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A BRIEF ANALYSIS OF POLICY AND LITIGATION

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Franchise No-Poach Agreements – the Debate of Standard of Review

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Vice President Erica E. Greulich is an empirical microeconomist who consults on employment and antitrust matters.

A Michigan federal judge recently ruled against Domino Pizza's motion to dismiss a lawsuit accusing it of violating antitrust laws with a no-poach agreement that prevented a franchisee from hiring employees away from other Domino's locations. Additional suits have been filed by employees of other franchisors, including McDonald's and Pizza Hut. Employees argue that because no-poach clauses prevent them from applying for jobs at other locations within the same chain, they are denied potential promotions and higher pay.

This year, the Department of Justice ("DOJ") filed Statements of Interest in three no-poach class actions brought by former employees of Arby's, Auntie Anne's and Carl's Jr. DOJ contends that in the absence of an agreement among franchisees, restrictions in a franchisor-franchisee agreement that prevent franchisees from poaching each other's employees are a vertical restraint of trade. According to DOJ, these types of vertical agreements have potential consumer benefits, such as the promotion of inter-brand competition, and the no-poach class actions should be judged under the rule of reason standard. DOJ further argues that courts should weigh the potential anticompetitive effects against these consumer benefits, which renders the "quick-look" form of rule of reason analysis inapplicable.

Several states are at odds with DOJ's position, including the state of Washington. Washington's Attorney General filed a Statement of Interest opposing DOJ in the same three cases, asserting that not all franchisor-franchisee agreements should be viewed as vertical restraints, and to the extent that such agreements include horizontal restraints they should be analyzed under the *per se* standard. For example, a franchisor and franchisees can be horizontal competitors in a specific employment market if the franchisor operates company-owned locations in the same market as a franchisee.

The three cases in which DOJ and the Washington Attorney General filed their Statements of Interest settled before any ruling was issued regarding the legal standard workers must meet to prove that no-poach agreements between a franchisor and franchisee are illegal. The Domino's case, if it does not settle, will probably consider the applicable legal standard. Market- and franchise-specific factors, including whether the franchisor owns and operates competing locations, will likely be determinative. Despite the lack of rulings on legal standards, franchisors have responded to these no-poach class action suits and state attorney generals' investigations. Many, most notably fast food restaurants, have agreed to cease their use of no-poach clauses that prevent employees from moving among locations.

Also In This Issue

The Federal Trade Commission and Department of Justice Diverge on Qualcomm SEP Licensing

Robert D. Stoner discusses the recent opposition between the Federal Trade Commission ("FTC") and Department of Justice ("DOJ") due to the Statement of Interest filed by the DOJ in the FTC's antitrust lawsuit against Qualcomm. Dr. Stoner finds that there are several factors that are somewhat unique to the Qualcomm case that may explain part of DOJ's divergence from the FTC position. These factors include, among others, that Qualcomm is not a typical innovator/implementer and a FRAND royalty rate based on a component price is not clearly theoretically superior to one based on the end-use product price. For these reasons, DOJ's differences with the FTC on this case may not necessarily signal conflicting positions on future cases.

Changing the Consumer Welfare Standard

John M. Gale discusses the Consumer Welfare Standard ("CWS") and the current debate as to whether the CWS should be broadened to include additional non-price measures. Dr. Gale discusses the concerns raised by proponents of broadening the CWS, including concerns over increases in market concentration. Dr. Gale also considers empirical studies that find that the increase in concentration is not across all industries or marketplaces, but tends to occur under specific circumstances. Dr. Gale concludes that while the goal of a broadened CWS is to better protect consumers and promote other societal benefits, a broadened CWS also may have significant drawbacks – including how to measure benefits, how to balance tradeoffs, and how to consistently and efficiently enforce.

