

March 26, 2002

BOSTON

Office of the Secretary  
Federal Trade Commission  
600 Pennsylvania Avenue, N.W.  
Washington, DC 20580

BRUSSELS

HARRISBURG

HARTFORD

RE: December 19, 2001, Notice Requesting Comments Re: Disgorgement

LONDON

To the Commission:

LUXEMBOURG

On December 19, 2001, the Commission issued a notice requesting comments on various issues relating to the use of disgorgement under Section 13(b) of the Federal Trade Commission Act ("FTCA"), 15 U.S.C. §53(b), as a remedy for violations of the FTCA, Hart-Scott-Rodino ("HSR") Act, and Clayton Act (the "Notice"). This letter is submitted in response to that Notice primarily to comment on the standards applied by the Commission to determine whether or not to seek disgorgement as a remedy. This letter does not comment specifically on how disgorgement should be calculated, though it does touch on this question in the context of explaining which cases are appropriate for use of a disgorgement remedy.

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WASHINGTON

The Commission has explained that disgorgement is an extreme remedy that should be used only in the most egregious cases to ensure that serious violations of the law are not profitable. (See Part I infra.) We agree with that premise and, in this letter, propose standards for identifying those cases that are sufficiently egregious to warrant disgorgement, (see Part II infra), and defend the principle that disgorgement should only be sought when necessary to ensure that the violation at issue is not profitable, (see Part III infra). We do not argue that disgorgement is never appropriate, but we do believe that the conditions justifying its use will very rarely be present.

We agree with Commissioner Leary that, "[a]t the very least," the Commission should make clear that the disgorgement "remedy will not be sought in cases where the violation is unclear and where private damage remedies are available and being pursued." (FTC v. Mylan Pharms., Inc. et al., File No. X990015 ("Mylan"), Statement of Commissioner Leary, Dissenting In Part and Concurring In Part at 1 ("Mylan, Leary Stmt.") (emphasis added).) In particular, we propose that disgorgement should only be sought in cases where each of the following conditions apply: (1) there has been a violation of the law that was well established as such under clearly articulated existing precedent, (see Part II infra); (2) other remedies, including private actions for treble damages, are not being pursued or are inadequate to make the challenged conduct unprofitable, (see Part III infra); and (3) the

profits to be disgorged result directly from the unlawful conduct at issue, (see Part IV infra). We also propose that disgorgement proceeds should be paid to the victims of the unlawful conduct, to the extent those victims have valid claims for relief against the wrongdoer. (See Part VI infra.)

We want to thank the Commission for this opportunity to comment on this important aspect of its enforcement policy. It is our hope that out of this exercise will come clear standards for determining when the Commission will seek disgorgement. Given the paucity of case law or other authority defining the bounds of the Commission's disgorgement remedy under Section 13(b), such standards will provide much-needed guidance for counseling clients in this area.

**I. The Commission Should Only Seek Disgorgement To Prevent Egregious Violations Of The Antitrust Laws From Being Profitable.**

The Commission has explained that disgorgement is an extraordinary remedy that should only be used in the most egregious cases to ensure that serious violations of the antitrust laws are not economically rational. In the recent Mylan case, for example, the Commission agreed that it "should cautiously exercise its prosecutorial discretion to seek disgorgement in antitrust cases," explaining that "[s]uch relief is best reserved for cases, like this one, in which the defendants have engaged in particularly egregious conduct." (Mylan, Statement of Chairman Pitofsky and Commissioners Anthony and Thompson at 4 ("Mylan, Stmt. of Majority").) The Commission added that "[t]he purpose of a disgorgement order is to ensure that the defendant does not reap the rewards of its unlawful conduct." (Id. at 2-3.)

Similarly, when the Commission authorized the filing of a complaint in FTC v. The Hearst Trust, File No. 991 0323 ("Hearst"), it explained that "[t]he remedy of disgorgement should be sought by the Commission in competition cases only in exceptional circumstances." (See 04/04/01 Statement of Chairman Pitofsky and Commissioners Anthony and Thompson.) It further explained that divestiture would be an "inadequate [remedy in the Hearst case] because it allows the respondent to walk off with profits gained as a result of its allegedly illegal behavior." (Id.; see also Hearst, Statement of Commissioners Swindle and Leary Dissenting from Decision to Authorize Complaint ("We particularly dissent from the Commission's decision to seek disgorgement in this situation . . . [W]e believe that, if a violation is proved, existing private remedies are adequate to ensure that respondents do not benefit from any possible wrongdoing. . . ."))

