Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

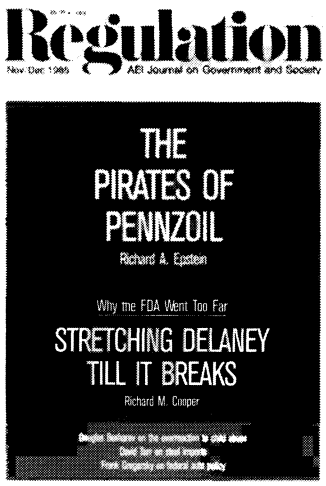
It's Delaney,
It's De Minimis . . .

TO THE EDITOR:

I read with interest former FDA Chief Counsel Richard Cooper's article "Stretching Delaney Till It Breaks" (*Regulation*, November/December 1985) describing the evolution of the agency's interpretation of the Delaney clause and other food safety laws as they relate to the regulation of possible carcinogens in the food supply. The bulk of the article represents a reasoned analysis of agency decisions and judicial interpretations spanning four administrations, acknowledging the relevance of increasing scientific sophistication in analytic methodology and the emergence of quantitative risk assessment techniques in what the author describes as "the rational elaboration of a major and sound approach to regulation," driven by scientific facts and progress. The logic of Mr. Cooper's analysis breaks down, however, in the conclusion that in considering a *de minimis* interpretation of the Delaney clause we may have crossed the line defining the limits of administrative discretion in interpreting a statute.

First and foremost, the mission of the FDA, and the purpose of the food safety laws, is the protection of the public health, in this instance protecting the public from potential risks posed by the use of food and color additives. In carrying out this mission, our primary tools are scientific ones. After carefully reviewing all the data presented we must come to a conclusion as to the general safety and likely carcinogenic risk posed by an additive. Only if we can conclude as a matter of public health that the risk is so small as to be effectively no risk, and that the benefit to the public of prohibiting an additive's use is essentially nil, may we then conclude as a legal matter that the risk is *de minimis* with respect to the Delaney clause.

To date, the FDA has tentatively invoked a *de minimis* interpretation



in a single instance, the use of methylene chloride to decaffeinate coffee, a process that may result in minute amounts of residual methylene chloride in the finished product. The detailed rationale for that conclusion is set out in a *Federal Register* proposed rule open to public comment (50 FR 243, 51551-51559), and is grounded on our best scientific assessment of exposure and potential risk. Even though all available human data and animal feeding studies showed no carcinogenic effects, agency scientists took an extremely conservative approach in assessing risk based on the most sensitive rodent inhalation study, and then evaluated likely exposures to small but detectable residues of methylene chloride now permitted in coffee. We concluded that the risk, if any, is essentially nonexistent.

In short, a *de minimis* interpretation is not in any meaningful sense different from a "no risk" standard. An extremely conservative lifetime risk estimate, for example on the order of one-in-a-million—a theoretical maximum risk, not an actuarial risk—is not zero, but is so small as to be indistinguishable from no risk for any practical, public health purpose. If that were not so, I would agree with Mr. Cooper's assertion that the *de minimis* interpretation should not be adopted without legislative authorization.

Mr. Cooper criticizes the FDA primarily for exceeding his view of the limits of its institutional authority as part of the executive branch. Yet the *de minimis* concept is a well-accepted principle of statutory interpretation applied over the years to many statutes, including those designed to protect the public health, and it always has the effect of introducing some limited degree of flexibility when a law appears absolute on its face, but no statutory purpose or gain to the public would be achieved by interpreting it literally. In this respect, the *de minimis* principle is no different from the other interpretations described in Mr. Cooper's article, which he believes were justified.

According to the article, there is a "settled understanding" that the Delaney clause was intended to permit no risk of human cancer from food additives. It is certainly debatable that everyone knowledgeable about the Delaney clause and its history believes that the provision is literally absolute. It is not the rule in any event that a law widely understood to have particular meaning can never be further interpreted administratively, and the courts have held that changing circumstances (e.g., the development of new knowledge) since enactment may be taken into account. The article gives several examples of interpretations that represented departures from what had been the "settled understanding," but Mr. Cooper apparently views them as part of the "rational elaboration" of policy.

Should we have awaited express authorization from Congress? Although it may be most clear cut

and inarguable to insist on specific legislative action to codify an agency's interpretation of any statute, the potential of getting the law amended should not be a justification for inaction in the face of problems that must be addressed. I am persuaded that the *de minimis* interpretation is a rational approach to applying the Delaney clause in modern circumstances consistent with the latest scientific knowledge. Adopting a *de minimis* interpretation will permit FDA to reach sensible results that take into account the paramount concern for protecting the public against the risk of cancer. Certainly it will not expose the public to greater risk than did the other decisions described in Mr. Cooper's article.

