JONES DAY

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PROPOSED FTC RULE CHANGES WOULD SQUEEZE LITIGANTS IN MERGER AND CONDUCT CASES

On Thursday, September 25, the Federal Trade Commission announced and released for public comment proposed changes to the rules governing trials held before the Commission. The changes, if adopted, could have a significant effect on both merger and non-merger litigation. They should be of particular interest to companies in industries that are traditionally subject to review by the FTC, including companies in the pharmaceutical, medical devices, health care, computer, semiconductor, chemical, energy, and retail sectors.

The announced purpose of the changes is to address concerns that the FTC's internal litigation procedure is too slow. Although the proposed changes would affect the litigation schedule in both merger and non-merger cases, the greatest impact would be in merger cases. Indeed, it appears that an intended goal of the changes is to reduce the role of federal courts in merger litigation, and to strengthen the position of the Commission, not as a litigant but as a decision-maker, in such cases. The proposed rule changes would fail to address the single most significant source of delay in Part 3 litigation, however—the length of time taken by the Commission to issue decisions on appeal.

Instead, by condensing the pretrial and trial schedule, the specific changes will affect the way parties prepare and try cases in Part 3 litigation. Many of the changes to the discovery process, motions practice, and trial procedures are likely to make it more difficult for respondents to litigate effectively in Part 3 proceedings. Whatever the effect of the Commission's proposed rule changes on preliminary injunction litigation against the Commission in federal court, the changes are likely to make it more difficult for respondents in both merger and non-merger cases in Part 3 litigation to mount an effective defense.

The Commission will accept and review comments from interested parties before deciding whether to adopt the proposed rule changes. The deadline for

public comments is 30 days from the date of publication of the proposed rule changes in the Federal Register.

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Section 5(b) of the FTC Act, 15 U.S.C. §45(b), provides that, if it has "reason to believe" that a corporation is engaging in an unfair method of competition, the Commission may issue a complaint stating its charges and hold a hearing with respect to those charges. If the Commission finds that a violation has occurred, Section 5(b) grants it the authority to issue an order requiring the corporation to cease and desist the practice in question. Parts 3 and 4 of the Commission's Rules of Practice, 16 C.F.R. Parts 3 and 4, govern adjudicative proceedings held before the Commission. The Commission's Part 3 rules set forth the procedures for pleading, discovery, motions, trial, and post-trial briefing and argument before an administrative law judge, and following issuance of an initial decision by the administrative law judge, for appeal of the initial decision to the full Commission. (The Commission may consider the record de novo and may adopt, modify, or set aside any and all parts of the initial decision. The Commission's decision and order may be appealed to a United States Court of Appeals.) The Commission's Part 4 rules govern miscellaneous Commission procedures.

The Commission's Part 3 procedures have been used primarily in conduct cases and also in a small number of consummated mergers. When it challenges a merger prior to consummation, the Commission typically authorizes the filing of a Part 3 complaint at the same time it files a complaint and motion for a preliminary injunction in federal court; as a practical matter, however, the federal court action usually proves determinative. If the Commission obtains a preliminary injunction, and issuance of the injunction is sustained on appeal, the merging parties usually lack the practical ability to keep the transaction together long enough to contest a Part 3 action. Conversely, if the Commission loses the injunction hearing and fails to have that result overturned on appeal, the Commission usually has chosen to abandon its Part 3 action. In fact, we are aware of no instance where a merger case has been tried administratively after entry of a preliminary injunction, nor of any merger case in almost 15 years that has been tried administratively after denial of a preliminary injunction. The federal courts have recognized this practical reality, and in response usually permit an extensive presentation of evidence with live witnesses in preliminary injunction hearings.

Recently, the Commission has sought to reduce this decisive influence of federal courts, and to assume a greater role as decision-maker, in its merger challenges. In *Fed. Trade Comm'n v. Inova Health System Found.*, Docket No. 1:08cv460 (E.D. Va., filed May 12, 2008), the Commission, as it typically does, filed a motion for a preliminary injunction in federal district court. However, the Commission argued that, because it was committed to conducting a full trial on the merits in its Part 3 procedure as rapidly as possible, the district court need not hold as extensive a preliminary injunction proceeding as it otherwise might. In its parallel Part 3 proceeding, the Commission designated Commissioner Rosch as the administrative law judge to preside over the matter. Commissioner Rosch entered a scheduling order that set trial for approximately five months after the date the complaint was filed. Whether in response to the Commission's arguments or otherwise, the district court ruled that it would not hold an evidentiary hearing, but instead would conduct its review entirely on the papers. The parties abandoned the transaction shortly thereafter.