From the perspective of practical enforcement policy, it is important that there be standards for identifying those cases that are "sufficiently egregious to justify the extraordinary remedy of disgorgement." In particular, explication of such standards is important so that the Commission's use of the disgorgement remedy is (and is perceived to be) principled, fair, and predictable and, relatedly, so that parties seeking to comply with the law have notice of when they may be subject to disgorgement. As Commissioner Leary explained in his concurrence and dissent in the Mylan case, although the "present members of the Commission may only intend to seek this extreme relief in extraordinary cases," the Commission's rulings do not limit the remedy and leave much room for over-application. (Mylan, Leary Stmt. at 1.)

II. **Disgorgement Should Only Be Sought When The Unlawfulness Of The Violation Is Clear And Well Established.**

In the Notice, the Commission asked whether there are “particular violations of the Clayton Act, the HSR Act, the competition provisions of the FTC Act, or final orders of the Commission in competition cases where disgorgement would be especially appropriate or, in contrast, less useful.” (Notice Question 1.) The Commission also asked what significance “the egregiousness of the conduct at issue” should have in determining whether to seek disgorgement. (*Id.* Question 2.) We believe that disgorgement should be reserved for use only in cases in which there has been a serious violation of the antitrust laws that was clearly established as such by prior precedent.

The scope of the Commission’s authority under Section 5 of the FTCA is murky. *See, e.g., FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239 (1972). The vague contours of the Commission’s authority under Section 5 pose serious problems for parties trying to conform their conduct to the law. Indeed, courts have recognized this problem and have explained that there must be “workable rules of law” for determining what conduct violates Section 5. *See, e.g., E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 137 (2d Cir. 1984) (explaining that “[a]s the Commission moves away from attacking conduct that is . . . a violation of the antitrust laws . . . and seeks to break new ground . . . , the closer must be our scrutiny upon judicial review”). The Commission itself has recognized that “[w]hile Section 5 may empower the Commission to pursue those activities which offend the ‘basic policies’ of the antitrust laws, we do not believe that power should be used to reshape those policies when they have been clearly expressed and circumscribed.” *In the Matter of General Foods Corp.*, 103 F.T.C. 204, 365-66 (1984) (footnote omitted).

The need for “workable rules of law” becomes even more acute when the Commission is considering the extreme remedy of disgorgement. Parties should not be subjected to an extreme form of relief for previously unknown or ill-defined violations of the law or for violations that are otherwise at the margins of the Commission’s mandate under Section 5. Indeed, the historical premise behind Congress’ grant of a broad mandate to define new unfair methods of competition was that the Commission’s remedies would be prospective only. *See, e.g., Heater v. FTC*, 503 F.2d 321, 324 (9th Cir. 1974) (“[T]o reconcile the Commission’s broad power with the need for a specific notice to an individual who must conform his behavior to the terms of the Act, Congress limited the consequences of violation of the Act to a cease and desist order.”)<sup>1</sup>

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1. *Accord Mylan*, Leary Stmt. at 5 (“I suggest that this kind of remedy in this kind of case is hardly what Congress had in mind when it passed the [FTCA] in 1914 or, for that matter, when it gave the Commission the power to seek injunctive relief in 1973. Our traditional role in competition matters has been to look forward rather than backward, to articulate the law where the law is uncertain, and to seek relief that is prospective and remedial rather than retrospective and punitive. As we stray progressively further away from that vision . . . we may unwittingly neglect our special mission.”)

Where the FTC “seeks to break new ground” by pursuing novel theories of liability or new extensions and applications of the law, or where it seeks to proscribe “incipient” violations or violations of the “spirit” of the antitrust laws, it should not seek disgorgement. Instead, as Commissioner Leary and former Bureau Director Parker have suggested, disgorgement should only be sought when the violation at issue is both serious and well-defined as being unlawful. See Report from the Bureau of Competition, Prepared Remarks of Director Parker, ABA Spring Meeting 2000 at 10 (April 7, 2000) (“Parker Rpt.”) (“The criteria for 13(b) cases include a serious violation of the antitrust laws . . .”); Mylan, Leary Stmt. at 1 (“At the very least, we might indicate that the remedy will not be sought in cases where the violation is unclear . . .”).