There are no losers when a federal agency acts sensibly, based on the relevant science and in light of established judicial precedent.

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Keelhaul the Pirates

TO THE EDITOR:

As one would expect from something written by Richard A. Epstein and published in *Regulation*, much of "The Pirates of Pennzoil" is both thoughtful and lively. Professor Epstein is quite correct that it is absurd to award Pennzoil $10.5 billion for losing the opportunity to acquire Getty for approximately $3.8 billion, especially when Pennzoil valued it at less than $4.3 billion. (That is the price paid by Texaco for the three-sevenths of Getty that Pennzoil wished to acquire—a price Pennzoil declined to match).

As Professor Epstein recognizes, Pennzoil at most might claim the difference between its alleged contract price and the market price (about $500 million); this point was recently urged upon the Texas courts by the attorney general of New York, the state whose law governs the dispute, in an *amicus curiae* brief urging reversal of the trial court's judgment.

Professor Epstein is also correct that so many important unresolved issues remained to be negotiated between Getty and Pennzoil (and were never agreed upon) that whatever tentative agreement they had when Texaco's higher bid was made, did not amount to a contract. New York law is particularly strict on this point as the attorney general of New York has emphasized to the Texas appellate court (after the verdict and after the Epstein article).

It is also worth emphasizing that both Getty and Pennzoil described their deal as merely an "agreement in principle"—language that is well understood to mean something less than a contract. And that language was not inadvertently chosen. The press relations representatives used the term "agreement" in their first draft; the lawyers changed it to "agreement in principle" in an obvious effort to distinguish clearly between a contract and an "agreement in principle" under New York law.

Pennzoil argued to the jury that a January 2, 1984 "Memorandum of Agreement" was evidence of a contract. However:

(a) The memorandum was expressly not effective until signed on behalf of the Getty Oil Company—and it was never signed;

(b) even after January 2, 1984, Pennzoil and Getty continued to refer to their deal as merely an "agreement in principle";

(c) the Memorandum left many matters to be negotiated, matters on which the parties never agreed (in fact, Pennzoil's own trial counsel advised the trial judge that "we were continuing to negotiate when suddenly the rug was pulled");

(d) even if the Memorandum had been intended to be binding, it would have violated SEC Rule 10b-3, which prohibits a tender offeror from entering into private agreements during a tender offer, and hence would have been unenforceable (New York law adapts the view suggested by Professor Epstein that only an enforceable contract can support an action for inducement of breach of contract).

How did a jury ever manage on these facts to find a valid contract? The surprising answer is that the jury did not—and, even more surprisingly, was not even asked to make such a finding.

Although the existence of a valid contract is a requirement of Pennzoil's claim under New York law, the charge to the jury omitted any mention of the word "contract." Instead, over Texaco's repeated objections, the jury was merely asked about the existence of an "agreement"—language particularly confusing since all parties described the deal as an "agreement in principle" and the issue was whether that "agreement" constituted a "contract." As was to be expected, Pennzoil's counsel made the most of this confusion in his closing argument to the jury:

> And, for Mr. Miller [Texaco counsel] to stand here and attempt to change the Court's charge, the wording in it, by inserting things that he likes, is typical.
>
> It's what they've done from the beginning of this case.
>
> Judge Casseb is one of the most honored and brilliant judges in America.
>
> If he had wanted to say to you, "Contract," he would have said it.

Perhaps even more striking was the way that the trial court instructed the jury on how it should decide whether Texaco knew of the existence of the alleged Pennzoil agreement (a second essential requirement of Pennzoil's claim). As the New York Attorney General has emphasized, New York law is clear that a plaintiff claiming inducement of contract must prove that the defendant actually knew a valid contract existed; it is not enough under New York law that a defendant should have known a contract existed. The trial court not only refused to permit Texaco to introduce testimony that its lawyers advised it that no contract existed, but also told the jury, in instructions written by Pennzoil, that it would be sufficient to establish liability if Texaco had failed to investigate further as to whether a contract existed. The barring of such testimony and the giving of such instructions are flatly contrary to New York law.

It was perhaps inevitable that a jury deprived of critical testimony and instructed the way it was would return the verdict it did. Presumably those errors will, on appeal, result in a new trial.