The Federal Trade Commission and Department of Justice Diverge on Qualcomm SEP Licensing

Robert D. Stoner

The Federal Trade Commission (FTC) and the Department of Justice (DOJ) recently appeared to be in opposition as a decision was pending (and subsequently delivered) in the FTC's antitrust lawsuit against Qualcomm relating to licensing practices for its modem chip standard essential patents (SEPs) used in cellphones. DOJ filed a Statement of Interest indicating that any remedy should not interfere with the defendant's innovation incentives going forward, and the FTC immediately opposed the DOJ position. What does this apparent opposition say about the future direction of enforcement policy on licensing SEPs? A further look into the facts of the Qualcomm case suggests that these opposing views may be at least partly due to case-specific facts and circumstances. Thus, this current opposition may not necessarily signal conflicting positions on future cases.

Apple also brought, and recently settled, an antitrust lawsuit against Qualcomm. The central issue in both the FTC and Apple lawsuits was Qualcomm's practice of requiring iPhone assemblers not only to pay for Qualcomm's modem chipsets but also to license its patented chip technology at an allegedly exorbitant royalty rate applied as a percentage of end use phone prices ("no license no chips"). The FTC litigation additionally challenged Qualcomm's refusal to license to its chip competitors. The court in the FTC lawsuit found for the FTC, holding that Qualcomm must not condition the supply of modem chips on a customer's patent license status (rejecting "no license no chips"), and that Qualcomm must, counter to its longtime business model, make SEP licenses available to competitor modem-chip suppliers on a fair, reasonable, and non-discriminatory (FRAND) basis.

"Thus, this current opposition may not necessarily signal conflicting positions on future cases."

DOJ argues in its Statement of Interest that the remedy in this case (which could potentially force Qualcomm to renegotiate all of its existing licensing agreements and significantly reshape the industry licensing structure) needs to be very carefully tailored so that it does "not interfere with the defendant's innovation incentives going forward." Further, the DOJ Statement of Interest states that "the remedy should work as little injury as possible to other public policies" and suggests that an overly broad remedy "could reduce competition and innovation in markets for 5G technology and downstream applications that rely on that technology." FTC staff immediately opposed DOJ's position, stating that it generally "disagree[ed] with a number of contentions in the Statement."

Principal Robert D. Stoner advises clients on matters involving standard essential patents, FRAND obligations, and patent damages. He is based in EI's San Francisco Bay Area office.

DOJ's pro-patent holder intervention could simply be a reflection of AAG Makan Delrahim's stated position that antitrust enforcement had gone too far in accommodating the concerns of implementers at the expense of the patent owners of SEPs. However, there are several factors that are somewhat unique to the Qualcomm case that may also be driving the DOJ position.

First, Qualcomm is not a typical innovator/implementer. In a more typical case, the patent holder either has no implementer position or has both a significant number of SEPs relevant to the end use product and also manufactures the end-use product. Thus, the potential licensing concern is one either of "hold up" or of exclusion/raising rivals' costs, since the patent holder may want to raise the costs of its end-product rivals by charging them high patent royalty rates. By contrast, Qualcomm holds SEPs relative to a *component* (modem chips) of the end-use product and also manufactures those chips, but does not compete in the end-use market. Thus, Qualcomm has little or no incentive to raise the costs of smartphone manufacturers and every incentive to maximize sales to smartphone manufacturers. This being the case, Qualcomm appears to be using its strong position in modem chips (where it has a high market share and allegedly makes advanced chips preferred by smartphone manufacturers) to get smartphone manufacturers, as a prerequisite to receiving those superior chips, to license based on a percentage of smartphone prices. There is nothing inherently confiscatory about such a strategy—as long as the royalty when applied to the royalty base is in line with the true value of the patents in the end-use product. DOJ's position appears to recognize Qualcomm's lack of implementer status and its economic interest in maximizing phone sales, which may explain part of its divergence from the FTC position.

continued on page 4

Changing the Consumer Welfare Standard

John M. Gale

Vice President John M. Gale has experience testifying on the market effects and damages due to anticompetitive conduct.