Specifically, disgorgement should only be sought (1) when the conduct at issue has previously been held to be per se unlawful or (2) when, based on clearly-articulated precedent, no reasonable litigant could believe the conduct to be lawful. Moreover, to justify the extraordinary use of a disgorgement remedy, there should be clear evidence that the violation at issue caused substantial harm to the public. This test should permit the Commission to remedy, when necessary, egregious violations of the antitrust laws, while also providing sufficient predictability to parties subject to those laws. Thus, with respect to competition cases arising solely under Section 5 of the FTCA (as opposed to, for example, cases like Hearst that involved violations of the HSR Act), the Commission should only seek disgorgement when the alleged violation is also a well-established violation of the antitrust laws (i.e., the Sherman Act, the Clayton Act, or the Robinson-Patman Act).

The rule advocated here is consistent with the Commission’s recent practice. For example, in the recent Hearst case in which the Commission sought disgorgement, it characterized the conduct as being a “particularly egregious”<sup>2</sup> and “grossly illegal”<sup>3</sup> violation that resulted in drastic price increases to consumers. Similarly, in Mylan, the Commission confronted “a clear cut antitrust violation that resulted in substantial consumer harm.” (Mylan, Leary Stmt. at 1; see also Parker Rpt. at 10 (“The 13(b) remedy is well-suited for the Mylan case because it does not involve such novel or complex concepts as to necessitate the Commission’s expertise in an administrative forum. This is an allegation of a classic antitrust violation, in which a group of firms conspired to keep competitors out of the market, enabling them to charge higher prices.”).)

In contrast, in Hoechst Marion Roussel, Inc. et al., Docket No. 9293 and Abbott Labs. and Geneva Pharms. Inc., Docket Nos. C-3945 and C-3946, the Commission explained that it was not seeking disgorgement because, *inter alia*, “the behavior occurred in the context of the complicated provisions of the Hatch-Waxman Act, and because [these are] the first government antitrust enforcement action[s] in this area.” (Abbott/Geneva, Stmt. of

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2. Hearst, Stmt. of Commissioners Swindle and Leary Dissenting from Decision to Authorize Complaint.
  3. See 04/04/01 FTC Press Release re: Hearst Complaint (quoting the then Acting Director of the Bureau of Competition, Molly Boast).

Commission with Analysis to Aid Public Comment.) The Commission warned, however, that “[p]harmaceutical firms should now be on notice . . . that arrangements comparable to those addressed in the present consent orders can raise serious antitrust issues” and that, “in the future, the Commission will consider its entire range of remedies . . . including possibly seeking disgorgement of illegally obtained profits.” (*Id.*)<sup>4</sup>

The distinction drawn by the Commission in these recent cases between egregious, well-established violations of the antitrust laws and new theories of liability should be confirmed by the Commission as a threshold test for seeking disgorgement. Fairness dictates that novel or close cases be remedied, not with disgorgement, but with prospective relief pursuant to cease and desist orders. (*See id.* (“[W]e believe the public interest is satisfied with orders that regulate future conduct by the parties.”).) For the reasons set forth above, the Commission should make clear that disgorgement will only be sought in cases in which the violation was well-established as a violation either under *per se* analysis or under clearly-articulated precedent pursuant to which no reasonable litigant could doubt the unlawfulness of the conduct at issue.

### III. **The Commission Should Not Seek Disgorgement When Other Remedies Are Available And Adequate To Make The Unlawful Conduct Unprofitable.**

In the Notice, the Commission asked how it should “weigh and what is the relevance to the Commission of . . . the adequacy of other forms of relief,” including the “ability of an affected party to secure relief independently of the Commission, *e.g.*, by private actions.” (Notice Question 3.) The Commission also asked whether “pending or potential private litigation, actions by attorneys general, or civil or criminal prosecutions by the Antitrust Division of the Department of Justice, [should] affect the Commission’s decision to seek disgorgement.” (*Id.* Question 4.) We believe that the availability and adequacy of other remedies is critical and that the Commission should not seek disgorgement when other available remedies are adequate to render the unlawful conduct at issue unprofitable.