In the meantime the damage is severe and continuing—to Texaco, which must operate under a cloud of uncertainty; to the State of New York, whose law has been mangled; to companies attempting to enter into contracts in New York, who can no longer depend on what the law is; to Texas, which is already seeing companies reluctant to subject themselves to the jurisdiction

of Texas courts; to public shareholders who receive less than full value for their shares because competitive bidding is chilled; and to the national economy, which may be deprived of the efficient, competitive market for the sale of companies which federal laws seek to ensure and which the Pennzoil judgment surely inhibits.

It is a fair test of our legal system how well we avoid such disasters—and how quickly we correct them when they occur.

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Editor's Note: Mr. Boies is lead counsel to Texaco in its litigation with Pennzoil.

"How IBM Raised Prices"

TO THE EDITOR:

In the September/October 1985 issue of *Regulation,* David Levy and Steve Welzer hypothesize that the pendency of *United States* v. *IBM* caused IBM to charge higher prices. They present data which suggests that IBM charged a price premium in 1967 and 1971, but offered a 20-percent discount over other mainframe sellers in 1981-83. They also summarize data to suggest that the only period from 1961 to the present when IBM gained market share was from 1979-83. They conclude that IBM started its aggressive pricing policy in 1979-80 when it could predict that a favorable outcome to *United States* v. *IBM* was likely. Unfortunately, their interesting conjecture is inconsistent with several important facts.

First, during the pendency of the Justice Department suit, IBM developed and implemented its SMASH program intended to change the plug-compatible manufacturers into "dying companies." This program spawned four major private antitrust actions and was challenged by the Justice Department in an amendment to its original complaint. Such conduct appears inconsistent with the hypothesis that IBM was restraining its competitive behavior during *United States* v. *IBM.*

Second, the 1979-80 time period is simply too early for IBM to have predicted a favorable outcome to the Justice Department suit or the two private suits which were still pending at that time. As late as December 1, 1980, *Legal Times of Washington* reported on the Justice Department transition team report and noted that no change was expected in antitrust enforcement. Indeed, *United States* v. *IBM* had survived both the Nixon and Ford administrations. William Baxter's nomination for assistant attorney general for antitrust was not announced until February 1981. While IBM received a favorable decision in the *Memorex* case in 1980, certiorari was not denied until 1981. The trial court in *Transamerica* found for IBM in 1979, but the decision was appealed and not resolved by the Ninth Circuit until 1983.

Third, Levy and Welzer present no evidence of pricing prior to 1967 when the Justice Department began its investigation. Their data does indicate that IBM's market share was declining since 1961, the earliest point for which they present data. Gerald W. Brock in *The Computer Industry* (1975), presents data to support his hypothesis that even before the Justice Department suit, IBM was following a dynamic limit pricing strategy. It was deliberately sacrificing market share for the high profits that high prices would bring. Without careful analysis of IBM's pricing strategies prior to the initiation of the Justice investigation, it is premature for Levy and Welzer to conclude that the suit caused IBM to raise its prices.

Finally, an article in the June 13, 1983 issue of *Fortune* suggests another explanation. In 1977, IBM failed to develop its Future System and as an alternative cut prices on two models of its aging 370 system by a third. This strategy sold many more machines than expected. In 1979, IBM used a low price strategy to market its new 4300 system and could not keep up with demand.

Thus it appears that in 1979, IBM changed from a high-price strategy to a low-price/higher-volume strategy. Such a change in strategy is consistent with business strategy literature which suggests that the latter strategy is more appropriate for a maturing market. IBM appears to have modified its previously long-standing strategy without regard for possible antitrust consequences because it could not have predicted in 1979 that its antitrust problems were over.

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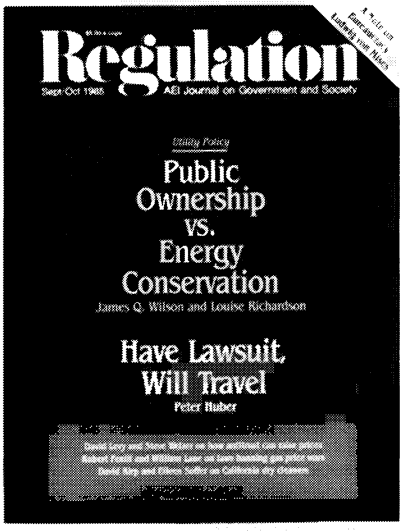
Levy and Welzer Respond

TO THE EDITOR:

Petty makes four points which he claims are inconsistent with the hypothesis that the *IBM* suit caused an increase in mainframe prices. He agrees that IBM has been discounting prices recently, but offers an alternative explanation. While it is difficult to establish causality in an industry as subject to change as the computer industry, Petty's observations are not convincing when viewed from the perspective of long-term trends.



