: FTC Initiatives To Protect Competitive Markets, before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce* (May 22, 2007), at 16-17, *available at* http://www.ftc.gov/os/testimony/070522FTC_%20Initiatives_to_Protect_Competitive_Petroleum_Markets.

81 H.R. 1500, "Gasoline Price Stabilization Act of 2007," § 7; S. 878, "Oil Industry Merger Antitrust Enforcement Act," §§ 3-4.

82 *See* supra text at nn. 68-71.

83 *See* Statement of The Honorable Patrick Leahy, "Crude Oil: The Source of Higher Gas Prices?," Hearing Before the Subcommittee on Antitrust, Competition Policy and Consumer Rights (April 7, 2004) (suggesting that enforcement agencies may need new legal tools to bolster competition in petroleum markets), *available at* http://judiciary.senate.gov/member_ statement.cfm?id=1142&wit_id=103.

Luck of the Draw: Avoiding the Traps of Running a Sweepstakes Contest

By: Tom Van Arsdel[1]

Sweepstakes or random-chance giveaways are an effective and popular way to promote a business's products and services. But let the contest promoter beware - comprehensive state laws regulate the content and conduct of sweepstakes. Also, sweepstakes and contests of skill are monitored by the attorneys general of each of the states in which there are participants to the contest. Accordingly, it is typically not the law of any one state that will govern a contest (unless the contest is strictly local), but the laws of *all* of the states, as well as federal laws.

Consequently, when planning a sweepstakes promotion, businesses should be mindful of the do's and don'ts of running such a contest. This article discusses the general requirements for running a sweepstakes. Key differences in the various state laws will be noted, but if you are planning on running a multi-state contest, you should make sure you comply with the rules for each state from which entries will be accepted. Additionally, this article is not exhaustive. If you are planning a sweepstakes, you should have your rules drafted or reviewed by a qualified attorney.

A Sweepstakes Cannot be a Lottery

The most important rule in planning a sweepstakes is to ensure that it does not violate state lottery laws. Most states prohibit private lotteries, which generally have three characteristics: (1) something of value is given away; (2) by random chance; (3) and entrants must provide consideration for their entry. Sweepstakes necessarily require the first two characteristics, but must scrupulously avoid the third. This is accomplished by providing a method of free entry for the sweepstakes without requiring any payment or consideration. Thus, the popularity of the highly-recommended words "No purchase necessary" in contest rules.

If game pieces are provided with products that are typically purchased, then alternate free means of entry must be provided. The alternate method of free entry must be real and must be treated the same as other entries in the sweepstakes process in all respects (times for entry, number of entries per transaction, limitations, etc.). Alternate free entry methods must not be unduly burdensome so as to discourage participation.

One must use care to not require consideration of any form in a sweepstakes. For example, in Tennessee the requirement of the use of the winner's name or photograph for publicity purposes is considered "consideration." Requiring extensive surveys for entry or extra marketing benefits may also be viewed as consideration.

Businesses should also be careful to avoid consideration "traps" such as allowing one free entry and permitting extra entries in exchange for purchasing a product. Such inducements require the consumer to pay something for an extra chance in the sweepstakes, and potentially run afoul of the private lottery prohibition.

Best Practices for a Successful Sweepstakes

To ensure a properly-conducted sweepstakes, a written set of rules should be drafted to comply with the universal requirements for a sweepstakes. Sweepstakes rules do not have to be lengthy, but they need to be accurate. When authoring rules for a contest, one should be mindful that the rules are essentially a contract between the participants and the sponsor.

ENTRY AND WINNING

Rules relating to the method of entry and the nature of the contest should be stated with particularity. Entry details should include the starting and ending dates of the contest and limits on the number and type of entries (e.g. "one entry per person").

The methodology for selecting the winner should be clear and complete. Is the winner selected at random from all entries? Or are only the entries meeting certain qualifications entered in the drawing? If any requirements are made of the winner, such as releases or affidavits of eligibility or if additional information is required of the winner, these should also be set forth in the rules. The rules should contain the odds of winning the contest, if they can be computed. If the odds are variable (because of variations in the number of entries received or the number of prize tickets distributed, etc.), this should be noted, along with the factors upon which the odds will vary.

PRIZE DESCRIPTION

The prize description should be complete and accurate, and should address all possible questions. By way of example, when the prize includes a trip, one should disclose as much as possible in order to prevent misconceptions about the prize package: What is the mode of transportation? Is the airfare provided coach, business, or first-class? From where does the plane depart? Is hotel included? Meals? Spending money? Taxes? Each of these questions that can be answered should be answered, providing a complete description of the prize. Finally, the prize description should include an approximate retail value, noting any expected variations.

ADVERTISING

Once the rules for a contest have been established, the contest must be advertised to the target audience, usually the public at large. Advertisements should clearly identify the sponsor of the contest.

In all states except for Florida, a sponsor may use abbreviated rules in advertising. Such abbreviated rules should include the identify of the sponsor, mention of the eligibility and dates of the contest, and include statements that no purchase is necessary and that the contest is void where prohibited. Importantly, abbreviated rules must also disclose how to get a copy of the full set of rules. That means that full copies of the rules must be made readily available to contestants, and, depending on the state, may have to be posted at retail establishments where the sweepstakes is played.

Florida requires that all print advertising of contests to the residents of its state contain the complete official rules of the contest. Video and audio media may use abbreviated rules.

WE HAVE A WINNER!

Once a winner is determined, certain steps are required to make sure that any sources of liability are optimally covered.

All prize winners should be required to sign a release and affidavit of eligibility as a condition of receipt of the prize. Such a requirement should be disclosed in the rules. Releases should certify compliance with the contest rules, acknowledge forfeiture for non-compliance, acknowledge acceptance of the prize as complete and final, and release the sponsor (and its officers, etc.) from all liability from the contest. Consideration for the release may be noted to be the prize.

Generally, contest rules will make all taxes the responsibility of the winner. If a prize is awarded having more than $500 in value, the sponsor must provide the winner a 1099 for federal income tax purposes at the end of the year.

By addressing all of these details ahead of time, businesses can conduct a sweepstakes that generates publicity rather than liability.

ENDNOTES

1 Tom Van Arsdel is an attorney in the Houston office of Winstead PC. His practice includes litigation and counseling in business torts, intellectual property, lender liability, and international construction.

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By Gregory S.C. Huffman

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