There are at least two important reasons for such a rule. First, where other available remedies are adequate to deprive the wrongdoer of any unlawful gains, there is no legitimate purpose to be served by disgorgement, and the disgorgement remedy becomes impermissibly punitive. Second, there is a real concern that, if disgorgement is duplicative of other remedies, its use will run afoul of the principles of the Supreme Court’s decision in Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

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4. Although it is beyond the scope of this letter to argue this point, the violations at issue in the Abbott/Geneva and Hoechst/Andrx cases do not yet seem to be sufficiently well defined to justify disgorgement in future cases. (*See id.* (“We recognize that there may be market settings in which similar but less restrictive arrangements could be justified, and each case must be examined with respect to its particular facts.”).)

A. **Where Other Available Remedies Are Adequate To Deprive Wrongdoers Of Unlawful Profits, Disgorgement Would Be Impermissibly Punitive.**

Disgorgement is an equitable remedy designed to ensure that parties who violate the law do not profit from their wrongdoing. (See Part I *supra*; accord FTC v. Febre, 128 F.3d 530, 537 (7th Cir. 1997).) As is the case under other federal statutes permitting disgorgement as a form of equitable relief, disgorgement under Section 13(b) of the FTCA may not be used punitively. See, e.g., Febre, 128 F.3d at 537 (“This court has held that disgorgement is designed to be remedial and not punitive.”); accord SEC v. First City Financial Corp., 890 F.2d 1215, 1231 (2d Cir. 1989) (holding that “disgorgement may not be used punitively”; applying Securities Exchange Act); Commodity Futures Trading Comm’n v. American Metals Exchange Corp., 991 F.2d 71, 78 (3d Cir. 1993) (disgorgement as relief ancillary to equitable injunctive power under the Commodity Exchange Act “must be remedial and not punitive in nature”); United States v. Local 295 of the Int’l Brotherhood of Teamsters, No. 90 CV 0970, 1991 WL 128563, at \*1 (E.D.N.Y. June 28, 1991) (“Disgorgement under RICO is a non-punitive equitable remedy which deprives wrongdoers of their ill-gotten gains.”)

It follows that the Commission should not seek disgorgement if other remedies, including private actions for treble damages, are available and adequate to deprive the wrongdoer of its unlawful profits. In such cases, the justification for a disgorgement remedy does not exist. Where other remedies will deprive the wrongdoer of its unlawful gains, disgorgement will not “remedy” anything, but instead can only serve as a punitive measure.

For these reasons, courts considering the use of disgorgement to remedy violations of the Securities Exchange Act “have ensured that disgorgement serves as a remedial, and not as a punitive, measure.” SEC v. Lorin, 869 F. Supp. 1117, 1123-24 (S.D.N.Y. 1994). They have done so “[b]y refusing to subject securities law violators to liability both to the SEC for disgorgement and private parties for the recovery of damages.” Id. (citing cases holding that a contrary approach would be “clearly punitive in its effect and would constitute an impermissible penalty assessment”). The Commission has relied upon this very line of cases to justify its use of the disgorgement remedy. (See Mylan, Stmt. of Majority at 5 n.3 (noting, for example, that the court in SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir. 1971) used the disgorged funds to establish an escrow account “to protect the defendants from double liability”) (brackets and internal quotation marks omitted).)

To ensure that disgorgement is not impermissibly punitive, it should be reserved for those rare cases when other available remedies are not being pursued or are inadequate to deprive a wrongdoer of the profits from an egregious violation of the antitrust laws.

**B. Where Other Available Remedies Are Adequate To Deprive Wrongdoers Of Unlawful Profits, Disgorgement May Violate The Dictates Of The Supreme Court's Decision In Illinois Brick.**

In Illinois Brick Co. v. Illinois, the Supreme Court held that indirect purchasers of goods sold at a supra-competitive price in violation of the Sherman Act may not recover for the portion of the overcharge passed on to them. 431 U.S. at 748. The Court explained, in part, that it would be extremely difficult to apportion damages among all the direct and indirect purchasers and that, even if such apportionment were possible, it would weaken the enforcement of the antitrust laws by diffusing the incentive for private parties to sue. Id. at 731-32, 734, 737-46. "First" among the Court's reasons for rejecting a contrary result, however, was the fact that "allowing offensive but not defensive use of pass-on would create a serious risk of multiple liability for defendants." Id. at 730. The Court explained that "we are unwilling to 'open the door to duplicative recoveries.'" Id. at 731 (citation omitted). In so doing, the Court rejected the argument that "it is better for the defendant to pay sixfold damages than for an injured party to go uncompensated," and it found unacceptable the risk entailed in arguing that "a little slopover on the shoulders of the wrongdoers is acceptable." Id. at 731 n.11 (ellipses and citation omitted).