Two points should be noted with respect to Petty's first point regarding the so-called SMASH program. It involved selective policies that were aimed at the plug-compatible manufacturers and does not negate the evidence and observation by industry observers that IBM's overall policy in the late 1960s and early 1970s was to maintain a price umbrella. Second, this program was precipitated by the tremendous and to some extent unexpected loss in share of market to plug-compatible firms. (They were charging upwards of a 10 percent discount relative to IBM and losses of up to 60 percent of share of market in certain peripherals were pre-

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der incumbent management, despite the glaring spotlight of media attention and intense study by armies of professional analysts that normally accompany control contests. This evidence makes students of takeover activity skeptical, and rightfully so, of the myopia theory which rests so singularly on the assumption that takeover targets are undervalued by the stock market.

While we believe that the data support the economic theory of takeovers, showing them to be caused primarily by competition encouraging more efficient use of assets, we would add a caution. This theory suggests only that takeovers occur due to potential gains from recombination or redeployment of corporate assets; it does not directly imply anything about the competence or motivations of target management. We would thus stress, once again, that those subscribing to this view do not necessarily believe that all hostile takeovers are caused by inefficient target managements or that takeover defenses by target managements are usually bad for target shareholders. To the contrary, managers may be doing a good job of managing a target firm, yet be subject to a takeover bid because the bidder can realize special synergies from the asset combination. Similarly, target managements may undertake defensive measures not to preserve their jobs, but in order to generate higher premiums for shareholders. It is unfortunate that the economic view of takeovers, which is inherently a synergistic view, has come to be equated with an implicit criticism of target management. Entrenched management is only one of many possible reasons that bidders may perceive substantial gains from takeover activity. ■

Selected Readings

Bradley, Michael, A. Desai, and E.H. Kim. "The Rationale Behind Interfirm Tender Offers: Information or Synergy?" *Journal of Financial Economics*, Vol. 11 (1983).

Jarrell, Gregg. "The Wealth Effects of Litigation By Targets: Do Interests Diverge In a Merge?" *Journal of Law and Economics*, Vol. 28 (1985).

Jarrell, Gregg, and Ken Lehn. "Institutional Ownership, Tender Offers and Long-Term Investments." Securities and Exchange Commission, Office of Chief Economist, 1985.

Pound, John. "Institutional Investors' Effects on Takeover Activity: A Quantitative Analysis." Washington, D.C.: Investor Responsibility Research Center, 1985.

Pound, John. "Are Takeover Targets Undervalued? An Analysis of the Financial Characteristics of Target Companies." Washington, D.C.: Investor Responsibility Research Center, 1986.

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dicted by IBM, see Fisher, Mancke and McKie, *IBM and the Data Processing Industry*, 1983, chapter 10). To suggest that IBM generally raised prices does not necessarily mean that it was going to sit idly when faced with a major threat in a particular segment of the market. It is important to examine long-term trends in share of market rather than isolated incidents. The fact is that efficient plug-compatible companies such as Storage Technology survived and prospered during the 1970s.

In response to Petty's second point, there are strong reasons to believe that IBM began to feel confident of its future antitrust prospects as early as 1976. The Appeals Court decided the important *Telex* case in favor of IBM in 1975 and the District Court judge dismissed the *Calcomp* case in 1977 without even a hearing. Although several suits were still outstanding in 1979, IBM was not to lose any. Furthermore, by the late 1970s, many of the issues in the original complaint, such as IBM's practice of bundling, were moot. Also, the market had expanded substantially to include substitutes such as the plug-compatible machines and superminicomputers, and the political climate toward antitrust had changed considerably with the Burger Court and a perceived threat of foreign competition.

In response to Petty's third point, we do not deny that IBM lost share of market in the early 1960s, but that is not inconsistent with our hypothesis. This loss in share of market is consistent with a number of hypotheses, including the possibility that IBM was restrained by the threat of antitrust in the early 1960s. (Remember its earlier history with antitrust.) However, the crucial points to note are the glaring increase in the rate at which IBM's share of the market fell starting about 1968 when the suit was initiated, and the dramatic reversal in trend in the late 1970s once IBM expected a favorable end to the suit.

Finally, the low price/higher volume trend noted by Petty is not inconsistent with our hypothesis that this business strategy is appropriate for a maturing market. But, what does he mean by a mature market? The mainframe market has been experiencing rapid growth in the 1980s, especially at the upper end, where industry observers have noted that IBM has been particularly aggressive in their pricing and introduction of new machines. Furthermore, their aggressive approach to the emergent microcomputer market and the relatively young minicomputer market of the 1980s contrasts with their late and slow entrance into the early minicomputer market of the 1970s.

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