The definition of the Consumer Welfare Standard ("CWS") as a measure to judge the effects of market consolidation or firm competitive practices is under review. The CWS used by both the Federal Trade Commission ("FTC") and Department of Justice ("DOJ") analyzes the effect on the final price to consumers with some consideration of non-price factors such as innovation, quality, and efficiencies. The price-based CWS has been a fairly objective and consistent standard based on economic theory and market facts. This price-based CWS is now under scrutiny, because recent studies suggest there is an ongoing economy-wide increase in concentration. Additionally, a purely price-based CWS may not be adequate for analyzing markets where consumers pay a zero price, and it also may not capture the effect on consumers and market efficiency when "big data" allows some sellers to perfectly price discriminate among buyers. However, there is no consensus among economists on how, or even whether, to broaden the CWS to address these issues or whether to add measures that consider the effects on other participants in a market.

The FTC's recent public hearings on "Competition and Consumer Protection in the 21st Century" included comments on broadening the CWS to include non-price measures of consumer welfare and measures of effects on other market participants. Chairman Simons stated in his opening remarks, "...some are debating the very nature of antitrust itself, calling for antitrust enforcers to take account of policy goals beyond consumer welfare. Inequality, labor issues, excessive political power are perhaps the main examples." The central issue is whether antitrust enforcement is properly focused on protecting consumers from price increases or if enforcement should be broadened to protect competition in order to ensure additional benefits to society.

"However, there is no consensus among economists on how, or even whether, to broaden the CWS..."

Economists and practitioners in favor of including non-price effects on consumers and effects on other market participants argue that empirical studies over the last twenty-five years show increases in market concentration, decreases in share of costs accruing to labor, and a slowdown in innovation and productivity growth. They attribute these changes to the fact that some industries have only one firm, or a small handful of firms, dominating the industry. They argue that merger review using the current price-based CWS may allow these larger and more dominant firms to acquire small competitors and potential competitors. Some studies suggest that dominant firms may not have incentives to ensure data privacy, may wield significant political power, and may lead to increased income inequality, decreased wages, and higher unemployment. For example, in some technology markets, individual firms that pioneered an industry and have a large market share may be able to raise significant barriers to entry, either through network effects, proprietary control of consumer-generated content, or exercising political power. Thus, these economists and practitioners argue that a welfare measure that includes effects on income distribution, labor cost share, privacy protection, and innovation may be better suited for analyzing some markets.

Broadening the CWS to include these types of additional measures is not simple and raises other potential concerns. A broadened CWS may create a new "multi-goal" framework, and which goals should be considered, and the relative importance of each goal, may vary from case to case. This variation can create confusion for practitioners and the courts, which can result in firms forgoing efficiency-enhancing actions and inefficient enforcement. Practitioners and courts are familiar with the price-based CWS, and there is a long litigation history of using a "small but significant price increase" as the measure of consumer welfare. Proponents of a broadened standard have not articulated how different benefits to consumers (such as price, quality, variety, and privacy) should be traded off against benefits to employees, ownership, and society in general. In addition, other societal problems, such as wage rates and income distribution, may be better addressed through regulation, tax policy, and other legislative functions.

Moreover, the studies showing increased concentration, cited by proponents of broadening the CWS, have mixed

continued on page 4

The FTC and DOJ Diverge on Qualcomm SEP

Second, it is not clear that Qualcomm's refusal to license its chip competitors necessarily puts these competitors at a competitive disadvantage. Qualcomm's refusal to license its chip competitors does not mean that these chip suppliers were unable to supply their own standard-compliant chips to handset manufacturers due to fear of infringement The license was already "paid" by the handset manufacturer (for example, Apple) by means of the handset-based royalty paid to Qualcomm. It is only in the unlikely case that standard-compliant chips sold by Qualcomm's competitors did not infringe Qualcomm SEP technology that there is an arguable issue that Qualcomm's competitors are disadvantaged, since in that event Qualcomm would receive a handset-based royalty despite the use of non-infringing competitor chips.