If the Commission were to seek disgorgement of unlawful profits, irrespective of whether other remedies are available and being pursued, the antitrust defendant may well be subject to duplicative recoveries. Indeed, because the Clayton Act permits private damages to be trebled, this "duplicative" recovery might, in fact, exceed fourfold the actual harm caused by the conduct at issue. With this possibility in mind, the rule that disgorgement may not be used punitively has particular force. Moreover, Illinois Brick teaches that it is not sufficient to respond to this problem by answering that the wrongdoer must bear this "piling on" simply because it is the wrongdoer. Id. ("We do not find this risk acceptable.")

As Commissioner Leary explained in his dissent and concurrence in Mylan, "[w]idespread use of Section 13(b) . . . can directly undermine [one of] the . . . policy foundation[s] for Illinois Brick, namely, avoidance of duplicative recoveries." Mylan, Leary Stmt. at 4. Commissioner Leary added that "[o]ver-deterrence of antitrust violations . . . can have the unfortunate consequence of chilling neutral and even procompetitive, efficiency-enhancing conduct," and thus "excessive deterrence in the antitrust context does not 'redound to the public's benefit.'" Id. at 5 (quoting United States v. United States Gypsum Co., 438 U.S. 422, 442 n.17 (1978); see id. at 7 n.29 (noting that "the prospect of multiple damages can threaten corporate bankruptcy").)

In Mylan, the majority of the Commission argued that the Supreme Court's concern in Illinois Brick for preventing duplicative recoveries did not limit the Commission's authority to seek disgorgement because Illinois Brick involved Section 4 of the Clayton Act, not Section 13(b) of the FTCA. Mylan, Stmt. of Majority at 3-4. The majority argued that Illinois Brick "was not concerned that a defendant's overall liability might exceed treble damages. Rather, the Court was concerned that multiple recoveries under the same statute would violate the Clayton Act's legislative intent." Id. at 4. Thus, the majority concluded the "Commission's claim for disgorgement [in Mylan] does not 'literally conflict' with Illinois Brick." Id. at 3.

The language of Illinois Brick, however, seems clearly to express a concern that an antitrust defendant's total damages (regardless of the statutory source of those damages) might exceed the treble damages provided by the Clayton Act. Moreover, for the reasons set forth by Commissioner Leary in his dissent, the "literal" distinction relied upon by the majority in Mylan should not determine enforcement policy with respect to disgorgement. From the plain language of the decision, it seems highly unlikely that the Supreme Court would embrace the view that Illinois Brick only speaks to Section 4 of the Clayton Act. As the majority in Mylan recognized, there is a "legitimate concern" that an "action for disgorgement could . . . conflict with the policy underlying Illinois Brick." Id.<sup>5</sup>

Ultimately, the Mylan majority concluded that Illinois Brick did not prevent disgorgement because "there is little risk of multiple recovery in excess of the treble damages amount in the present case" because "all the relevant cases are consolidated before" a single district court. (Id. at 4.) The majority explained that "[c]ourts have routinely coordinated remedies in government disgorgement actions, and are readily able to surmount the problem of duplicative recovery." (Id.)<sup>6</sup> Whether or not it is true that district courts "are readily able to surmount the problem of duplicative recovery," if all victims of an antitrust violation -- including indirect purchasers -- are permitted to make claims to the disgorged funds, then the policy objectives of Illinois Brick will have been defeated. (See Mylan, Leary Stmt. at 5 ("It would be ironic, indeed, if a barrier against indirect purchaser suits under a federal statute (Clayton Act Section 4) that specifically refers to monetary recoveries in antitrust cases could be so easily avoided by a backdoor approach under a statute (Section 13(b) of the FTC Act) that nowhere specifically authorizes monetary recoveries in antitrust cases and that was never so employed until very recently."))