The Commission's proposed changes to its Part 3 rules appear calculated to institutionalize portions of the procedure used by the Commission in *Inova*. An important question will be whether federal courts believe these changes would speed up the administrative process sufficiently to permit parties to a pending merger to complete a Part 3 trial rather than being forced to abandon their transaction. If so, the Commission's proposed rule changes could reduce the role of federal courts and increase substantially the importance of the Commission's Part 3 procedure in merger cases. However, the most important aspect of these rule changes for the way federal courts treat preliminary injunctions may be what the changes do not do—they do not speed up the extremely slow review of administrative law judge decisions by the Commission. In addition, whether intentionally or otherwise, many of the specific proposed changes will have a far-reaching impact on companies facing Part 3 litigation before the Commission in all types of cases, and in some instances may affect adversely the ability of companies to litigate effectively. In short, the increased speed to be achieved

by the proposed new rules comes primarily at the expense of curtailing the ability of respondents to conduct discovery and mount an effective defense in response to the extensive third-party evidence typically collected by the Commission staff during its pre-complaint investigation.

Among the significant changes are the following:

Expedited Trial Date. The Commission proposes to set trial, as a matter of course, five months after the complaint is filed in merger cases and eight months after the complaint is filed in non-merger cases. While some respondents may welcome a rapid trial, this provision is also likely to disadvantage respondents significantly, particularly in conduct cases. Complaint counsel (a.k.a. Commission staff) has the opportunity to conduct months, sometimes years, of third-party discovery during its pre-complaint investigation. Even if the entirety of this material is turned over to respondents promptly at the outset of Part 3 litigation (which is not always the case), respondents start at a significant disadvantage. An expedited trial date gives respondents very little time to gain a thorough understanding of the information collected by Commission staff during the investigation and to conduct their own third-party discovery.

Answers. The Commission proposes to require respondents to file an answer within 14 days of service of the complaint (rather than the current 20 days). Commission complaints are often quite detailed, especially in non-merger cases, and the answer requires significant care and attention. Indeed, the answer can shape a respondent's entire case. A deadline of 14 days would require a respondent to be well-organized and prepared before completion of the investigation in order to be able to craft an effective answer that is consistent with its planned litigation strategy.

Dispositive Motions. The Commission proposes to give the Commission, rather than the administrative law judge, the authority to decide dispositive pre-hearing motions. Put bluntly, the Commission would have the authority to decide whether its own complaint should be dismissed pre-trial. Currently, complaint counsel can appeal to the full Commission an order by the administrative law judge dismissing the complaint; thus, the net effect may be little changed. (This occurred, for example, in *In the Matter of Unocal*.) Nevertheless, the change could have two consequences. First, respondents would lose the opportunity to have a separate, neutral decision-maker provide an independent written opinion with respect to respondent's motion (even if that motion were ultimately decided by the Commission). And second, respondents would lose one of very few opportunities to present its views on the dispositive issues to the administrative law judge before trial.

Commission Presiding Over Discovery. The Commission's changes would permit an individual Commissioner to preside over discovery and other pre-trial proceedings. (The language of the amendment would also permit the full Commission to preside over discovery, but as a practical matter this would be almost impossible within the deadlines contemplated by the amended rules.) Again, this has potential adverse consequences for respondents. Typically, Commission staff has had months, even years, to conduct the discovery it wants during its investigation. In light of the Commission's avowed interest in expediting the pre-trial schedule, a Commissioner presiding over discovery may have an incentive to limit discovery sought by respondents so as not to jeopardize the Commission's desired schedule. In addition, this change (in combination with others) would eliminate almost all opportunities for the administrative law judge to learn about and become engaged in a case before the start of trial. It also has the potential to delay resolution of discovery disputes, given a Commissioner's other responsibilities and schedule, which is more likely to disadvantage respondents than complaint counsel.

Standard Protective Order. The Commission proposes to require the administrative law judge to enter a standard protective order in every case. Under current rules, issuance of a protective order sometimes takes two or three weeks as the parties negotiate specific issues. Entry of a standard protective order is likely to permit respondents to gain faster access to confidential information in the possession of complaint counsel. Depending on the specifics of the standard order, however, it may come at a cost. For example, a common issue of negotiation is whether a respondent's in-house counsel will have access to confidential third-party information, including copies of party briefs and filings containing such information. One result of a standard protective order is that respondents may lose the opportunity to seek

authorization for an in-house representative to have access to confidential third-party information.