Third, a FRAND royalty rate based on a component price is not clearly theoretically superior to one based on the end-use product price. The value paid for the intellectual property would still be the same as long as a royalty rate is calibrated to the royalty base—i.e., a lower royalty rate is applied to a larger royalty base and a higher royalty rate is applied to a smaller royalty base. In addition, there could be transactions cost savings connected with collecting royalties at the end-user stage compared to the intermediate product stage, meaning that the choice of alternative can be more of a business decision rather than a competitive strategy. This view that royalty rates can efficiently be taken at any level of the production process, which is consistent with a contract view of FRAND licensing, may well have been another factor leading DOJ to view Qualcomm's licensing policy more benignly than the FTC.

Finally, DOJ seems particularly concerned that the remedy phase in the FTC case comes at a time when the smartphone industry is currently transitioning to 5G. For these reasons, DOJ's differences with the FTC may be more idiosyncratic to this case than they appear at first blush and may not indicate differences on cases going forward.

Changing the Consumer Welfare Standard

findings. Additional studies find that the increase in concentration is not across all industries or marketplaces, but tends to occur in industries with technological innovation, where successful firms may have a first-mover advantage, or in declining industries which are experiencing exit by participants. Thus, stating that a single "big" firm dominates a market is not sufficient for determining whether competition has been harmed. It must be determined whether a firm's actions are part of the competitive process or disruptive of the competitive process. Broadening the CWS will complicate such an analysis.

Another concern is that broadening the CWS may lead to a Total Welfare Standard (TWS). A TWS values firm efficiencies, whether or not passed through as lower prices to consumers, and increased participant profits as part of the determination of whether a merger or competitive action is likely to harm competition. A review using a TWS may approve mergers or competitive actions that raise consumer prices in the short run, because there are benefits to firms, employees, and the overall economy.

The current price-based CWS, while facing criticism, has resulted in fairly objective and consistent enforcement. Additionally, the *Horizontal Merger Guidelines* allow for the evaluation of non-price factors, such as quality and innovation, and merger efficiencies, as well as any potential monopsony concerns. While the goal of a broadened CWS is to better protect consumers and promote other societal benefits, a broadened CWS also may have significant drawbacks – including how to measure benefits, how to balance tradeoffs, and consistent and efficient enforcement.

EI News and Notes

Simona Andrei Joins EI

Simona Andrei recently joined EI's Tallahassee, Florida office. Dr. Andrei provides expertise in matters involving disparate impact in employment practices, wage and hour compliance, and the calculation of potential economic exposure in labor and employment matters. Dr. Andrei earned her Ph.D. degree from the University of Maryland.

Spring 2019 Utility of the Future Rates Group (UFRG) Meeting Held

The Spring 2019 Utility of the Future Rates Group (UFRG) meeting was successfully held in Redondo Beach, CA, on May 30-31, 2019. Utility directors and managers from private and publicly-owned utilities across several regions of the United States and Canada met to discuss critical issues and innovative approaches related to electricity rates and programs for Distributed Energy Resources. EI's Senior Vice President Amparo Nieto directs the UFRG. The next UFRG meeting will be held in the Fall. For more information about the group please visit https://ei.com/utility-future-rates-group/.

Global Competition Review Selects Five EI Economists for Inclusion in the International Who's Who of Competition Lawyers and Economists 2019

Corporate Vice President and Principal David A. Argue, Senior Vice President Lona Fowdur, Senior Vice President Paul E. Godek, Special Consultant and Director William C. Myslinski, and Principal Philip B. Nelson are included in the latest edition of *The International Who's Who of Competition Lawyers and Economists 2019.* Economists are selected for inclusion based on Global Competition Review's independent surveys of general counsels and private practice lawyers worldwide.

Third Circuit Affirms Judgment for Argos

The Third Circuit affirmed a district court ruling in favor of Argos USA in a Robinson-Patman case brought by Spartan Concrete Products. EI Chairman Barry C. Harris was the economic expert for Argos in the federal court case. EI Special Consultant Kent Mikkelson and EI Senior Vice President Lona Fowdur worked with Dr. Harris.

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