For all of the foregoing reasons, the "legitimate concern" that disgorgement may violate the principles of Illinois Brick strongly supports the conclusion that the Commission should only seek disgorgement when other available remedies are not being pursued or are

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5. Immediately after agreeing that Illinois Brick presents "a legitimate concern," the majority stated that "[w]e cannot agree, however, that because a claim for disgorgement in some future case under a different set of facts might conflict with the policy of Illinois Brick, the Commission should never seek disgorgement (or use disgorged monies to compensate overcharged consumers). . . ." (Id.) We are not taking the position that Illinois Brick always forecloses the use of disgorgement or the use of disgorged funds to compensate overcharged consumers. Rather, our position is that Illinois Brick requires that the Commission not seek disgorgement where other remedies are available and adequate to deprive the wrongdoer of its unlawful profits. This rule is consistent with Illinois Brick's teaching that antitrust defendants should not be subject to duplicative recoveries under federal law, and it is also consistent with (and similar to) the rule that disgorgement should not be punitive.
  6. In so doing, the Court cited several cases involving disgorgement under the Securities Exchange Act in which the courts made certain that the disgorgement remedy was not duplicative of private damages. (Id. at 5 n.3.)

inadequate to deprive a wrongdoer of profits from a serious violation of the antitrust laws. This is particularly true in light of the fact that the egregious cases that are appropriate for disgorgement are also the cases most likely to attract private actions for treble damages. Thus, there is a particularly high risk that disgorgement might function punitively or in violation of Illinois Brick.

To avoid these problems, the Commission can, has, and -- we believe -- should require that disgorged funds be used to offset private claims for treble damages. (See Part VI infra.) If the Commission pursues a disgorgement remedy before private claims are settled, however, it may simply be wasting its resources. The Hearst case demonstrates this problem. There, the Commission obtained \$19 million in disgorgement that was used to satisfy, and was therefore duplicative of, the \$26 million settlement obtained in private class-action lawsuits. Because the class plaintiffs ultimately recovered more than the disgorgement amount, and because disgorged funds were properly used to compensate the class plaintiffs, the disgorgement remedy was entirely unnecessary. See Hearst, Stmt. of Commissioner Leary Concurring In Part and Dissenting In Part ("This particular case, however, is a classic example of a situation where the [disgorgement] remedy is unnecessary, if not affirmatively harmful."). Had the Commission waited, it might have concluded that disgorgement was not necessary in light of the successful settlement of the class-action lawsuits. This is clearly the preferable approach not only because it conserves limited Commission resources, but also because it minimizes the risk that disgorgement will be punitive or violative of Illinois Brick.

#### **IV. The Commission Should Only Seek Disgorgement Of Profits That Resulted Directly From The Violation At Issue.**

In the Notice, the Commission asked specifically whether it should seek disgorgement "where the violator reduces its investments in future technology because of a reduction in the competition it faces." (Notice Question 2.) We believe that the answer to this question is clearly: No.

Because disgorgement is an extreme form of relief that may not be used punitively, the Commission should only seek disgorgement of profits that have a direct causal link to the violation at issue. See generally First City Financial Corp., 890 F.2d at 1231 (explaining that disgorgement "must distinguish between legally and illegally obtained profits"). Attempting to identify, for example, "unlawful profits" resulting from a reduction in research and development costs or an alleged reduction in overhead expenses after an unlawful merger is extremely speculative and risks making the disgorgement remedy unworkably complex and potentially punitive. See generally Parker Rpt. at 10 ("The criteria for 13(b) cases include . . . the ability to be able to *identify* and return a substantial portion of the disgorgement to the injured consumers.") (emphasis added).

Moreover, with specific respect to the question posed in the Notice, it seems that disgorgement in such situations could also be counterproductive. If the Commission seeks disgorgement of amounts allegedly saved on research and development as a result of a reduction in competition, then the Commission will only be ensuring that the allegedly foregone research and development work is never done. There is also the possibility, for

example, that an allegedly unlawful merger will result in cost savings or other efficiencies that *permit additional* research and development. If this leads to the development of a new product, the Commission certainly should not seek to disgorge profits relating to that development. Not only would disgorgement in such a case be too attenuated and speculative, but it would also be counterproductive and anticompetitive. See, e.g., First City Financial Corp., 890 F.2d at 1232 (recognizing that disgorgement of alleged profits made from illegal profits is not proper).