Limit on Waivers of Privilege. In one of very few pieces of good news for respondents, the proposed rules would expressly limit any waiver of privilege resulting from inadvertent disclosure of privileged materials. This is unlikely to have a significant impact on current practice, however, as Commission staff generally have followed this policy and, in the rare instances where they haven't or there has been a dispute as to whether the disclosure of privileged material was inadvertent, the administrative law judges usually have been very reluctant to find that privilege has been waived.

Limit on Number of Expert Witnesses. The Commission proposes to limit the number of expert witnesses to five per side. While this may be adequate for a case involving a single respondent, it may work significant injustice in a case involving multiple respondents, especially if respondents have inconsistent theories or strategies. (For example, if multiple respondents accused of collusion assert that they acted independently, the limitation of the number of expert witnesses could severely hamper the ability of individual respondents to present their defenses.)

Limit on Length of Trial. The Commission proposes to limit the length of trial to the equivalent of 30 trial days, to be divided evenly between each side. As with the limit on expert witnesses, this could seriously disadvantage respondents in a multiparty case. Even in cases involving a single respondent, complaint counsel may have an advantage if it has significant evidence from the depositions of respondents' witnesses. It may be able to enter the written transcripts into evidence as party admissions, forcing the respondent to use valuable trial time to present its witnesses live.

Video Recording of Testimony. The Commission would also require that all witness testimony be video recorded. A likely purpose for this change is to strengthen the Commission's position on appeal, if the Commission reverses the initial decision of the administrative law judge. In *Schering-Plough*, for example, when the Eleventh Circuit rejected the Commission's findings of fact that contradicted those of the administrative law judge, the court specifically noted the importance of the credibility findings of the administrative law judge who "observed the witnesses." *Schering-Plough Corp. v. Fed. Trade Comm'n*, 402 F.3d 1056, 1070-71 (11th Cir. 2005). The Commission may expect that this change in rules would permit it to argue on appeal that it also "observed" the witnesses, and thus is entitled to make credibility findings on par with those of the administrative law judge.

Deadline for Commission Decision. One change that is conspicuously absent from the Commission's proposal is a deadline for the Commission itself to render a decision. As noted above, the proposed changes appear calculated to permit the Commission to argue to a federal court in a preliminary injunction hearing that, because the merging parties can expect a rapid trial and decision by the administrative law judge, the potential burden of a preliminary injunction is lessened. This argument fails to consider that the largest source of delay in the Commission's Part 3 process is not at the trial level but on appeal to the full Commission. Indeed, review of the eight Commission Part 3 cases filed since 2000 that have resulted in an initial decision (*In the Matters of Schering-Plough Corp.*, *Polygram Holding, Inc., Chicago Bridge & Iron Co.*, *Rambus Inc.*, *Kentucky Household Goods Carriers Ass'n*, *North Texas Specialty Physicians*, *Evanston Northwestern Healthcare Corp.*, and *Realcomp II Ltd.*) reveals that the average time from the complaint to the initial decision (encompassing full factual discovery, motions practice, trial, post-trial briefing and argument, and the initial decision) has been 15.6 months. By contrast, in the seven matters in which the Commission has issued a decision, the average time on appeal, from the initial decision to the Commission's final order, has been 21.6 months. (The *Realcomp* matter is currently pending before the Commission; briefing on appeal was completed in March 2008, and there has been no action since April 2008.) Even disregarding any specific remedy proceedings added by the Commission, it has taken the Commission on average more than 18 months to render a liability decision on appeal.

The Commission's proposed changes appear calculated to reduce the average time of 15.6 months from complaint to initial decision to a maximum (assuming no extensions are granted, which is a big assumption) of approximately 9.5 months in merger cases and 12.5 months in conduct cases. This would be accomplished by compressing the busiest part of the schedule—the pre-trial discovery and motions period,

the trial, and the immediate post-trial briefing and findings—with potential adverse consequences for respondents. It would fail to address, however, the greatest source of delay—the average of 18 to 21 months it takes the Commission to issue decisions on appeal. While respondents may welcome a reduction in the average three-year duration of Part 3 litigation from complaint to final Commission order, many respondents may conclude that the relatively modest reductions that would result from the Commission's proposed changes to its Part 3 rules are not worth the likely adverse impact on respondents' ability to litigate effectively before the Commission and establish a record for appeal to a circuit court. Certainly, respondents would want the ability to influence the tradeoff between the desire for a rapid result, on the one hand, and the importance of allowing adequate time for full discovery, a meaningful motions practice, a complete trial, and a carefully reasoned initial decision, on the other, rather than be forced to conform to the proposed new schedule without regard to the circumstances of the particular case.

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The deadline for submission of public comments to the Commission is 30 days after the date the Commission's notice and proposed rules are published in the Federal Register. Publication is expected in early October 2008.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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