Again, the approach we advocate here appears to be consistent with Mylan and Hearst. Both of those cases involved enormous price increases as a result of what the Commission characterized as clear violations of the law. In Mylan, for example, prices went up over 2000%. Although the Commission sought disgorgement of unlawful profits relating to the drastic price increases in these cases, there is no indication that the Commission sought to disgorge any alleged “profits” relating to such things as savings on overhead, research and development, or advertising and promotional expenses. (See, e.g., 04/4/01 FTC Press Release at 1 (reporting that the Commission requested that Hearst “forfeit its profits from the anticompetitive price increases”). Unlike the profits attributable to the price increases in Mylan and Hearst, these latter examples of alleged “profits” are far too speculative and difficult to calculate to be pursued as part of a legitimate disgorgement remedy.

V. **The Court’s Opinion In *SEC v. First City Financial Corp., Ltd.* Is Consistent With The Rules Advocated In This Letter.**

In the Notice, the Commission specifically asked whether “the approach used to calculate disgorgement in *S.E.C. v. First City Financial Corporation, Ltd.*, 890 F.2d 1215 (D.C. Cir. 1989), [is] appropriate for the Commission’s use.” (Notice Question 2.) Although it is outside the scope of this letter to discuss the best or precise method(s) for calculating disgorgement, we believe that the First City decision strongly supports the analysis set forth above with respect to the standards for determining when the FTC should seek disgorgement.

To begin with, First City involved a deliberate violation of well-established SEC reporting requirements that caused clear harm to the public. Thus, the case is consistent with the standards suggested in this letter for determining when a violation is sufficiently egregious to warrant disgorgement. In fact, the court of appeals in First City found that the district court was clearly right that the defendant had *intentionally* violated the law. Id. at 1228-29 & n.20.

First City also makes clear that disgorgement may not be used punitively and that disgorged property must be causally linked to the alleged wrongdoing. Id. at 1231. To this end, the court explained that, “[s]ince disgorgement primarily serves to prevent unjust enrichment, the court may exercise its equitable power *only* over property causally related to the wrongdoing. The remedy may well be a key to the SEC’s efforts to deter others from violating the securities laws, *but disgorgement may not be used punitively.* . . . Therefore, the SEC generally must distinguish between legally and illegally obtained profits.” Id. (emphasis added). The court also recognized that some allegedly “unlawful profits” related to the violation may be too far removed causally to permit disgorgement. In particular, the

court cited SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972), where the court refused to permit disgorgement of income subsequently earned on the initial illegal profits. Id. at 1232.

Overall, First City -- like other cases under the Securities Exchange Act -- supports the conclusion that the Commission should seek disgorgement only in the most egregious cases when other available remedies are not being pursued or are inadequate and when the amounts to be disgorged are clearly causally related to the violation at issue.

#### VI. Disgorged Funds Should Be Paid To Victims Of The Unlawful Conduct.

In the Notice, the Commission asked “[w]hen and how should disgorgement funds recovered by the Commission be distributed as restitution when there is parallel private litigation.” (Notice Question 6.) We believe, and the Commission appears to agree, that disgorged funds should be used to satisfy any amounts paid by the wrongdoer as a result of other available remedies for the unlawful conduct (e.g., settlements or judgments from private litigation). When and how disgorged funds should be distributed depends on when the Commission seeks disgorgement, and, here again, we believe there are strong reasons for the Commission only to seek disgorgement in cases in which other available remedies are not being pursued or are inadequate to deprive the wrongdoer of unlawful gains.

There does not seem to be any dispute that disgorged funds should be used to satisfy amounts that the wrongdoer is required to pay as a result of other available remedies relating to the same wrongdoing, including settlements and judgments from private litigation. In fact, the Commission adhered to this approach in Mylan and Hearst, and courts have endorsed this rule both in applying Section 13(b) in consumer protection cases<sup>7</sup> and in reviewing the use of disgorgement under other statutes. Similarly, it seems clear that the amount of unlawful profits sought in a disgorgement proceeding should be off-set by amounts already paid or required to be paid under other available remedies. (See, e.g., Mylan, Stmt. of Majority at 5 n.3 (“In the event that we deem disgorgement [to the SEC] appropriate, defendants will have the opportunity to prove that they have already relinquished their ill-gotten gains [in a private damages action].”) (quoting SEC v. Penn Central Co., 425 F. Supp. 593, 599 (E.D. Pa. 1976)).)

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7. See, e.g., Febre, 128 F.3d at 537 (affirming order of disgorgement that would be distributed, to the extent possible, to the victims of the unlawful conduct) (following FTC v. Gem Merchandising Corp., 87 F.3d 466 (11th Cir. 1996)). It is important to note, however, that consumer protection cases often differ substantially from competition cases like Mylan and Hearst. For several reasons, consumer protection cases are generally less likely to be remedied by private actions for damages. These reasons include the fact that treble damages are not available and the fact that consumer protection violations are less susceptible to being proved (e.g., with respect to damages) on a class-wide basis. Moreover, as is explained above, competition cases are restricted by Illinois Brick.

If disgorged monies were not applied to claims made by victims (or were not off-set by payments already made to the same), disgorgement might in many cases violate Illinois Brick or be impermissibly punitive. Even if the Commission does not agree that Illinois Brick prohibits a duplicative recovery under Section 13(b) of the FTCA -- i.e., even if the Commission does not agree that it *must* apply disgorged proceeds to claims made by victims of the unlawful conduct -- the Commission's practice of doing so minimizes potential conflicts with Illinois Brick, avoids making the disgorgement remedy impermissibly punitive, is consistent with case law applying Section 13(b) and other similar statutes, and should be followed in all cases in which disgorgement is sought.

When and how disgorged funds are actually distributed will depend on when the Commission seeks disgorgement. If the Commission seeks disgorgement while other available remedies are being pursued (as the Commission did in the Mylan and Hearst cases), we believe that the disgorged funds should be placed in escrow to be used to satisfy any later judgments, settlements, fines, etc. on a "first-come, first-served" basis. For example, if a defendant pays \$1 million to the Commission as disgorgement and later settles with a group of plaintiffs for \$500,000, one-half of the disgorgement fund should be released to be applied to the settlement. The remainder can be used to satisfy any future settlements, judgments, or fines. If there are any monies left over after other remedies were exhausted, those monies could be paid into the federal treasury. This approach has the benefit of relieving the Commission of the responsibility of claims administration. The Commission would not need to decide which parties are entitled to the disgorged funds, but instead could rely on settlement agreements and judgments for this purpose on a first-come, first-served basis.

As we have explained above, however, we believe that the Commission should refrain from seeking disgorgement when other available remedies are being pursued and are adequate to deprive the wrongdoing of its unlawful gains. By doing this, the Commission will conserve its resources not only because it will seek disgorgement in fewer cases but also because the Commission will reduce the likelihood that it will have to administer the distribution of disgorged funds. If, after other available remedies have been exhausted, the Commission concludes that the wrongdoer has not been deprived of all of its allegedly ill-gotten profits, then disgorgement could be sought and would be limited to the shortfall amount necessary to make the unlawful conduct unprofitable. (Any more would be beyond the justification for the equitable remedy of disgorgement.) When that amount is recovered through disgorgement, there would be no need, for example, to distribute it to plaintiffs who have already settled their claims to their satisfaction. Rather, it is likely that, in the rare cases where disgorgement is actually *necessary* to remedy a serious violation of the law (because other remedies have failed to make the violation unprofitable), the disgorged monies could be paid directly to the United States Treasury.

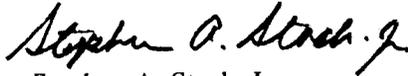
## VII. Conclusion

For all the reasons set forth herein, the Commission should only seek disgorgement when it is necessary to prevent an egregious violation of the law from being economically rational. In particular, disgorgement should be limited to cases in which (1) there has been a serious violation of the antitrust laws that was clearly established as such and (2) other available

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remedies are not being pursued or are inadequate to deprive the wrongdoer of any unlawful gains. Moreover, to prevent disgorgement from being punitive or violating the dictates of Illinois Brick, the Commission should only seek to disgorge profits that result directly from the unlawful conduct, and disgorged monies should be applied to satisfy claims by victims of the wrongdoing.

Sincerely,



Stephen A. Stack, Jr.  
George G. Gordon  
Thomas L. Kenyon

TLK/cdg